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The Effect of Corporate Governance Investigating and Earnings Management on Earnings Forecast in Initial Public Offerings of Stock (case study: listed companies in Tehran Stock Exchange)

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Abstract: The main purpose of this research is to examine the effect of corporate income management and corporate governance on the forecasting of profit in the initial shadow supply of listed companies in Tehran Stock Exchange. To this end, this research, using various concepts and theories in the field of corporate governance, profit management and profit forecasting, tries to estimate the relationship between the above variables according to the research model. The statistical population of the study is the companies listed in the Tehran Stock Exchange between 2016 until 2020. These samples consisted of 39 companies that have features such as availability of data, financial statements' consolidation in the years considered by the Stock Exchange. Considering the fact that this research uses past information to test hypotheses, it is a kind of post-mortem research and data analysis and test was done using the panel data regression model and in the Eviews software environment. The results of the research showed that on the one hand, there is a negative and significant relationship between earnings management and profit forecast in the initial supply shifts of the companies accepted in the Tehran Stock Exchange and On the other hand, there is a positive and significant relationship between corporate governance and profit prediction in the initial supply of companies.

Key words: profit management, profit forecast, corporate governance index

Introduction

The stock market is considered as one of the key sources of financing for companies. This source of funding is also mentioned as an efficient tool in the optimal allocation of community resources. Therefore, the existence of an active capital market with the participation of investors is of particular importance. The presence of investors in the stock exchange depends on gaining profit and achieving the desired financial results in this capital market. Investors can hope to make a profit in the market if they make the right decisions. Making optimal decisions by investors depends on obtaining useful information from various information sources. One of the most important sources of information for investors to make investment decisions is the financial statements submitted by listed companies.

Evidence suggests that corporate governance has become one of the most common terms in world trade terms at the beginning of the new millennium. The collapse of large corporations such as Enron and WorldCom in the United States in recent years has drawn public attention to the prominent role of corporate governance and the seriousness of these principles in preventing such collapses, and professional associations and universities in The whole world is showing great interest in this issue. The existence of good corporate governance reduces the vulnerability of developing markets, including the Iranian market, to financial crises, and above all, targets the healthy life of the enterprise in the long run, and therefore seeks to protect the interests of shareholders against the management of organizations.

Haley and Wallen define profit management as follows: Profit management occurs when managers use their personal judgments in financial reporting and manipulate the transaction structure to change financial reporting. This goal is either intended to mislead some profit owners about the company's economic performance or to affect the results of contracts that are subject to personal profit (Mashayekhi, 2016) Beaver et al. Defines part of the expected profit judgments as profit management. Earnings management is a deliberate interference in the external financial reporting process with the intention of making a profit (Chang et al., 2015).

Flexibility in accounting allows the profession to have processes. Deviations such as earnings management occur when people take advantage of this flexibility and these deviations are used to cover real financial fluctuations. Importantly, the actual results of management performance are not revealed. This phrase implies that within the accepted accounting principles, if accounting decisions are used to transform or conceal the true economic performance of the company, it can be considered profit management (Buta et al., 2017)

Problem Statement

Profit is one of the most important issues in accounting, which has long maintained its special place in theoretical discussions. Awareness of users about the reliability of profits can help them make better decisions about profitability and analyze financial statements as well as future estimates (Buchner et al., 2017).

Profit estimation and forecasting is a type of mandatory disclosure that provides information about companies' expected profits and is a key aspect of the disclosure principle. The existence of transparent and comparable financial information is the main pillar of accountability and informed economic decisions (Zang et al., 2019). Shareholders, creditors and other users need relevant and understandable financial statements to make decisions about buying, selling, holding, lending, evaluating the performance of managers and other important economic decisions. The amount of information disclosed to capital market participants affects the amount of earnings estimates. These findings extend to the disclosure of information related to strategic accounting management analysis. Finally, these findings suggest that companies that disclose more information have greater accuracy in forecasting and estimating profits (Rogers et al., 2017).

The existence of transparent and comparable financial information is the main pillar of accountability and informed economic decisions. Owners of capital, creditors, and other users need relevant and understandable financial information to make decisions about buying, selling, holding stocks, lending, evaluating managers' performance, and other important economic decisions (Choi et al., 2015).

Short-term planning in various fields is essential for the continued operation of economic units and the need to make effective investment and financing decisions by managers, shareholders, creditors and others. Planning enables the proper use of existing opportunities and can be used to show appropriate reactions before facing adverse economic events. To increase the effectiveness of planning, it is necessary to improve the ability of accurate and continuous forecasting that is necessary (Hashemi and Khaleghi, 2019).

Prediction is important because it is a fundamental and key element in the decision making of users inside and outside the organization. Accordingly, the ultimate efficiency and effectiveness of any decision depends on the outcome of the events that follow each decision. In this way, it will be an efficient and effective decision based on predictions that are based on the correct. One of these forecasts is profit forecasting, which should provide logical, reliable and timely information that is understandable and relevant. Accurate and timely forecasts improve users' financial reporting decisions. In general, voluntary and mandatory disclosure are two important channels of communication for managers to transfer information to external investors. Although there are many principles and bases that state that mandatory and voluntary disclosure has important and relevant information and has a significant effect on the price of securities, but such disclosures can lead to errors (Soleimani and Taheri, 2017).

Due to the economic and business fluctuations that companies are always facing, the economic environment is associated with instability or little stability, and that is why senior managers do not have a correct assessment of the business future of companies and therefore there are errors. Normal in such revelations is not unexpected. Earnings management occurs when the management of a for-profit unit uses its own judgment in financial reporting, and the purpose is to mislead some shareholders about the actual economic performance or to deviate from the results of contracts that depend on the accounting figures reported. (Buchner et al., 2017).

Today, with the growth of capital markets and the increase of mortgage capital in securities, companies listed on the stock exchange are required to submit interim financial statements. Preparing interim financial statements can help keep accounting information up to date, thereby helping to evaluate companies' securities correctly and in a timely manner. In other words, the presentation of interim financial statements by reducing the time intervals of providing information to the capital market, reduces the possibility of abuse of some people who have access to specific information, and thus provides a good platform for the relative efficiency of the capital market. N.

Accounting Standard No. 22 of Iran considers the preparation of interim financial statements, both intensive and complete, to be useful if they are timely and reliable, stating that these reports should provide useful information regarding the ability to obtain Provide profit, cash flow, financial condition, and business unit liquidity to users.

Scott (1997) refers to earnings management as the firm's choice of accounting policies to achieve certain goals of for-profit unit management. Dee (1988) stated that the evidence suggests that earnings management is mainly derived from information asymmetry (Buchner et al., 2017). This view is the focus of the definition provided by Scott. Dee has also studied two important issues related to the issue of earnings management: a) Profit is managed to increase the rewards of senior managers provided by investors; B) Actual investors tend to have a better market perception of the company's value. Thus, there is a transfer of potential wealth from new investors to old investors who drive domestic demand for profit management. Therefore, all groups tend to manage profits, and new investors may suffer the most. In particular, the main purpose of this study is to provide a theoretical position for the special motivation of senior managers in earnings management in order to achieve rewards, and in this regard, earnings forecasts need a tool to achieve this goal.

Corporate governance mechanisms affect the quality of information disclosed by companies, including information about earnings forecasts. Disclosure of transparent financial information minimizes agency problems and issues by reducing information asymmetry between management and stakeholders. In contrast, poor disclosure of financial information often misleads shareholders and thus has adverse effects on their wealth (Beck et al., 2018). The results of previous research indicate that corporate governance mechanisms, such as the characteristics of the board, ownership structures and audit quality, affect the disclosure procedures of financial information.

This study uses data and financial information of companies listed on the Tehran Stock Exchange to investigate the effect of earnings management and corporate governance on earnings forecasts in the initial public offering of shares in companies listed on the Tehran Stock Exchange and This raises the question of what effect does corporate earnings management and governance have on the forecast of initial public offerings of shares of companies listed on the Tehran Stock Exchange?

Research history

Moradzadeh Fard et al. (2020) in a study investigated the error of forecasting management profit and information content of accruals in companies listed on the Tehran Stock Exchange. The aim of this study was to reveal the behavior of business units on the verge of financing through positive and negative discretionary accruals with management profit forecast error. Findings of the study indicate a significant inverse relationship between management profit forecast error and total discretionary accruals. Findings of other research hypotheses also indicate that management forecasts for debt financing have a significant positive relationship between positive discretionary accruals and management profit forecast error.

Foroughi and Safdarian (2019) studied the relationship between earnings management, earnings forecast error and abnormal returns in companies listed on the Tehran Stock Exchange. Findings from the study show that there is a significant positive relationship with this profit management and profit forecasting error in companies with high profit management and the average abnormal return of profitable companies is higher than the average abnormal returns of value creating companies.

Khodadadi and Tucker (2018) investigated the effect of corporate governance characteristics on the financial performance and value of listed companies and used the composite data regression method to test the hypotheses. They have a significant positive relationship. Major institutional investors have a significant negative relationship with the value of the company and do not have a significant relationship with the performance of companies. Also, the structure of corporate governance and its performance have a positive and significant relationship.

Sabzalipour et al. (2016) found that there was a positive and significant relationship between non-executive board members but there was no standard relationship between the size of corporate governance mechanisms (such as institutional ownership, dual role of CEO and audit quality) and profit forecast accuracy.

Hasas Yeganeh, Raeisi and Hosseini (2014) ranked the companies in terms of corporate governance and examined its effect on the performance of companies. In this study, the rank of sample member companies has been measured using a comprehensive questionnaire containing 25 criteria of corporate governance. These criteria are taken from the provisions of the bylaws of the management system of companies listed on the Tehran Stock Exchange and are divided into three categories: information transparency, board structure and ownership structure. For this purpose, one-year data of 90 companies were examined and research hypotheses were tested using regression method. The results show that there is no significant relationship between the quality of corporate governance and company performance.

Cheng and Weston (2019) examined the relationship between unreported stock transactions by individuals within the organization and future earnings and earnings forecast error. They showed that these transactions reduce the company's future profit and increase profit forecast errors.

Yan Shan (2018) in a study entitled Correlation Value, Profit Management and Corporate Governance in China addressed whether earnings management reduces the level of relevance of information value and also raised the issue of whether corporate governance leads to There is a limit or reduction in profit management. The results showed that earnings management has a negative effect on relevance value and companies that have good corporate governance activities are more likely to face more restrictions on earnings management than companies that do not have good corporate governance activities.

Asar (2016) examined the effect of managerial power on the accuracy of profit forecasting by financial analysts. The results of his research showed that the duality of the duties of the CEO and the chairman of the board and the power of management vote in the board as a managerial power has a positive relationship with the accuracy of predictions.

Chang (2015), by examining the relationship between corporate governance characteristics in financially disadvantaged companies in Taiwan, concludes that companies with board independence (companies with a high percentage of non-executive board members) compared to companies with a low percentage of board members They suffer from financial crisis and helplessness. The results also show that there is a positive relationship between board size and helplessness.

Research hypothesis

First hypothesis: Earnings management has a significant effect on the forecast of earnings of initial public offerings of shares of companies listed on the Tehran Stock Exchange.

Second hypothesis: Corporate governance has a significant effect on the forecast of initial public offerings of shares of companies listed on the Tehran Stock Exchange.

Statistical Sample and Population

The statistical population of the present study is the companies listed on the Tehran Stock Exchange for a period of 5 years from 2016 to 2020. These samples include companies that have made initial public offerings between 2016 and 2020. According to the mentioned condition (initial public offering of shares), 39 companies were selected as a statistical sample during a 5-year period from 2016 to 2020.

Research model and introducing variables

According to the research hypothesis, the following regression model, which is taken from the research of Buchner et al. (2017), is used to test the hypothesis.

$$\text{Earning\_forecast}_{it} = \beta_0 + \beta_1 EM_{it} + \beta_2 CG_{it} + \beta_3 SIZE_{it} + \beta_4 LEV_{it} + \beta_5 MB_{it} + \beta_6 ROA_{it} + \varepsilon_{it}$$

The variables of the above equations are described as follows:

A: Dependent variable

Earning_forecast: It indicates the projected profit that in this study, the average EPS forecasted by management is used (Buchner et al., 2017).

B: Independent variable

EM: Indicates earnings management that in earnings management studies, optional accruals are used as a substitute for earnings management. If we want to take a general look at the research done on measuring earnings management, previous research on determining earnings management behavior has focused on explaining accounting methods to test the relationship between an accounting method variable and a number of descriptive variables. . According to the research of Noroush et al., The modified version of Jones (1991) method is a strong test for examining profit management. Therefore, in this study, Jones (1991) modified multi-part method was used to measure optional deferred items. Total overdue items as a measure of changes in non-cash working capital (excluding current account long-term items) less total depreciation expense for the current time period in year z, which is scaled by total assets for year t-1. Has been; I mean we have:

$TAC_{jt}=[(\Delta CA_{jt}-\Delta Cash_{jt})-(\Delta DCL_{jt} - \Delta LTD_{jt} - \Delta ITP_{jt}) - DPA_{jt}]/A_{t-1}$

TAC_{jt} : Total accruals for company j at time t

ΔA_{jt} : Change in current capital (current debt-current assets) for company j in period t-1

$\Delta Cash_{jt}$: Cash change for Company j in period t-1

ΔLjt: change in current liabilities for company j in period t-1

ΔLTD_{jt}: Long-term debt changes, for company j in period t-1

ΔITP_{jt}: Change in income tax payable for Company j during period t-1

DPAjt: Depreciation cost for company j in period t-1

A_{t-1}**:** Total assets at the end of year t-1

The involuntary accruals of Company i in year t were also calculated using the following formula:

$$TA_{it} = \alpha_{it}\ {}^{1}/_{A_{i,t-1}} + \beta_{iit}\left(\frac{\Delta REV_{it}}{A_{i.t-1}} - \frac{\Delta REC_{it}}{A_{i.t-1}}\right) + \beta_{2it}\frac{PPE_{it}}{A_{it-1}}$$

where in:

ΔREV: Changes in Company i Income in year t

Δ REC: Changes in Company's net income in year t

PPE: Net assets, machinery and equipment of Company i in year t

Specific parameters αit, β1it, β2it for each company i based on the relevant industry of the company from the adjustment model

$$NDA_{it} = \alpha_i + (1/A_{it-1}) + \beta_{1it}(\Delta REV_{it}/A_{it-1} - \Delta REC_{it}/A_{it-1})\,\beta_{2it}(PPE_{it}/A_{it-1})$$

Optional deferred items for Company i in year t are defined as follows

$DACC_{it} = TA_{it} - NDA_{it}$

CG: Indicates the corporate governance index that the following variables are used:

1- The duality of the CEO's duty (DUALit): If the chairman and CEO are one person, this variable is equal to 1, otherwise it is equal to 0.

2- CEO's influence (CEODit): If the chairman of the board is a member, it is equal to one, otherwise it is equal to 0.

3- Board size (BRDSIZEit): the number of board members of the company

4- Independence of the board of directors (BRDINDit): The ratio of non-executive directors to all members of the board of directors.

.5- Audit Committee size (AudComit): the number of employees of the company's audit committee

.6- Ownership Concentration (OWNCONit): The total percentage of shareholders who own at least 5% of the company's shares

Whose equation is as follows :

$$CGO_{it} = \sum_{j=1}^{6} corporate\ governace\ mechanism_j$$

For variables that are in proportion or percentage, after calculating these variables for each company, an average for each variable of the total relevant samples during the period under review is prepared, if each of the variables calculated for each company in Each period is greater than the average calculated for all samples for that variable in all periods. That variable will be equal to 1 and otherwise equal to 0.

After determining the variables, the corporate governance ability is calculated as follows:

GOVINDEX =(∑di)/(∑ Hj)

In this relation, di stands for all items that have a score of one, and Hj stands for all items for which zero or one values are assigned. Thus, for each company, the measured corporate governance capability index is in the range of zero to one. This approach has been used in the research of people such as Wallace, Cook, Ahmad and Nichols, Sajjadi et al., Nikomram and Mohammadzadeh.

C: Control variables

LEV represents the financial leverage that is obtained from the ratio of total liabilities to total assets of the company in the year in question.

SIZE: is the size of the company and is obtained by logarithmic measurement of the book value of assets

ROA: Represents the return on assets, which is calculated from the distribution of profit before contingent items on the total assets of the company at the end of year t.

MB: Indicates the ratio of market value to book value of equity

Research Findings

First, the F-Limer statistical test was used to determine the method of using composite data and to determine whether they are homogeneous or heterogeneous. The statistical hypotheses of this test are as follows:

H0 = OLS individual units are homogeneous (Method)

H1 = FE individual units are not homogeneous (fixed effects method)

Chao test result	*F*	Probability*F*	Conclusion
Assumption H_0 is rejected	5.69	0.00	Individual units are not homogeneous (FE fixed effects method)

Given that the value of the F test statistic is an almost large number (5.69) and is greater than the critical quantity (also the probability value is less than 5%), so the null hypothesis is in favor of the opposite hypothesis that the FE method is used. It is appropriate to reject.

This test is performed in order to choose between the fixed effects model and the random effects model. The basic assumption in the stochastic effects model is that the sections studied belong to a larger community and have a common mean for the width of the origin. Differences in width values from the origin of each section are reflected in the disturbance error. In the fixed effects method, the width from the origin must be constant over time, while in the random effects method, the width from the origin can change over time. Therefore, in order to choose between fixed and random effects methods, Hausman test is used to estimate the accumulated data.

The hypotheses of this test are as follows:

Hypothesis Zero: The method of random effects is more efficient.

Mutual Hypothesis: The fixed effects method is more efficient.

Test result	Chi-Sq. Statistic	Chi-Sq. d.f	*p –value*	Conclusion
Assumption H_0 is rejected	22.28	5	0.13	Use the fixed effects model

Test result Since the p-value of Hausmann test was less than 0.05, therefore, the assumption of a Hausmann test is rejected and the multivariate regression equation parameters of the research should be estimated from the fixed effects model using Eviews software. To take. The result of estimating the research model is presented in the table below.

Prob	**Statistics t**	**Standard deviation**	**Coefficient**	**variable**
0.00	-7.24	0.01	-0.11	*EM*
0.00	6.32	0.06	0.38	*CG*
0.61	0.5	1.21	0.61	ROA
0.00	3.7	0.03	0.09	*SIZE*
0.00	-5.6	0.09	-0.53	*LEV*
0.1	1.6	0.06	0.01	*MB*
0.00	5.2	0.42	2.23	C
	F-statistic 5.12		**Prob(F-statistic) 0.000**	
	Durdin Watson 1.72		**R squared 0.79**	

Testing the first HP

H_0: Earnings management has no significant effect on earnings forecasts in initial public offerings of shares of companies listed on the Tehran Stock Exchange.

H_1: Earnings management has a significant effect on earnings forecasts in the initial public offerings of shares of companies listed on the Tehran Stock Exchange.

The coefficients of the regression model in the table above show that there is a negative relationship between earnings management and earnings forecasts in the initial public offerings of shares of companies listed on the Tehran Stock Exchange. In other words, the coefficient related to the earnings management variable, which shows the number -0.11, indicates that by increasing a earnings management unit, it is possible to predict earnings in the initial public offering of shares of companies listed on the stock exchange. Tehran had a 0.11% reduction (error). Also, considering that the level of significance is less than 5%, so this relationship is reliable and meaningful and the hypothesis of a research can not be rejected. Earnings management has a significant effect on earnings forecasts in the initial public offerings of shares of companies listed on the Tehran Stock Exchange.

Testing the second HP

H_0: Corporate governance has no significant effect on earnings forecasts in the initial public offering of shares of companies listed on the Tehran Stock Exchange.

H_1: Corporate governance has a significant effect on earnings forecasts in the initial public offering of shares of companies listed on the Tehran Stock Exchange.

The coefficients of the regression model in the table above show that there is a positive relationship between corporate governance and earnings forecast in the initial public offering of shares of companies listed on the Tehran Stock Exchange. In other words, the coefficient related to the corporate governance variable, which shows the number 0.38, indicates that by increasing a unit of earnings management, it is possible to predict earnings in the initial public offering of shares of companies listed on the Tehran Stock Exchange. , Had a 0.38% increase (no error). Also, considering that the level of significance is less than 5%, so this relationship is reliable and meaningful and the hypothesis of a research cannot be rejected. Corporate governance has a significant effect on earnings forecasts in the initial public offering of shares of companies listed on the Tehran Stock Exchange.

Discussion and Conclusion

The coefficients of the regression model of the first hypothesis show that there is a negative and significant relationship between earnings management and earnings forecast in the initial public offerings of shares of companies listed on the Tehran Stock Exchange. The findings of this hypothesis are consistent with the findings of Vilen (2012), Marquardt and Wiedemann (2014), Namra and Violin (2008) and Habib (2004).

The coefficients of the regression model of the second hypothesis show that there is a positive and significant relationship between corporate governance and earnings forecast in the initial public offering of shares of companies listed on the Tehran Stock Exchange. These results are in some way consistent with previous researches such as Mashayekh (2016), Khidmati (2013) and Mohammadzadeh (2011).

Research Suggestions

Suggestions based on research results

According to the theoretical foundations and research results, it is suggested that the Stock Exchange Organization and the auditing organization, rules and standards to better control the behavior of corporate management in the selection of various accounting methods and government regulations, which can lead to manipulation and presentation. Unrealistic profit, compile. In the process of developing accounting standards in Iran by the auditing organization, the literature and a clear definition of earnings management is not provided.

It is suggested that with the expansion of studies and theoretical literature on corporate governance of stock exchange activists, board members of companies, shareholders, auditing firms, researchers, etc. become more familiar with corporate governance issues so that they can properly play a role in corporate governance and As a result, they have the effect of increasing the quality of companies' financial reporting and, consequently, increase their profit forecasting power by reducing profit management.

Suggestions for future research

In future research, it can be suggested that the effect of profit management and corporate governance on profitability forecasting should be done separately for different industries and the results obtained from different industries should be compared. It is also suggested that in future research, the effect of profit relevance and book value per share on profitability forecasting power as well as the effect of qualitative characteristics of accounting information such as reliability and timeliness on profitability forecasting power, should be examined.

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