Journal of Humanities Insights 1(4): 183-186, 2017
Research Paper

Connection Between Changing the Company Management with Earnings Management, Default Risk and the Ability to Predict the Earnings in Tehran Stock Exchange

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Received: 12 October 2017 Accepted: 19 November 2017 Published: 01 December 2017

Abstract

In this research the connection between changing the company management with the earnings management, default risk and the ability to predict the earnings is being pursued. For conducting this research an example from 117 companies among the acceptable companies in Tehran Stock Exchange have been chosen by the help of systematic sampling. Data have been collected from the years 1385 to 1389 and the statistical tests have been performed on them. The results taken from the statistical tests have shown that there is a meaningful yet straight connection among the changing of the company management with the default risk and the earnings management, and also there is a straight connection between the changing of the company management with the ability to predict the earnings.

Keywords: Changing the Company Management; Ability to Predict the Earnings; Default Risk

How to cite the article:
M. Hematfar, Connection Between Changing the Company Management with Earnings Management, Default Risk and the Ability to Predict the Earnings in Tehran Stock Exchange, J. Hum. Ins. 2017; 1(4): 183-186, DOI: 10.22034/jhi.2017.86978

1. Introduction

Investigators are always in need of information which can help them in their strategic decisions. Stockholders mainly invest in the future of the companies and enterprises and due to this matter, factors which explain the continuous profitability and sustainable growth could be the appropriate criteria for creating value for these people [1]. In stockholders' perspective, value creation simply means creating advantages from investment more than the costs used in it. Therefore, it is necessary to find an indicator to rely on in order to describe the created value with relatively reasonable assurance. Stockholders as the owners of commercial units try to increase their wealth and due to the fact that the increase in wealth is the result of the performance of the commercial unit, evaluation of the commercial unit is important for the owners [2].

In the recent decades, the power of capital markets in one hand and the increase in managers' information about the procedures and guidelines of accountancy on the other hand, lead to the creation of an emerging phenomenon called earnings management. Financial reports are considered as the important informational sources for economic decisions which managers, investors, creditors and other users use them for meeting their informational needs [3]. Since the information is not uniformly available to all users, there will be an information asymmetry between managers and investors. The information asymmetry is a condition that the managers have more not disclosed information than the investors about the operations and different aspects of the company in the future. This makes the managers to have

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motivation and opportunity in earnings management [4].

After the appearance of problems of ownership, in order to protect the public interest, the immunized information and the interests of the owners and managers should be aligned. For this purpose, the government used different tools such as creating theoretical framework, internal control, independent internal audit, presence of unbound managers in the board of directors, applying long-term procedures of reward and legislation. Not only there is no decrease in the amount of problems but also the complexity of it has increased [5,6].

On the other hand, there is a connection between the changing of the company management with the default risk, earnings management and the ability to predict the earnings, which means the more changing in the company management the more the possibility of earnings management with the use of discretionary items and non-discretionary items [7]. Also, with the changing of the company management there will be the possibility of decrease in the ability to predict the earnings because according to this matter that the new management is not yet familiar with the internal and external conditions of the company and the industry the one has entered, the predictive ability of management about the future earnings decreases, and when there is a changing in the company management, considering the unfamiliarity of the management and the waste of time to familiarizing the management with the accounts and the financial situation of the company and also dominance on the condition and the effects of changing in the management increase the possibility of the default risk of the company [4].

Splendor and the positive performance of the companies lead to splendor and expansion of stock which itself results in directing the flows of caught funds in to investment. The splendor and expansion of stock also leads to increase in the earnings of investors which itself results in more interest of the investors in stock and the expansion of its culture among people and entering more people in the stock activities. Finally, it helps the economic growth to emerge, and nowadays the stock is the economic pulse of every country [8,9]. So if we are seeking for economic growth and prosperity in Iran, we should be seeking for solutions which lead to growth and expansion of stock. One of the best solutions is that the companies whose shares are traded on the stock exchange have properly operating mechanisms. And one of the most important actions affected by the properly operating mechanisms in the changing of company management is the changes in the higher management of the company. In this research we are looking for the answer to this question that whether the changing in the higher management of the company can affect the earnings management, earnings prediction error and finally the default risk of the company [10,11].

2. Methodology

The current research study sample covering the available companies in Tehran Stock Exchange from years 1385 to 1389, the number of companies reaches to 454. 117 companies were selected from this sample that didn't make any changes in their fiscal year, and they have been accepted in the Tehran Stock Exchange until the end of the 1384 fiscal year. At least 5 years of their financial statements are reachable from the record exchange or the existing databases. These companies are not among the financial intermediation companies (financial and investment companies) and the required financial information especially notes with the financial statements are available for extracting required data. According to the goal of this research we consider it as an applied research. The method of research is correlational in nature and content. The information used in this research is gathered from the financial statements and the notes attached to financial statements and also from the initial data of exchange board (collected from Tadbirpardaz software, Rahavard Novin and exchange database statistics department). Regression analysis is a statistical technique for analyzing and modeling the relationships among variables. In other words, in regression we are seeking for estimating a mathematical relationship and its analysis, in such way that with its help we can determine the quantity of a variable by using another variable or variables.

3. Results

The results of the current research showed that there is a meaningful relationship between dependent variable (default risk) and independent variable (changing the company management) ($F_{(172.11)}= 24.332$, $P \le 0.05$). The relationship between changing the company management and the default risk is direct, which means the more change in the company management the more default risk in the company and vice versa (r=0.77). At the end the regression equation is as followed:

$$\begin{aligned}\mathrm{Risk}_{it-1} &= .093 + 2.909\mathrm{Ceochange}_{it} + 7.523\mathrm{Ceochange}_{it-1} - .109\mathrm{Debt}_{it} + .229\mathrm{Roa}_{it} - .003\mathrm{Lnasset}_{it} \\ &\quad - .945\mathrm{Same} - \mathrm{dir}_{it} - .990\mathrm{Direct}_{it} + 2.511\mathrm{yo1}_{it}\end{aligned}$$

Also there is a meaningful relationship between the dependent variable (earnings management) and the independent variable (changing the company management) ($F_{(150.12)}$=9.56 ,$P \leq 0.05$). The relationship between changing the company management and the earnings management is direct, which means the more changing in the company management the more earnings management in the company and vice versa (r=0.86). The regression equation is as followed:

$$DA_{it-1} = 2.370 + .806Ceochange_{it} + .686Ceochange_{it-1} + .968Debt_{it} + .316Roa_{it} + .881Lnasset_{it} + .942Same - dir_{it} + .764Direct_{it} + 3.305yo1_{it}$$

The results also show that the model of the ability to predict earnings is meaningful.
($F_{(537.2)} = 82.28$, $P \leq 0.05$). So, the regression equation is as followed:
$\Delta E_{it+1} = 374.090 - .232E_{it} + .033\Delta E_{it} + \varepsilon_{it}$
Finally, there is a meaningful relationship between dependent variable (the ability to predict earnings) and the independent variable (changing the company management), ($F_{(138.12)}$ =48.801, $P \leq 0.05$). The relationship between changing the company management with the ability to predict earnings is reversed, which means the more the changing in the company management the less the ability to predict the company's earnings and the less the changing in the company management the more the ability in predicting the company's earnings (r=0.88).
The regression equation is as followed:

$$EFA_{it-1} = -40.799 - 3.642Ceochange_{it} - 1.010Ceochange_{it-1} + 12.314Debt_{it} + 20.791Roa_{it} + 2.011Lnasset_{it} + 9.734Same - dir_{it} + 2.131Direct_{it} + 3.737yo1_{it}$$

4. Discussion and Conclusion

The results showed that the positive correlation coefficient between two variables of changing the company management and the default risk exists in the accepted companies in the Iran Capital Market and the amount is 778; According to statistic t, the independent variable's relationship (changing in company management) with the default risk is direct, which means the more the changing in the company management the more possibility for the increase of default risk in that company, and in case the changing in the company management decreases the possibility of default risk in that company decreases as well. Studies showed that the above hypothesis is confirmed, and there is a positive linear relationship between changing the company management and the default risk. At the end, according to this result that (there is a meaningful relationship between changing the company management and the default risk) which is now confirmed, we recommend the stockholders and other investors to pay more attention to the companies that have more changes in their managements, because, according to the results of this hypothesis, the possibility of emerging default risk increases due to the changes happen to the company management and also the unfamiliarity of management with the internal situation of the new company and also due to the costs imposed on the company because of the changing of management.

Also there is a positive correlation coefficient between two variables of changing the company management and earnings management in the accepted companies in Iran Capital Market and the amount is 863. The relationship between independent variable (changing the company management) and the earnings management is direct, which means by the increase in changing the company management the possibility of increase in earnings management emerges, and if the changing in company management decreases the possibility of decrease in earnings management emerges. According to the result that (there is a meaningful relationship between changing the company management and the earnings management) which is confirmed, we recommend the stockholders and other investors to pay attention to the companies that have more changes in their management framework, because when a new manager enters a company or operates in it for a short period of time, for proving one's self manipulates the accruals and earnings management and tries to show unreal earnings and this leads to identifying more earnings and as a result more earnings should be distribute between the stockholders and the operating income will be paid to the stockholders as DPS and goes out of the company and distributes among stockholders and the ultimate result is the decrease of fund in the company and as a result decreases the future growth of the company.

There is a positive correlation coefficient between two variables of changing the company manager and the ability to predict the earnings in the accepted companies in Iran Capital Market and the amount is 882; the relationship between independent variable (changing the company management) and the ability to predict earnings is reversed, which means the more the changing in the company management the less the possibility of ability to predict the earnings, and if the changing in the company management decreases the possibility of the ability to predict the earnings increases. According to the result that (there is a meaningful relationship between changing the company management and the ability to predict earnings) which in confirmed, we recommend the stockholders and the other investors to pay more attention to the companies with more changes in their managerial level, because when there is more changes in the company management, because of the unfamiliarity of the management with the internal and external conditions of the company and also the factors affecting the industry in which one enters, one would have less power and ability to predict the company's earnings and as a result the predicted earnings and the earnings declared by the company management always have so much distant with the realized earnings at the end of fiscal period. At the end, we suggest the future researchers to examine the relationship between the changing in company management and the company bankruptcy, or the relationship among changing the company management and the default risk and transparency in financial reporting.

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