Studying the moderating effect of the corporate governance on the relationship between accounting conservatism and earnings management on the Stock Exchange

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Abstract

The purpose of corporate governance is to increase confidence of corporate activities and management policies in line with the interests of shareholders in particular and all stakeholders, in general. Therefore, it is expected that corporate governance mechanisms are able to control opportunistic behavior of managers in order to maximize their wealth and prevent damage to the shareholders. In this regard, shareholders consider conservatism and corporate governance as monitoring tools that restrict earnings management. The aim of this study is to investigate the impact of corporate governance mechanisms on the relation between conservatism and earnings management in Tehran Stock Exchange.

Test hypotheses have been carried out using multiple regression analysis and estimated generalized least squares method (EGLS), with panel data for the period of 1387 to 1393, based on data gathered from 150 participants. The results showed that as concluded by Watts (2003), conservatism through real-time detection of losses and delay in recognizing economic benefits, reduce management opportunities based on the accrual-based earnings. Furthermore, corporate governance variables according to their supervisory role, increase conservatism and reduce the firm's earnings manipulation.

Keywords: earnings management, corporate governance, accounting conservatism.
Introduction
Companies as economic units always look for profitability and achieving greater wealth. For various reasons, the most important of which is the separation of ownership from management, in addition to doing business, companies have the duty of being accountable to people outside the company.
Due to agency problems, the managers may not use the company's resources to increase shareholders' wealth. In order to protect the interests of shareholders and creditors and to control opportunistic behavior of management, varieties of instruments are used to mitigate the cited problems. Due to the crucial role of accounting in determining the terms of the contract and monitoring the proper implementation of the contracts between managers and owners, accounting principles and procedures apply conservatism concept with the aim of balancing optimism of managers, protecting the rights of beneficiaries, and fair presentation of the financial statements. According to these issues, the aim of this study is to investigate the moderating effect of corporate governance on the relationship between accounting conservatism and earnings management in Tehran Stock Exchange.

Research background
Foreign studies
In a study, Jarbou (2013) examined the relationship between ownership structure and composition of the board with conservatism in Tunis Stock Exchange from 2007 to 2011. In this study, where conservatism was measured according to Basu's model (1997), the result showed that there is a significant relationship between ownership structure and composition of the board with accounting conservatism.
In a study, Jadeson and Walker (2014) examined the relationship between corporate governance features and earnings management with conservatism in American Stock Exchange during the period from 1999 to 2012. The results showed that the features of the board reduce earnings management and conservatism and the existence of a high number of independent members of the Board of Directors reduces information asymmetry, conservatism, and earnings management.
In a study, Malida and Anwar (2015) examined the relationship between corporate governance, earnings management, and tax management in Indonesia's stock exchange. The results indicated a significant negative relationship between board independence and tax management, and a positive correlation was observed between the sizes of the board with the tax management.

Domestic studies
In a study, Ansari et al (2013) studied the effect of conservatism on accrual-based earnings management, actual earnings management, and general level of earnings management. The results showed a negative relationship between conservatism and accrual-based earnings management, and a positive relationship between conservatism and actual earnings management.
In a study, VahidiElizee and Ravanan (2015) studied the effect of audit quality and corporate governance characteristics on earnings management in the Tehran Stock Exchange. The results showed that there is a significant negative relationship between audit quality, the size of the board, non-executive board members, and earnings management and a positive relationship between board remuneration and earnings management.
In his study, Nurizadeh (2016) evaluated the effect of accounting conservatism on the relationship between earnings management and rigorous tax reporting. The results of his study showed that there is a negative relationship between earnings management and accounting conservatism.

**Research hypotheses**
First hypothesis: There is a significant relationship between accounting conservatism and earnings management.

The second hypothesis: Institutional ownership has a moderating effect on the relationship between accounting conservatism and earnings management.

The third hypothesis: Managerial ownership has a moderating effect on the relationship between accounting conservatism and earnings management.

The fourth hypothesis: The size of the board has a moderating effect on the relationship between accounting conservatism and earnings management.

The fifth hypothesis: The independence of the board has a moderating effect on the relationship between accounting conservatism and earnings management.

**Study population**
The firms listed in the Tehran Stock Exchange during the seven-year period 2008-2014 are examined in this study.

**Type and methods of the study**
The present study is of proving accounting research. Regarding the aim, the research is applied, and in terms of nature, it is descriptive. Regarding the time, the study is post hoc and uses historical data of sample firms. To estimate the regression model and to test the hypotheses, econometric method of combined data will be used.

**Models used to test hypotheses**

Regression model (1) for the first hypothesis: studying the relationship between conservatism and earnings management.

Regression model (2) for the second to fifth hypotheses: studying the moderating effect of corporate governance features on the relationship between conservatism and earnings management.

In these models:

Dac, earnings management; Cons, accounting conservatism; Instown, institutional ownership; Manown, managerial ownership; Boardsize, board size; Bind, board independence; size, size of the company; Leve, financial leverage; and $\varepsilon$: the errors.

**Analyzing of the hypotheses using combined data**

The result of testing the first model of the research:

Figure (4-8): The result of testing the first model of the research in combined data level.

<table>
<thead>
<tr>
<th>Description</th>
<th>coefficients</th>
<th>The standard error</th>
<th>T student</th>
<th>p.v</th>
<th>VIF</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intercept $\beta$</td>
<td>-0.009</td>
<td>0.01</td>
<td>-0.77</td>
<td>0.44</td>
<td>1.001</td>
</tr>
<tr>
<td>CONS</td>
<td>-0.01</td>
<td>0.006</td>
<td>-2.29</td>
<td>0.03</td>
<td>1.001</td>
</tr>
</tbody>
</table>
As seen in the table (4-8), F statistic is significant with 95% confidence level. Therefore, the model is overall significant and independent and control variables have the ability to explain the dependent variable.

**First hypothesis:**
According to the results of Table (4-8) t statistic related to the independent variable accounting conservatism (CONS) and its significance level (p.v) are, respectively, -2.29- and 0.03, and its coefficient is -0.01. Thus, accounting conservatism has a significant effect on earnings management and the research first hypothesis is confirmed at 95% level of confidence.

The coefficient of CONS is negative. As a result, the relationship between accounting conservatism and earnings management is a negative and reverse one that is as conservatism is more; the likelihood of earnings management reduces in the company.

The result of testing the second model of the research:

**Figure (4-9): The result of testing the first model of the research in combined data level**

<table>
<thead>
<tr>
<th>Description</th>
<th>coefficients</th>
<th>The standard error</th>
<th>T student</th>
<th>p.v</th>
<th>VIF</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intercept β</td>
<td>-0.006</td>
<td>0.01</td>
<td>0.35</td>
<td>0.72</td>
<td></td>
</tr>
<tr>
<td>CONS</td>
<td>-0.01</td>
<td>0.002</td>
<td>-4.33</td>
<td>0.00</td>
<td>1.3</td>
</tr>
<tr>
<td>CONS*INSTOWN</td>
<td>-0.09</td>
<td>0.04</td>
<td>-2.24</td>
<td>0.02</td>
<td>2.7</td>
</tr>
<tr>
<td>CONS*MANOWN</td>
<td>-0.03</td>
<td>0.006</td>
<td>-5.69</td>
<td>0.00</td>
<td>1.006</td>
</tr>
<tr>
<td>CONS*FSIZE</td>
<td>-0.28</td>
<td>0.03</td>
<td>-8.14</td>
<td>0.00</td>
<td>1.04</td>
</tr>
<tr>
<td>CONS*BIND</td>
<td>-0.07</td>
<td>0.02</td>
<td>-3.35</td>
<td>0.00</td>
<td>1.09</td>
</tr>
<tr>
<td>SIZE</td>
<td>0.003</td>
<td>0.001</td>
<td>2.36</td>
<td>0.01</td>
<td>1.01</td>
</tr>
<tr>
<td>LEVE</td>
<td>0.01</td>
<td>0.01</td>
<td>1.49</td>
<td>0.13</td>
<td>1.01</td>
</tr>
<tr>
<td>Durbin-Watson</td>
<td></td>
<td></td>
<td>1.77</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Adjusted coefficient of determination (R²)</td>
<td></td>
<td></td>
<td>0.57</td>
<td></td>
<td></td>
</tr>
<tr>
<td>F-static) p.v</td>
<td></td>
<td></td>
<td>20.79 (0.000)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

As seen in the table (4-9), F statistic is significant with 95% confidence level. Therefore, the model is overall significant and independent and control variables have the ability to explain the dependent variable.

**The second hypothesis:**
According to the results of Table (4-9), t statistic related to independent variable multiplied by accounting conservatism and institutional ownership (CONS * INSTOWN) and its significance
level (p.v) are, respectively, 2.24 and 0.02, and its coefficient is -0.09. In addition, the correlation between conservatism and earnings management is -0.01. When institutional ownership is multiplied in accounting conservatism as a mechanism of corporate governance, conservatism coefficient increases to -0.09. In other words, institutional ownership moderates the relationship between conservatism and earnings management. The second hypothesis is confirmed at 95% confidence level.

This result means that institutional investors have an active monitoring role over the company's decision in the exercise of their earnings management and by increase of institutional ownership percent, the flexibility of the company's stock decreases to manipulate the company's actual activities.

**The third hypothesis:**
According to the results of Table (4-9), t statistic related to independent variable of multiplying accounting conservatism and managerial ownership (CONS * MANOWN) and its significance level (p.v) are, respectively, -5.69 and 0.00, and its coefficient is -0.03. In other words, managerial ownership also moderates the relationship between conservatism and earnings management. Thus, the third hypothesis of the research is also confirmed in the confidence level of 95%.

**The fourth hypothesis:**
According to the results of Table (4-9), t statistic related to independent variable of multiplying accounting conservatism and board size (CONS * BSIZE) and its significance level (p.v) are, respectively, -8.14 and 0.00, and its coefficient is -0.28. Thus, the fourth hypothesis of the research is confirmed in the confidence level of 95%. This result means that, given the regulatory role of board members, as the number of these people is high, usually earnings management is less due to conflicts of interest of members and beneficiaries, and board members do not allows opportunism of managers in manipulating earnings.

**The fifth hypothesis**
According to the results of Table (4-9), t statistic related to independent variable of multiplying accounting conservatism and board independence (CONS * BIND) and its significance level (p.v) are, respectively, -3.35 and 0.00, and its coefficient is -0.07. Thus, the fifth hypothesis of the research is confirmed in the confidence level of 95%. This result means that the role of non-executive directors in Iran is in accordance with agency theory and the ability of this monitoring tool in reducing earnings management is strong. Based on agency theory, the presence of independent non-executive directors on the board of directors and their regulatory practices, as independent individuals, help reduce conflicts of interest between shareholders and managers a lot.

**The results of the testing the hypotheses**

**The results of testing the first hypothesis**
Research results based on combined data showed that there is negative and significant relationship between accounting conservatism and earnings management, and as a result, the first hypothesis was confirmed at 95% level of confidence.

**The results of the testing the second hypothesis**
Research results based on combined data showed that institutional ownership has a moderating effect on the relationship between accounting conservatism and earnings management. As a result, the second hypothesis was confirmed at 95% level of confidence. In other words,
institutional ownership hinders the opportunism of managers in manipulation of earnings and undesirable use of free cash flow. As a result, the second hypothesis was confirmed at 95% level of confidence.

**The results of the testing the third hypothesis**
Research results based on combined data showed that managerial ownership has a moderating effect on the relationship between accounting conservatism and earnings management. As a result, the third hypothesis was confirmed at 95% level of confidence. In other words, managerial ownership hinders the opportunism of managers in manipulation of earnings and undesirable use of free cash flow. As a result, the third hypothesis was confirmed at 95% level of confidence.

**The results of the testing the fourth hypothesis**
Research results based on combined data showed that board size has a moderating effect on the relationship between accounting conservatism and earnings management. As a result, the fourth hypothesis was confirmed at 95% level of confidence.

**The results of the testing the fifth hypothesis**
Research results based on combined data showed that board independence has a moderating effect on the relationship between accounting conservatism and earnings management. As a result, the fifth hypothesis was confirmed at 95% level of confidence.

**Discussion and conclusion**
The results showed that there is a negative and significant relationship between accounting conservatism and earnings management. This means that as the level of conservatism in a company is more, the likelihood of earnings management reduces in the company. In fact, with increasing levels of conservatism, opportunities of earnings management reduce and managers have no incentive for accrual-based earnings management, which leads to accurate reports of earnings immune from manipulation or applying opinion. Moreover, corporate governance variables lead to the moderation of the relationship between conservatism and earnings management, and in companies where corporate governance mechanisms are strong, accounting conservative is more and manipulation in their earnings through this channel is low. Using the results of this study it can be concluded that with increasing levels of conservatism, the overall level of earnings management reduces. In fact, conservatism leads to reporting more reliable earnings reports with more quality by limiting the opportunities of earnings management.
References


