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Investigating the Effects of Surplus Free Cash Flow on Earnings Management in Corporations of Accepted in Tehran Stock Exchange

Ardeshir Bostan [1], Rahmatollah MohammadiPour [2*]

[1,2] *Department of Accounting, Ilam Sciences and Research Branch, Islamic Azad University, Ilam, Iran*

Corresponding Author:* ***Dr. Rahmatollah Mohammadipour*

Abstract

The purpose of this study is investigating the Effects of Surplus Free Cash Flow on Earnings Management in Corporations of Accepted in Tehran Stock Exchange .This study in terms of purpose is applied research. Regarding the method of inference, this research is descriptive – analysis and regarding the affection between variables, it is correlational Research. In this study, to find specific relationships between variables and population, regression analysis tests of panel data, T and F significance test is used and according to the hypothesis, multivariate regression, model and fitness model with the assumptions of the classical regression was performed. Information of 147 companies listed on Tehran Stock Exchange over the period 2008 -2014 was used. The results suggest that surplus free cash flow has a positive effect on earnings management of corporate.

Keywords: Surplus Free Cash Flow, Earnings Management, Auditor Size, Auditor Tenure

Introduction:

From information perspective, concept of profit as a result of economic activity expressed. Accrual accounting granted choice right to the director in determining benefit in different times. Earnings management as a conscious process steps within the limits of accepted accounting principles to deliver earnings profit level defined, which operates close to profit level reported to target earnings through accounting manipulation is done (khajavi et al., 2011)

Increasing economic units, development of communication technology and the existence of conflicts of interest, creates monitoring needs. In today's dynamic environment, users can decide various information includes financial information about businesses need. The important thing doubts about the reliability of the information that is a conflict of interest arises in addition to conflict of interest issues, including the lack of direct access to information users has resulted in demands for independent audit services. In fact, the role of auditors is to assess the quality of information to users (Hasas Yeganeh and Azin Far, 2010). In terms of the industrial unit's shareholders, free cash flow would be seen as a measure to create value for them. For the business units that have high positive free cash flow, it is expected that in the new funds investment plan could create value for its shareholders a (Rahimian et al., 2009).

Statement of the problem

Investors have confidence in stock investment companies with more stable profits (Norosh et al., 2005). Wilde et al (2001) suggest that earnings management to manage public intervention in the process of determining profits often is in line with the desired objectives of management, applied. Earnings management occurs when managers use judgment in financial reporting and the structure of the exchanges in order to mislead some stakeholders (including shareholders, creditors, employees, governments, investors) about the economic performance of the company or affect the contractual results reported by accounting figures; changes in the financial reporting.

Independent auditing is a part of monitoring and inspection of organizational infrastructure and important part based on the public interest that ensures that the information contained in the financial statements are presented fairly and accurately. From the perspective of agency theory, it plays an important role in reducing information asymmetry and reduces agency problems between management and owners as well as majority and minority shareholders plays role (Jensen and Mcling, 1976). Companies with positive free cash flows (surplus) enjoy higher performance, so management wants to reduce profits are declining due to political costs. Such as high-performance enterprise absorbs attention of public institutions (tax administration), that is why using earnings management to reduce or hide their high performance. However, companies with negative free cash flows are incapable of supporting the growth of profits and income. Insufficient free cash flow; it could force the company to increase its debt level. Therefore, management tends to increase earnings management show better performance (Yudianti, 2008).

In this study the impact of surplus free cash flow on earnings management determined so as it concluded whether earnings management changes can be explained by surplus free cash flow changes or not? (In this study the purpose of free cash flow is positive (surplus) part).

Research Objectives:

Main Objective:

Investigating the Effects of Surplus Free Cash Flow on Earnings Management in Corporations of Accepted in Tehran Stock Exchange

Minor Objectives:

1-Investigating the Effects of Auditor Size on Earnings Management in Corporations of Accepted in Tehran Stock Exchange

2-Investigating the Effects of Auditor Tenure on Earnings Management in Corporations of Accepted in Tehran Stock Exchange

Research Hypotheses:

Main Hypothesis:
There is significant effect between Surplus Free Cash Flow on Earnings Management in Corporations of Accepted in Tehran Stock Exchange

Minor Hypotheses:
1-There is significant effect between Auditor Size on Earnings Management in Corporations of Accepted in Tehran Stock Exchange

2-There is significant effect between Auditor Tenure on Earnings Management in Corporations of Accepted in Tehran Stock Exchange

Research Background:

Research carried out in the context of surplus free cash flow:
Zerni et al (2010) conducted a study in Sweden, evidence of positive value of free cash flow for companies that have a stronger board and better planning ahead for investment opportunities have acquired.
Hyung Ha (2011) in a study investigate the question whether the agency costs of surplus free cash flow, can lead to increase demand for conservatism or not. He believed the conservatives are part of a mechanism for efficient contracts that facilitate the reduction of agency problems. He received according to its forecast that the increase in agency costs due to surplus free cash flow, companies identify losses than profits in a timely manner. In other words, by increasing the agency problems caused by surplus free cash flow, increased demand for conservatism. Ying and Fen (2013) in their study concluded the relationship between growth opportunities and performance management in companies with no advantage and surplus free cash flow of the lesser of the relationship between yield and growth opportunities at other hosting company.
Khodadai et al (2013) in a study investigate the impact of ownership structure on the relationship between free cash flow and efficient use of their assets. The results show that with increasing managerial ownership, the relationship between free cash flow and efficient use of assets is negative and meaningful. Managers willing to invest free cash flows in projects with personal gain and forecast did not follow procedure and even negative net present value projects are ignored. A total investment of some activities may have positive returns; however, this efficiency is less than the cost of capital.
Setayesh and Salehinia (2015) in a study investigate the impact of ownership and capital structure on free cash flows. The findings indicate that corporate ownership directly and debt ratio reversely has a

significant effect on firm free cash flow. However, there is no evidence on significant relationship between institutional ownership, managerial ownership and corporate ownership concentration with free cash flow.

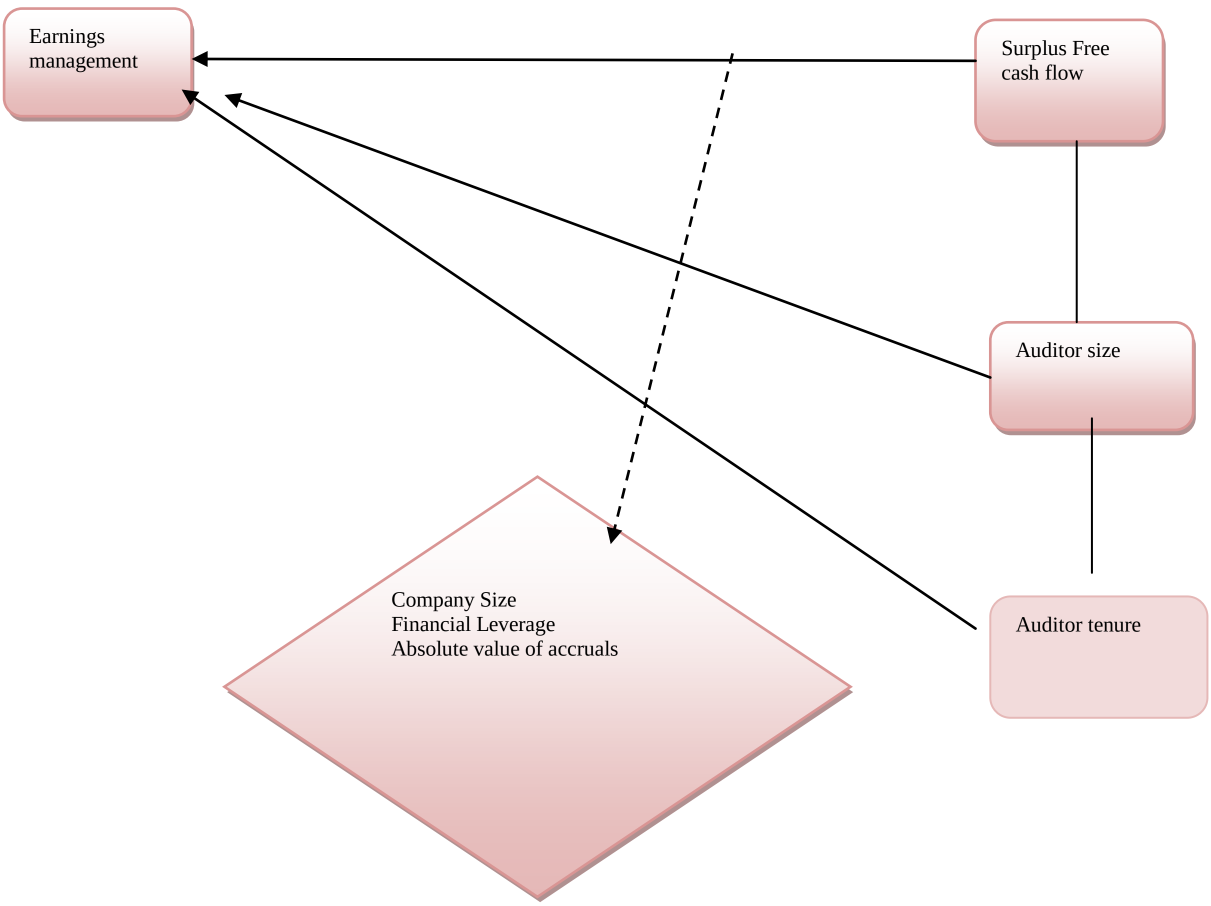
Research carried out in the context of earnings management:

Wang (2010) investigate the impact of shares on foreign exchange. The results indicate that the supply of foreign earnings management in firms with less stock and information content and value of the company's stock price is higher. Fakhari and Adili (2012) investigate the relationship between free cash flow and earnings management through real activities. The results suggest that there is a significant positive relationship free cash flows firms with low growth and earnings management measures based on actual activities (cash flow abnormally, produce unusual and abnormal discretionary costs).
The findings could further evidence of earnings management through real activities of companies in Iran, for investors, auditors and users and provide new indicators of earnings management.
Saee and Abdi (2013) in a study investigate empirical earnings management in the consolidated financial statements and original company's financial statements. The results, contrary to expectations, showed that the proportion of earnings management in the consolidated financial statements. Test of difference at industry levels, depending on the model used, the results show inconsistency.

Research methodology

This study in term of purpose is applied, in term of the logic of implementation is descriptive - survey research and the relationship between variables is correlational research. The research methodology is ex post facto (through use of past information).

Research Conceptual Model



Statistical Population, Sampling Method and Sample Size:

Statistical Population of this research is 147 companies of listed on Tehran Stock Exchange over the period 2008 -2014.

Sampling Method:

Sampling Method in this study is systematic removal method

Sample Size

After considering all the criteria for research, 147 companies as a screening community remained, all of which were selected as study samples so our observations in 1029 year - company reached to (7 years × 147 companies).

Testing research hypotheses

Table 1: Results of pattern selection to estimate research model

Test type	Test Statistic	Test of Statistic rate	Freedom degree	P-Value
LIMER F test	F	11.114	(867,146)	0.0042
Hausman Test	χ^2	90.418	6	0.000

Considering the results of LIMER F test, since P-Value of the research is lower than 0.05 (0.0042), homology of the y intercepts is rejected and it is necessary to use panel data method to estimate the model. Additionally, considering the results of Hausman test, since P-Value of the test is lower than 0.05 (0.0000), therefore fixed effects method must be used in the estimates. Estimate results of the research are presented in table 2.

Table 2: Results of research model estimates

Dependent variable : Earnings Management				
Variable	Coefficient	T Statistic	P-Value	VIF
Fixed Coefficient	-3.3845	-10.149	0.000	-
Surplus Free Cash Flow	2.6207	9.647	0.000	1.228
Auditor Tenure	-0.0252	0.527	0.5977	1.368
Company`s size	0.2506	12.400	0.000	1.142
Financial leverage	-0.6479	-2.714	0.0068	1.256
The absolute value of accruals	0.6144	0.939	0.3478	1.017
Model Determining	0.2651			

Coefficient			
F Statistic of the model (P-Value)	2.058 (0.000)	Jarque - Bera Statistic (P-Value)	2.866 (0.2385)
Durbin – Watson Statistic	2.157	Breusch - Pagan Statistic (P-Value)	1.733 (0.0874)

In examining the overall significance of the model, given that the probability (P-VALUE) F-statistic is smaller than 0.05 (0.0000) with confidence level 95% overall significance of the model is confirmed. Determining model suggests that management changes 26.51% of corporate profits is explained by variables in the model.

The Results of Testing the Main Hypothesis

H_0: There is not significant effect between Surplus Free Cash Flow on Earnings Management in Corporations of Accepted in Tehran Stock Exchange

H_1: There is significant effect between Surplus Free Cash Flow on Earnings Management in Corporations of Accepted in Tehran Stock Exchange

According to the results presented in table 2, significant level (P-Value) of t statistic related to “surpluses free cash flow” variable is lower than 0.05 (0.0000) and its coefficient is positive (2.6207). Therefore, in confidence level of 95 percent we can say that there is significant effect between surpluses free cash flow and earnings management in Corporations of Accepted in Tehran Stock Exchange, since by increasing the amount of surpluses free cash flow that companies will increase the level of earnings management. Thus the first hypothesis was confirmed in 95% confidence level and represents the increasing impact of surpluses free cash flow on earnings management in companies are active in the exchange.

The Results of Testing the First Minor Hypothesis

H_0: There is not significant effect between Auditor Size on Earnings Management in Corporations of Accepted in Tehran Stock Exchange

H_1 : There is significant effect between Auditor Size on Earnings Management in Corporations of Accepted in Tehran Stock Exchange

According to the results presented in table 2, significant level (P-Value) of t statistic related to "Auditor Size" variable is lower than 0.05 (0.0000) and its coefficient is negative (-0.5933). Therefore, in confidence level of 95 percent we can say that there is significant and negative effect between Auditor Size and earnings management in Corporations of Accepted in Tehran Stock Exchange, since by increasing the amount of Auditor size companies will increase the level of earnings management. Thus the first minor hypothesis was confirmed in 95% confidence level and represents the decreasing impact of Auditor size on earnings management in companies are active in the exchange.

The Results of Testing the Second Minor Hypothesis

H_0 : There is not significant effect between Auditor Tenure on Earnings Management in Corporations of Accepted in Tehran Stock Exchange

H_1 : There is significant effect between Auditor Tenure on Earnings Management in Corporations of Accepted in Tehran Stock Exchange

According to the results presented in table 2, significant level (P-Value) of t statistic related to "Auditor Tenure" variable is bigger than 0.05 (0.5977) .Therefore, in confidence level of 95 percent we can say that there is not significant effect between Auditor Tenure and earnings management in Corporations of Accepted in Tehran Stock Exchange, since by increasing the amount of Auditor Tenure to more than four years considerable change in amount of the companies' earnings management does not occur .Thus the second minor hypothesis is rejected in 95% confidence level.

Results of Hypotheses test

Results of main Hypothesis test

There is significant effect between Surplus Free Cash Flow on Earnings Management in Corporations of Accepted in Tehran Stock Exchange. According to studies conducted in the period from 2008 to 2014 and the findings of the study, the results showed, the review adjusted coefficient of determination model, represents the explanatory power of the model is to illustrate the dependent variable earnings management.

According to the results presented in table 2, significant level (P-Value) of t statistic related to "surpluses free cash flow" variable is lower than 0.05 (0.0000) and its coefficient is positive (2.6207). Therefore, in confidence level of 95 percent we can say that there is significant effect between surpluses free cash flow and earnings management in Corporations of Accepted in Tehran Stock Exchange, since by increasing the amount of surpluses free cash flow that companies will increase the level of earnings management. Thus the first hypothesis was confirmed in 95% confidence level and represents the increasing impact of surpluses free cash flow on earnings management in companies are active in the exchange.

Result of Minor First Hypothesis Test

There is significant effect between Auditor Size on Earnings Management .according to accomplished studies in during time of 2008-2014 and resulted findings of this study, the results showed that the results showed, that investigating the adjusted coefficient of determination model, represents the explanatory power of the model is to illustrate the dependent variable earnings management. According to the results presented in table 2, significant level (P-Value) of t statistic related to “Auditor Size” variable is lower than 0.05 (0.0000) and its coefficient is negative (-0.5933). Therefore, in confidence level of 95 percent we can say that there is significant and negative effect between Auditor Size and earnings management in Corporations of Accepted in Tehran Stock Exchange, since by increasing the amount of Auditor size companies will increase the level of earnings management. Thus the first minor hypothesis was confirmed in 95% confidence level and represents the decreasing impact of Auditor size on earnings management in companies are active in the exchange.

similarity of research with Yodianty study (2008) is that it showed there is a positive significant correlation between free cash flow and earnings management and he came to the conclusion that the second hypothesis test with 99% confidence. In addition, profit management at total sample level and at the level of positive cash flows undermined, the wealth created for shareholders is related cash flows.

The Results of Testing the Second Minor Hypothesis

There is significant effect between Auditor Tenure on Earnings Management in Corporations of Accepted in Tehran Stock Exchange.

According the accomplished studies in during time of 2008-2014 and resulted findings of this study, the results showed that the results showed, that investigating the adjusted coefficient of determination model, represents the explanatory power of the model is to illustrate the dependent variable earnings management. According to the results presented in table 2, significant level (P-Value) of t statistic related to “Auditor Tenure” variable is bigger than 0.05 (0.5977) .Therefore, in confidence level of 95 percent we can say that there is not significant effect between Auditor Tenure and earnings management in Corporations of Accepted in Tehran Stock Exchange, since by increasing the amount of Auditor Tenure to more than four years considerable change in amount of the companies’ earnings management does not occur .Thus the second minor hypothesis is rejected in 95% confidence level.

General Conclusion of the Research

What can be said in the general summary and conclusion of the research hypotheses test from 2008 to 2014 is that there is positive and significant effect between Surplus Free Cash Flow and Earnings Management in Corporations of Accepted in Tehran Stock Exchange.

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