Examine the Relationship between Management Independence and Disclosure Quality on Earning Management of the Firms Listed on Tehran Stock Exchange

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ABSTRACT

The purpose of this study was to investigate the relationship between management independence and disclosure quality on earning management of the firms listed on Tehran Stock Exchange. There were participated 157 listed companies on Tehran Stock Exchange during 2006 to 2013. Disclosure timeliness, reliability of disclosure, independent of board of directors and company size indicators were used as control variables for adjusting the relationship between management independence of disclosure quality on earning management. The results showed that quality of disclosure and management independence had significant effect on earning management; while timeliness and reliable corporate disclosure had no significant effect on earning management.

KEY WORDS: management independence, disclosure quality, earning management

INTRODUCTION

The reported earnings by companies have been always considered as one of criteria in financial decision-making. But if goals of owners and managers are not consistent, management may prepare financial statements toward its interests. Users of financial statements have always been unhappy about imbalance of accounting information and they looking for information that could be used for logical decision (Setayesh et al., 2012). Watts and Zimmerman (1978) stated that according the conducted studies, researchers have found that accounting figures and numbers play important role in interest conflict between managers and shareholders. In other words, this indicator the figures and numbers can play an accelerator role in this category. In units with weak earnings performance and the fall price of shares, serious risks threaten security of career manager, and finally, shareholders may replace manager. There are two financial mechanisms to fill information gap between managers and investors (Hassani, 2010). First, the accepted accounting norms and standards that limit management ability to manipulate financial information, although managers can keep their information superiority because of their knowledge and expertise. Second, auditors increase fiscal credibility by estimating management evaluation and the reported numbers and figures. The mechanisms have yet their special weaknesses and they have not been able to fill information gap between managers and investors fully. Disclosure of information is a strategy to remove information asymmetry between managers and investors through balancing conflicts in available interests (Izadinia, 1998). Therefore, the present study sought to answer the question whether there is a significant relationship between management independence disclosure qualities with earning management.
**Methodology:**
The research was descriptive. The population of all the companies listed in Tehran Stock Exchange in the period from 2006 to 2013. Companies that participated in the study had the following conditions:
1. The financial year ending in March each year;
2. They should be accepted in Tehran Stock Exchange prior to 2001 and should not leave it until ending 2010;
3. All required information should be available;
4. It should not be a financial company (investment, brokering etc);
5. It should have at least 20 trading days per year.
Diagram 1 shows conceptual model of the research.

![Diagram 1: The research conceptual model.](image)

The following regression equation was used to measure the research variables.

$$EM = \alpha + \beta_1 CE + \beta_2 DUALITY + \beta_3 BRDIND + \beta_4 SIZE + \beta_5 TD + \epsilon$$

Where

- CEOM: Disclosure timeliness
- DUALITY: Reliability of disclosure
- BRDIND: Management independence
- SIZE: Company size
- TD: Disclosure quality
- EM: Earning management

Disclosure timeliness, reliability and quality variables were calculated by corporate disclosure scores reported by Tehran Stock Exchange. Quality of company disclosure is one of endogenous variables of the research. In the research, there were used annual scores of company disclosure quality for the listed companies on Tehran Stock Exchange during 2006 to 2013. Tehran Stock Exchange calculated scores of company disclosure quality in periods 3, 6, 9 and 12 months for after 2003. The scores show evaluation of the Stock Exchange on awareness of company disclosure. The scores are calculated according mean weight of timeliness and reliability of the disclosure information criteria. The information was evaluated based on provisions of information disclosure at the Stock Exchange including annual financial statements, periodic financial statements (3, 6 and 9 months audited) and forecast earnings per share in periods of 3, 6, 9 and 12 months. Delay in sending information to the Stock Exchange in compared to the identified time period and difference in the realized profits than expected calculation of timeliness and reliability of disclosure. Earnings management is a kind of artificial manipulation by management to ensure on level of the expected profit for some specific decisions of investors. In fact, earnings management is difference between the expressed benefit and actual benefit of company. Requirements of independence of board of directors were that if an independent member of board of directors is shareholder, his/her shares will be disclosure because he/she is a member of board of directors and it should not be higher than 5%. Over past two years, the independent member should not work in an independent company and any a company associated with it or any other related companies. Independent members should be employed by any company that provides basic goods and services for the company. Independent members should not be first degree family of company's major shareholders or management-executive position that can affect company's internal control mechanisms. Pearson correlation was used for data analysis. The significance level was $p < 0.05$ for all analyzes.
Results:

Table 1 shows the mean and standard deviation of the research variables. As seen number independent is between zero and one, and the index mean indicates 0.61 of companies have an independent board of directors averagely. Size is calculated in terms of net sales revenue on million Rls. Therefore, this variable is much larger than other variables. Disclosure quality is a number between zero to hundred, and the obtained number for the mean (26.38) shows mean quality of disclosure in the studied companies.

<table>
<thead>
<tr>
<th>Variable name</th>
<th>Sign</th>
<th>Mean</th>
<th>Middle</th>
<th>SD</th>
</tr>
</thead>
<tbody>
<tr>
<td>Disclosure timeliness</td>
<td>CEO</td>
<td>0.89</td>
<td>1.00</td>
<td>0.31</td>
</tr>
<tr>
<td>Reliability of disclosure</td>
<td>DUALITY</td>
<td>0.19</td>
<td>0.00</td>
<td>0.39</td>
</tr>
<tr>
<td>Independence of board of directors</td>
<td>BRDIND</td>
<td>0.61</td>
<td>0.60</td>
<td>0.21</td>
</tr>
<tr>
<td>Company size</td>
<td>SIZE</td>
<td>2277457</td>
<td>567752</td>
<td>7167953</td>
</tr>
<tr>
<td>Disclosure quality</td>
<td>TD</td>
<td>26.38</td>
<td>19</td>
<td>23.90</td>
</tr>
<tr>
<td>Earnings management</td>
<td>EM</td>
<td>5.23</td>
<td>6.17</td>
<td>20.43</td>
</tr>
</tbody>
</table>

Pearson correlation was used to examine the relationship between the research variables. Table 2 shows the results. According the results, we can say that quality of disclosure has a significant effect on earnings management. Corporate timely disclosure has no significant effect on earnings management. Corporate disclosure reliability has no significant effect on earnings management. Management independence has a significant effect on earnings management.

**Table 2:** Results of correlation analysis between the research variables.

<table>
<thead>
<tr>
<th>Earnings management</th>
<th>Disclosure quality</th>
<th>Disclosure timeliness</th>
<th>Reliability of disclosure</th>
<th>Management independence</th>
</tr>
</thead>
<tbody>
<tr>
<td>r</td>
<td>0.17*</td>
<td>0.4</td>
<td>0.37</td>
<td>0.28*</td>
</tr>
<tr>
<td>p</td>
<td>P&lt;0.05</td>
<td>p&gt;0.05</td>
<td>p&gt;0.05</td>
<td>P&lt;0.05</td>
</tr>
</tbody>
</table>

Discussion and Conclusion:

The purpose of this study was to investigate the relationship between management independence and disclosure quality on earning management of the firms listed on Tehran Stock Exchange. The results showed that quality of disclosure and management independence had significant effect on earning management; while timeliness and reliable corporate disclosure had no significant effect on earning management. Results of this research are not consistent with the obtained results by Bodaghi and Bazazzadeh (2007) who estimated a negative correlation between quality of disclosure and earnings management because this study shows a significant positive relationship between disclosure quality and earnings management. However, Lobo and Zhou (2001) have exactly revealed conclusions in line with results of this study, and they estimated a significant positive relationship between disclosure quality and earnings management. Nowravesh and Hosseini (2009) found results contrary with the obtained ones by this study. They found a significant negative relationship between disclosure quality and earnings management, while it was not significant in this study. According results of the study, it is suggested that companies can take necessary actions to increase quality and quantity of disclosures as well as voluntary disclosure in earnings management. Also, as there was no significant relationship between timely disclosure and earnings management, it seems that other important factors affect corporate timely disclosure, and it has no direct effect on earnings management. It is suggested to companies’ managers identify disclosure timeliness because they have indirect effect on earnings management. There is also suggested to managers of the listed companies in stock exchange to increase their transparency in corporate disclosure. Earnings management in stock exchange can be removed by special attention to reliable and appropriate disclosure. Therefore, it is recommended that managers of stock exchange companies try in quality and accuracy of disclosure. Other Results showed a significant relationship between management independence with earnings management. It is recommended that companies’ directors are independent and prevent implementing earnings management by non-factional decisions. As earnings management means manipulating in audit reports of company, it is recommended that board of directors monitor performance of CEO.

REFERENCES


