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Drivers of Earnings Management: The Profit and Loss before Earning Management

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Abstract

This study aims to evaluate the effect of two major drivers including: bad company and also the lower benefit from the profits over the previous year on earnings management process of active companies in the capital markets in Iran. Research time period is 6-year (from 2006 till 2011) and the population is all the listed companies in Tehran Stock Exchange. The sample was obtained by screening method includes 199 company. The results of hypotheses testing using panel data showed the probability of using of discretionary accruals in order to show profitable enterprise increases, when the company has loss before using earning management in Iranian market capital. The results also indicate that when the current company's profit is lower than the previous year's profit, the possibility of using the discretionary accruals increases to show positive changes in profitability. Thus, it can be announced that bad and also lower benefit from last year, are as two major driving of earnings management.

Keywords: earning management, profit before applying earnings management, discretionary accruals.

Introduction

Accounting earnings consist of cash and accrual item and accruals are largely in control by management. Often, investors and executives believe companies that have good profitability trends and their benefits have no major changes, have more value and more predictability in compare with similar company. Also, according to agency theory, managers can also have the incentive to manipulate earnings to maximize their interests. This study attempted to examine the influence of both major drivers of earning management including: being bad company and also have lower benefit from previous year, in active Iranian market.

Problem Statement

Studies have shown that low volatility and stabilize profit, are indicative of its quality. Therefore, investors with more sure invest in the stock of the companies that their profit process is more stable. Earnings management is defined as public involvement management in process of determining profits that is in line with the desired objectives of management (Wild et al, 2001, p238).Corporate earnings management behavior has been studied and it has been linked with a measure of profitability includes profit and increase profits (Bourg AstalrandDichew,1997, p 106). They have concluded that lack of continue in profits to near zero and near-zero changes in earnings leads to managers manipulate they Earnings to report its Earnings or maintain previous year profits.

Despite several studies that have been done in relation to earnings management, still whether or not to achieve the criteria by earnings manipulating are at least two reasons that remain unsolved. First, the claim that the presence of causal link between earnings management and profit criteria is based on reported earnings. Second, although the earnings discontinuity is visible, but regardless of the managerial manipulation, the level of normal profit is not defined (Kristian and Ray, 2007, p 402). In reality, the management recognizes in order to achieve the goal of real benefit is contingent on the nature real earnings which is rememberedasearnings before applying earnings management. Infact, profit before applying earningsmanagementis a function of executive recognition in order to adjusteearningsor decrease the lossforthestateto increase profitability or benefit reporting. So the main question in this study is as following:

Beingabadcompanyorreduceitsprofitability increase the possibility of using the discretionary accruals for showing a largecompanyisprofitable?

Research hypotheses

H1: the possibility of using the discretionary accruals in order to show profitable firm increase, when the firm is a bad company before applying earnings management.
H2: the possibility of using the discretionary accruals in order to show positive changesinprofitabilityincrease, when current earning is lowers than the previous year's earnings the firm.

Research methodology

Research methodology can be set of rules and toolsandsystematic reliable way to evaluate the facts, discover the unknown and achieve absolution to the problem. In humanities

severaldivisionof the researches been done. Based on objective, researchcan befundamental, appliedorscientific. .The purpose of applied research is practical application ofknowledgein a particular field (Khaki, 2002, p 74). Based on the method of data collection, research can be historical, descriptive, correlation, experimental or casual. Descriptive research consist of a set of methods that aim todescribeconditions orphenomena.Correlationalstudies, including studies in which the relationship between different variables, we canbeexploredandexplained using the correlation coefficient. The main objective of correlative studies is to determine the type, size and value of the relationship between two or more variables (Sarmad et al, 2011, p92). The present research is descriptive-correlation methodologically and twill attempt to use the correlation coefficient and regression in order to explore and explain relationships between variables. In terms of the survey data, this study is anex-post, becausetheprevious year data are studied. .Also, in terms of the purpose, thisresearchisin thereof applied research.

The population and statistical sample:

The statistical population of this study is listed companiesinTehran Stock Exchange. The sample consists of limited number of sections of the population that express the main features of the population (Azar&momeni, 2010, p 5). The study will be used elimination method to select a sample. For this purpose, fourcriteriaare considered. If acompanyhasmetall thecriteriawill beselectedasone of the companies in my sample. Thecriteriaare as follows:

FirmslistedinTehran Stock ExchangeBefore2006 and is active in the exchange by the end of 2011.

Firms did notchangethe fiscal yearanditend in March.

The firm does not participate ingroupinvestment firmsorfinancial intermediation.
The required informationisavailable on the firm.

After considering all of the above criteria, 199 companies remain as the screened population that all of them were selected as sample. Thus, ourobservationsreachedto 1194 firm-year that these observations are part of 28differentindustries.

Methods of data analysis and hypothesis testing

In this research, multivariate linear regression model is used to data analysis and hypothesis testing. Statistical method that is used in this study is a panel data approach. First, the accuracy of data integration is tested using theft-bound, then the type of testing method determined based on the resultsoftheHausmantest (fixed effects or random effects) and the model is estimated according to the type of approach. F statistic is used to evaluate the significance and to evaluate the significance of the coefficient of the independent variables inthemodel,t-statisticswere used and confidence level of 95% is used to make decisions to accept or reject hypotheses. Also, to verify the normality of variables, being equal variance and independent errors we used Jarque-Bera test andstatisticDurbin-Watsonrespectively.In this study, we used SPSS and Eviews software to data analysis.

Research key words:

Earnings management: earnings managements a methodusedby managementtomanipulate data. Inthisstudy, consistent with theapproachof SunandRoth (2012, pp 30) adjusted discretionary accruals is applied as a measure of earnings management.

Earnings before applying earning management: management recognition toachieveprofittarget, contingent on nature of real benefittothose dealingitis referred to as earnings before applying earning management. Forexample, management mayimprovetheprofitbefore applying earning management when it is less than optimal point. Also, management maydecreasetheprofitbefore applying earning management when it is more than optimal point and some of themmayreserveto coverprofitnext year (Income smoothing). Moreover, when the profit before earnings management is extremely lower than target profit and management efforts to achieveithas not results practically, usually accruals are used to reduce profit (SunandRoth, 2012, p 31).

Discretionary accruals: accounting earningsisseparableintotwo components: cashandaccrual.Accrualcomponent involves reflecting profit estimates and judgments of management (DechewandDechew, 2002, p41). Where accruals are also separable into two components: optional and non-optional. Discretionary accruals are items which management has control over them and can delay or eliminate them or accelerate the identification and record and used as criteria of detecting earnings management.

Financial reporting: purposes and quality

According toast's research (1997, p 13) timelinessoffinancial statements is the identification of economic losses, because the changes in the quantity of the balance sheet occur ifthefollowing of income statement. Identifying the profit and loss timely leads totimelyappealallfinancialvariables and financial ratios. Profit represents the ultimate performanceofthe companies and a high level of it represents that the performanceisgood (Israeli, 2006, p 38).

Income and the concepts related to concepts

Income orrevenueis theincreaseinequity, except what is related to bring by the capital owners (Iranian accounting standards, 2008). Reported profit help the economy in various ways, such as providing a basis for tax calculation, criteria for evaluating the successor performance, criteria for determining the amount of divisible profits, a measure to manage an economic unit and other items. Accounting Income is the difference between thecapitalof the business unit at the end and first of financial period and the capital considered to be synonymous with tenet assets. Therefore, the measurement of Income is affected by the basics of measuring assets and liabilities and in determining accounting earnings although expressing theaccountingactivity, but hasconstantlybeen criticized (Kordestani&Keshavarzi, 2010, pp.118).

Income types: operational income versus non- operational income

The concept of profit includes both of operating income and non-operational incomes. Operating income is defined as income is achieved fromcontinuingoperationsofthe business

and will be discussed by different headlines such as sales, fees, guaranteed interest, dividends, and patents (Iranian accounting standards, 2008). The concept of operating profit of business unit focuses on measuring the efficiency. In calculating the operating profit emphasize is on the term "operational". This means that changes only are due to the main operation and so, it is possible to compare it with other operations. Despite the emphasis of financial analysts on the number of only net income, -disclosure

of operatingitemsandnon- operatingisimportant. .Soifthereferenceisto aprofit figure, according toproponents ofthe concept ofoperating income, net income from current operations is better criteriaforevaluatingcurrent performance(SafarpurandSafarpur, 2008, p 13). In addition tooperatingincome, there's alsoother income thatbe created by the effects ofthe side activities andoperations ofthe company and is reported after operational income in income statement. Degree ofrepeatabilityandstability, as well as the contentinformation of them that are part of theNon- operational component of income, isthe subject that created disagreement between scholars and is a question between accountinginformation users. Non-operational nature ofthese itemshave causeda lot ofquestions anduncertaintyabout theotherfeatures of theseitems, such as stability,theirrelevancetofutureearnings, as well as theirrelevanceto themarket valueof the company(Izadinia&Dorri,2010,pp.32-17).

Earnings Manipulation

BrittonandAstolovy(2000, p 76)definedmanipulation ofaccountsareas:Usingmanagement insightstoselectaccounting proceduresortransactionsdesignedso that effects on thetransferof wealthbetween the company andsociety (political costs), fundsproviders(cost of capital) or managers(compensation plans). The company willbenefitfrom thewealth transfer in wealth transferbetween the company andsociety as well ascompany andprovidersof funds,but in thetransfer of wealthbetween the company andthe directors,managerswill actin their favor andthecompany's losses. Appropriatelyto applythe requirements ofaccounting standardswithadditionaldisclosurewhen necessary, isdesirablyresult infinancial statements andifmanagersmanipulatetheiraccounts usingmanagerialinsightswithinthegenerally accepted accounting principles, presentation of Financial Statementswould not befair. Ifthis manipulationis donein violation ofgenerally accepted accounting principles, beconsideredcheating(Zamani, 2009). Inthe frameworkofAstoloy&Britton(2000, p 81) to classifythe typesof accounts, theyoffered this fundamentalprinciplethatfinancial informationhas a major impacton reducingthe cost of financing. .Thisreducesisdependent onimprovement in investorsperception of the risk the company (Mashayekhiet al, 2005, pp. 74-61). EarningsmanipulationischangingEarningby directorsconsciouslyandwithspecific purposes.Theaimisto manipulatethe accounts, which may affecttheperceptionmarketfrom firm risk.

The concept of earnings management

Since thecalculation ofeconomicprofitsareaffected bythemethod ofaccounting estimates andbusiness unit managementisresponsible forpreparing financial statements and may,for various reasons, managementmayattempt tomanageearnings(Valizadeh, 2008, p 27).

TheMolforddandKamysky(2002, p 27) Earnings managementis aconsciousand

activemanipulationof accountingresultsin order toshow thechange intrade statusof economicunits. .InAccountingTheoryScott(1997) Earnings managementdefined asacompany'schoiceof accountingpoliciesto achieve somespecific goalsbythe administrator. According toGiroux(2004), earnings management consists of range whichstartsfromconservative accounting andcontinues withmoderateor unbiasedaccountingand then with deviations fromtheaccountingprinciples, rulesand conventions, courageous accounting and eventuallyleads tofraudulentor deceitful accounting.

Administratorsview canbeconservativeorcautious. Inthis case,circumventingaccounting standardsandpresence of unexpecteditems less View andof course,fulldisclosureis made. With realizing this idealresult, showing the figuresnearly to reality in thefinancial reportsand providehigh qualityand favorableearnings The reverse caseis managers extremeviewmodeintheaggression of regulation, andviolation ofrules andnormsaccepted accountingprinciples that adjustdeceitful and misleading financialreporting(Baharmoghadam, 2006, p 52).

Models and theories related to earnings management

There are differentpatterns ofearningsmanagement. The firstmodelinthis regard is proposed as relaxation model. Thismodelisthe most damagingtype ofearnings management. Destructive character ofthismodelis thatfirm performancedoes notjustifythe price ofthe stock market. .Insuch circumstances,artificially of the earningprovided by the companyappears. That thisnot onlyreducesshareholder value,butalsohurtthecompany's reputation(Ahmadpoor andJohnM.Farr, 2002, p.61). Anothermodel isprofit maximizationthat is applicable about themanagementbonus plan andmanagementtriesto increaseprofits in order toachievea morerewarding. Incontrast tothispattern, there is minimization model. This patternholds truein the case ofcompaniesthat have aconservativeapproachtolong-termprofitability. Butthe most commonpatternof earnings management isincome smoothingmodel. Thismodeltries toreducereported earningsdue totemporaryfluctuations that isinconsistentwitheconomic profit(AhmadpoorandKarimi, 2006, p 25). Varioustheorieshave been presentedregardingearnings management. One ofthetheoriesthathaveemergedasthe earnings managementexplanation is demonstrability theory. Thetheorywas expanded byWatz&Zymberman(1986). According to this, with presence of theefficient market hypothesis,two companies that have same cash flowshavethe samevalue,even thoughthey havedifferentaccountingpractices.According totheoriginalcontent, the main problem in demonstrability theory is determining themanner inwhichaccountingpractices will be effect on thecompany's cash flowand consequently thebenefitsofmanagement and lead tochanges in themarket price ofthe sharesfirm value. Another theory isthe agency theory which MaklingbyJensen(1976) hasbeen expressed their basics. Thistheoryemphasisonfreedom contracts and comesinto action betweendifferent organizationalgroupsasan efficientsolutionto eliminate theconflict of interest. The evolution of theory has led to the view that the organization is ring of contracts that throughJudgmentofdelegating with certaintasksare performedbyhigher authorities. Manager as the benefitof itsshareholderslooks for maximization of his benefits. Buthis interestslie intheinterests of shareholdersasspecifiedin the contract. On this basisthe company's performanceandfinancial informationprovided to

theCompany, resultingin abalance ofbenefitsbetween the twogroups and earnings managementpracticesbymanagement(income smoothing) not onlyprovidesbenefitsmanagement, Italsoprovidesshareholders' benefits (Ahmadpoor andKarimi, 2006). Othertheoriesare discussed inrelation toearnings management is income smoothingtheorythatthe first time is provided byGordon(1964, p 251). .According to this theory: 1) administrationcriteriaforselectionofaccounting principles, ispromotingits own interests.2) With the increasingin job security, the management benefits,revenuegrowthandcompanygrowth rateincreases.3) Achieving the objectivesstipulated inthe second paragraph depends on the consentof shareholders. That is much more shareholders are pleasing, the job security of management, salary and benefitswill be more.4) Average growth rate ofcorporate profitand its stability increases shareholder satisfaction.

Views of supporters and opponents of earnings management

Researchconducted byMychelsonandothers(1995) show thatfirms that have more smoothearningsconsiderably have higheraverageannual returnsthan firmsthatdonothaveincome smoothingoperation. .According toproponents, large fluctuations inearnings make difficult overallplanningand budgeting. In the other hand, opponents ofthesmoothingand earning management defined that smoothing is distortionsinfinancial reporting purposes. Emhaf (1981, p 23) believed thatwhen thevariablesaremanipulatedfor profitflat, It appearsthatdisclosureis notenough. Beidleman(1973, p 653) believesthat income smoothing makesdifficultanalyzefinancial statements.

Types of earnings management

Types ofearnings managementcan bedividedinto five groups: 1-earnings management through scheduling events: The administrator cancontrol thetimingof events, Such as the allocationof coststo future periods, constitutecapital of some expenditure. Managementhasthe authorityto how and whenidentify events.Timing ofbuyingandsellingpropertycan alsoaffecttheaccountingprofits(NazmiArdakani, 2010,p.114-119). The firstresearch onearnings management wasscheduled throughassetsalesbyBarreto(1993). The resultsof thesestudiessuggestthatmanagersusingthetiming ofthe asset sale smooth thetemporarychanges of profit and manage the earning.

Earnings management through selecting and changing accounting policies

Accountingpolicy choice effects on the timing ofrevenues and expenses recognition in profit calculation. For example,management has authorityin estimate ofservice life, residual value, intangible assets age, fuelrate of receivable accounts(NazmiArdekani, 1389,pp.119-114).

Earnings management through accruals

In fact, under this typeofaccounting system, managers have considerablecontroloverthe diagnosisof somecost items, including costsof advertising andR & Dexpenditures. On the other hand, administrators faced with several options at the time of revenue recognition in theaccrual accountingsystem, including diagnosisfasterrevenuefromcreditsales(Mashayekhiet al, 2002, 74-61).

Earnings management through real activities manipulation(real earnings management)

Schipper(1989) notedin their study that earnings managementcouldbeincluded real activities. Thistype ofearnings managementcarried outthrough changes inoperational activitieswith the intentionto misleadstakeholders. Manipulationof realactivities effects oncash flowsandaccruals in somecases(Valizadeh&Larijani, 2008, p 47). Roychodahry(2006, p 335) argues thatalthoughthesedeviations inthe company's operationsmanagerhelpsin achievingthe objectives offinancial reporting butit does not increasefirm value. The methods ofrealactivitiesmanipulate such asdecreasingsellingprices in order to increase in sales orreducediscretionary spendinginthe economiccrisis, includingoptimizationtechniquesthat helpmanagers. So althoughadministratorscanachieve toshort-termprofits by performingsuch activities butin the longtermtheywill not be ableto increasefirm value.

Earnings management by changing the classification

WhencurrentstatisticsonIncomeother thanprofit be managementissuesand makeup profit, administrators cancategorizeitems of components related to profit and therebyreducethe changes related to operating profit. Forexample, showing somenon-operating revenues in the form of operating revenues ortransfersome ofoperating expenses to generaland administrativeexpenses, all of these willlead toan increase inoperating profit of business units(MakVeigh, 2006, p501).

Incentives for earning management

Incentivessuch asjob security, bonuses, escaping the law,to avoidreportinglossesand reducedprofit, contracts of liabilities, increased wealth, achieve shareholderexpectations andanticipatedprograms, createan incentiveto managethedifferent methods manipulatingearnings intheirown interestandconflict with theinterest ofother groups 1385(BaharMoghadam, 2006, p 59). OtherIncentives forearnings management includetax incentives.Fourmaincontractual positionsmay lead to earnings management: 1) debt covenantrequirements, 2) compensation management contracts,3) job security, and 4) negotiations with theunions. Considering the fact thata violation of thedebt covenantrequirements(including complianceofworking capital ratio) imposesheavy costson companies, it is expected thatmanagers prevent fromearnings managementby applyingit.Managers canalso influence on the current and future rightsand benefits through earning management. Managersmay also attempt to income smoothingdue tojob security(Rahmani, 2009, p. 104-111). Earning management Incentives may be the resultofimplicitcontracts(unconditional) as well. Thesecontractsoccur ofcontinuous communicationwithstakeholders(shareholders, employees, materialsuppliers, customers, etc). Administrators canmanage Stakeholder confidence by earning management and highprofitreported infulfillingitscontractual obligations(Bowen et al, 1995, p 255). PoliticalIncentives are as other incentive forearningmanagement. (Pourheydari&Hemmati, 2002, p.47-63). Market incentives are as therIncentives forearnings management. Marketincentivesinearning managementarisewhencorporate executivesunderstandthe relationship betweenreported earningsandthe company's marketvalue. (Rahmani, 2009,pp.111-104).

Earnings management tools and methods:

Hendrikson& vanBerda(2006) uses accountingsolutionon theexpressionofearningmanagement toolsandthenoutlined thesepolicies as followings:

Inventoryvaluation(FIFOvs.LIFO),depreciation anddepletionof natural resources, the allocation of income tax, pensions, research &development research,goodwill, the time of income realization,comprehensive incomevs.operational profit concept from income statement ,joint ventures, long-termleases, theprinciples related to incorporating and combinecommercial entities, measuring of gains ininvestmentcorporations,intangible assets in theoil and gas industry, changes inclassification.

According toBurtonandAstoloy(2000, p 39) earnings managementtoolsshouldhavethe following features:

• Earnings management tools should be used once so that a company does not have a specific action in response to do next.

• Earnings management tools should be based on professional judgment in the context of generally accepted accounting principles and should not be forced to disclose the fact of manipulation and lead to paragraph in audit report.

• Earnings management tools should lead to a basic transfer of income from one year to another.

• Earnings management tools should not require actual transactions, but should be required to classify the internal accounts.

• Earnings management tools need to be act alone or with other acts and should be used during each successive period (Yaghoubi , 2007 , p 57) .

Accruals:

Accruals are differences between net incomeand cash flowsfrom operations. Dechewand Skinner(2002) state that earning managementis concerned withmanagement incentive and thisis linked tostockperformance, Therefore, if theincome smoothingresearchemphasis oncorporate value, the researchwould be beneficial.Obviously,income smoothing does notnecessarily lead to increase thecompany's value, butincome smoother should alsothink about theearnings qualityat the same time.

MacNicholsandWilson(1988, p 1179)divided earnings quality into threecategories:IncomeStability, accrualslevels andbenefitthat reflecttheeconomictransactions. Make relationship between qualitiesIncome and beneficial in making decisions and the economicdefinition of income. Income smoothingreduces thevarianceof reported earnings, butdoes not guaranteehigh quality ofIncome (the article that examines the relationshipbetween income smoothing, earnings quality and firm value).

Research background

Richardson et al (2002) in their study examined accounting informationadvantagein predicting thebehaviorof earnings management incompanies offeringdirectfurtherIncome statement. .The results showed thataccruals arekey indicatorsearningsmanipulationthatare leadingtorenewedreporting. Also, companiesthat provide renewed income statement aremore likely touseearnings management.Theresultsshowed thatcompanies thatmanipulate thefinancial statementstoreporthigh profits, after therestatementof financial statementsencountered witha largereductionin theprice of the stock.

Dechewand Skinner(2002) examined the behavior ofearnings managementincompanies that havestrongincentivesto break the income chainmodel, but theresult ofresearch do notindicate that to what extentandat what time,managerstend tobreak thechainsof corporate profits.

Morhady (2010) examined the earnings management relationship and its relationwith the lawsand standards Indonesia. The results show that earnings managementincompanies under study are not effected by accounting and auditingrules.

Recently San& Rat(2012, pp.56-29) examined earning managementand earning before applying earning management inAustralian companies. Thisstudyhas beenevaluated criteria whichmanagersattempt toincrease profits to achievetheoptimum income point. .Theyshowed thattwo measures including positiveearningsandearningschangesarepositivelyrelated toearningsmanipulation. Thoseusingdataof Australiancompanies during the yearsbetween 2000 and2006concluded when the primaryearningsisnegative or is lower thanthe previousyear'searnings, the possibility of using discretionary accrualsto increasecorporateearningsto achieveoptimal pointmay be higher.

In Iran alsoPourheydariandHemmati(2004, pp. 63-47), ina studyentitled "the effect of debt contracts, political costs, bonusplans, and ownershiponearnings managementof listed companies inTehran Stock Exchange" investigate the effective factors onearnings management. Statistical population of the study was listed companiesinTehran Stock Exchangeduringthe years1987to2001. The resultsshow that, there is no significant positiverelationship between theratio of debtto equityandearningsmanipulation. The examination of therelationship betweenthe size(total sales) andearningsmanipulation showed thatwith increases in firm size,management has greater incentive toincrease profitsand toprovidea betterpictureofits performanceto shareholders. Anothervariableused toexamine the effect ofpolitical pressuresrelated toearnings management was number of employees. The results indicatethatcompanies thathavealarge number ofemployeesarealso morepolitical pressure.As a result, themanagement of theseunits reducetheirearningsto alleviate the pressure. Hypothesistest results (bonusesand ownership as variables) indicatednosignificant relationshipbetween these variables earningsmanipulation.

HasasYeganeh&Yazdanian(12008, pp.171-151) studied the impactofcorporate governancemechanismsonearnings managementinIran. Thecorporate governanceprinciples ofthe present studythat their effects on thedecline inearnings management were examined, are as following: Ownership of institutional investors,non-responsible managers(non-executive) in boardcomposition, lack ofCEOas chairmanor vicechairman ofthe board, and the

presenceinternal auditors. In this researchthediscretionary accrualsusing themodified Jones modelhave been used as an indicator of corporateearningsto determine earning management. For this purpose,datafrom 177companies during years of 2002to2004 has been used.The results ofthisstudyshow that when thepercentage ofinstitutional ownershipin thecompanyismore than45%, earnings managementdecreases. In addition,the research findingssuggestthereis no relationship between the presence of non-executives managers in composition ofthe board ofdirectors, thelack ofCEOasChairmanor ViceChairman of theBoard of Directors, the presence of internal auditors in companies and earnings management.

Badaghi and Bazzazzadeh (2008, pp. 216-173) is about the relationship between earnings management and disclosure quality. The population of the research was firms listed in Tehran Stock Exchange during the years 2003 to 2004. Multiple regression was used to examine the research hypothesis, the results showed that no significant relationship between earnings management and the quality has not been disclosed. Inthisstudy,themodified Jones model used to measureearnings management and tomeasure the amount ofdisclosure235cases of mandatory disclosurewere collected according to theaccounting standardsof Iran, the IranianCommerce Act, Direct Taxation Act andthe rules and regulationsofthe stock market. Multiple regression was used to examine the research hypothesis, the results showed that there is no significant relationship between earnings management and the quality of disclosure.

Saghafi and Bharmoghadam(2008, pp.125-103) in their research studied drivers affect earnings management. In this paper, in addition to examination of earnings management literature, fifteen factors were identified as the most common incentives that affect earnings management. To consider the economic environment, social and cultural in Iran, seven factors (financial structure, ownership structure, major supply, reward management, quality of work for auditing, firm growth and firm size) of the drivers mentioned in the theoretical reasons were tested on the Tehran Stock Exchange market. In order to test hypotheses, the models commonly used in Western countries was discussed and examined, and finally the model was presented consistent with local situation.

Moradzadehfard et al (2009, pp.98-85) have been examined the relationship between institutional ownership and earnings management of listed companies in Tehran Stock Exchange. The research has been conducted to provide insights about the role of institutional investors, whetherinstitutional ownershipof shareshas an impactonprofitmanagement method.Inprevious studies about the relation betweeninstitutional ownership andearnings management, it is assumedthat corporationshavethe sameabilitytocreateabnormalaccrualstoearning management andthe impact ofcorporate governanceonmanagers' ability to earning management, have been ignored. Institutional investorsimprovethe quality ofcorporate governanceinfinancial reporting.Companies listedinTehran Stock Exchangeconstitutedthe population of the study. Two typesoftests, including correlation test and multipleregression analysishasbeen used toexamine therelationship between earnings managementand institutional ownership.Overall,these resultsindicatea significant negativerelationshipbetween the level ofinstitutional ownership andearnings management.

Noravesh&Hoseini (2009, pp.134-117) usinghistorical data during 2002 to 2006 fromthe51companies listed inTehran Stock Exchange have beenstudied the relationship between corporatedisclosurequality(includingreliabilityand timeliness) andearnings management.The underlying assumption ofthe researchis thatimproving the quality ofcorporatedisclosureisnegatively related toearnings management. Inthis study, thecriteria of timeliness andreliability were used for measuring disclosurequality,andthe management ofcorporate profitsis estimatedby using themodified Jones model. The finding of this studyindicate that there is a significantnegative relationship between thequality ofcorporatedisclosureand earnings management, thefindingsindicate there is a significantnegativerelationshipbetween timely corporatedisclosureand earnings management.

Ahmadpoor et al(2008, pp.89-69) examined earnings managementbehaviorand its relation to regulatory tools of corporate governance, non-executive directors(internal supervisory tools of corporate governance) andmajorinstitutional investors(external monitoringtools of corporate governance). The treatment of earnings managementin this study that is based ona thresholdmodelandis determined through maximization ofreported earnings and meet theoptimalthresholdtoprofitability(level of zero for profit andthe profitreportedof previous years) is defined as Increasing earningsmanagement anddecreasingearnings managementandabnormalaccruals in working capitalisrepresentative for earnings management. Theresearch hypotheses testing were conducted with the help ofregression analysisusingdata from185companies listed inTehran Stock Exchangeduring the period2003-2006andbycombiningtime seriesand cross-sectionalstudy. The results of treatment ofopportunisticearnings managementshowed thatabnormalaccrualscan't justify changedin futureprofits and is as asign toprofitabilityinfuture years. Theresults ofexamining corporate governancemonitoring toolsonearnings managementbehaviorindicatesthatWhenthemotive for income manipulation is high, non-executives managersandmaininstitutional investors have poor roleinreducingmalformations of abnormalaccruals.

Modarreset al(2009, pp.78-59) also explores the motivationsofearnings managementof listedcompaniesinTehran Stock Exchange. For this purposetheycalculated discretionary accrualsas a measureto detectearnings managementusingmodified Jones modelbetweenthe years2002-2007.The resultsshow thatfirm sizeanddebt contractsare stimulus for earning management for companies inbothexamined industries, but avoidlow-loss variable affected on earningmanagement in companies in theindustry ofoil products andchemicalproducts. Furthermore, we didn't find a significant relationship between deviationinoperating activities and earning management in the both industries. Also the results suggestthatmotivationsof firm size anddebt contracts has morestrength for earning management in basicmetalsand miningindustryin thedebt contractsin compared tooil products andchemicalindustry.

Tariverdi&Rostami (2011) studied theeffect of earnings management on the quality offinancial reporting. They considered the Predictionaccuracyoffutureoperatingcash flowsandearningsstabilityasan indicatorwhichmeasuresearningsqualityof financial reporting and Arsenic model is applied forcalculatingearnings management and cash flowapproach is used for accruals.Also, the adjusted Barth modelBarth was used for measuring of

forecastingfutureoperating cashflows through operational income components and the income beforeabnormalitems was used for predicting thestabilityof earnings before abnormal items. The results of this studyindicate thatearnings managementthroughaccrualsreduce the qualityoffinancial reporting. It means that thepurpose ofearnings management is orientationtowards distortsfinancial reportsandmanagement opportunistic benefits. Sinceearnings management willbringreducing in thepredictionof futureoperatingcash flows. Also the resultsindicate thatearnings management does not increase the income stability. (S. QakemShirazi, 2012, p 53).

The model and research paradigm:

In this study wetest the hypothesisaccording toSun andratstudies(2012, p 36) will beused in the followingmodels:

$$Adj(DA)_{it} = \alpha_0 + \beta_1 CLUSTER\_N_{it} + \beta_2 SIZE_{it} + \beta_3 GROWTH_{it} + \beta_4 ROA_{it} + \beta_5 WC_{it} + \beta_6 LEV_{it} + \epsilon_{it}$$

In this model wehave:

$Adj(DA)_{i,t}$ = the adjusted discretionary accrualsfor firm i in t year.

$CLUSTER\_N_{it}$ = virtualvariable of earnings before earning management for firm i in t year

$SIZE_{it}$ = firm size of firm I in t year

$GROWTH_{it}$ = growth opportunities for the firm i in t year

ROA_{it} = Profitability for the firm i in t year

WC_{it} = working capital for firm i in t year

LEV_{it} = financial leverage for the firm i in t year

Research variables:

Thestudyincluded7variables:

Dependent variable:

Adjusteddiscretionary accruals: in the modelHaley(1985, p 85) this item calculatedfromthecomparison of thetotalaccruals meanaccruals(scaled for prior periodtotal assets) of the previousperiod(period estimates) witheventperiod. In theliteraturethere isan edited versionofthe Jonesmodel,whichis calledthemodified Jones model. Thismodel was

usedthe first time by Dechewand others (1995).Jonesperformed this adjustmentfornon-discretionary accrualsin theeventperiod(ie in the periodthatis assumed in whichearnings managementhave been occurred) in this figure:

$$NDA_t = a_1\left(\frac{1}{A_{t-1}}\right) + a_2(\Delta REV_t - \Delta REC_t) + a_3(PPE_t)$$

Inthisstudydiscretionary accruals is used as a measure ofearnings management.Pensel et al(2000, p 313) haveproposeda new approachin estimatingdiscretionary accruals, where operating cashflowchanges entered into theJones model as an explanatory variable(1991, p 193).

$$TAC_{it} / TA_{it-1} = \alpha_1(1/TA_{it-1}) + \alpha_2(\Delta REV_{it} / TA_{it-1}) + \alpha_3(PPE_{it} / TA_{it-1}) + \alpha_4 \Delta CF_{it} + \varepsilon_{it}$$

Inthismodel:

TAC_{it} =totalaccruals in the firm i inwhichiscalculated from thedifference betweenoperating incomeandoperating cashflow

TA_{it-1} = total asset for firm i in t-1 year

ΔREV_{it} = the difference between net sales in t year with netsales in t-1 year

PPE_{it} = the netpropertyand equipment in the firm i for t year

ΔCF_{it} = the difference betweenoperating cash flow in the firm i for t year with inthecompany's operatingcash flowinthe t-1 year which arehomogenization usingthe totalbeginningassets of thefirstperiod. Inthis connection,themodified Jones modelis estimatedandthe resultingresidualsasdiscretionary accrualsareconsidered. Then thecompanies are classified ineach year based on the return on assetsratioindecile and the median for discretionary accrualsare computedfor eachdeciles will be deducted from discretionary accrualsfor eachcompany. Thus,the adjusteddiscretionary accrualswill be achieved.

$$Adj(DA_{it}) = DA_{it} - Median(DA)_{pt}$$

The research independent variables:

The earnings beforeapplying earningmanagement:thisvariableisan indicatorvariablethat is calculatedas follows:

First the earning before applying earning management is calculated usingthisequation:

$$PME_{it} = E_{it} - Adj(DA)_{it}$$
$$\Delta PME_{it} = \Delta E_{it} - Adj(DA)_{it}$$

PME_{it} =Profit beforeearningmanagement for firm i and t year

ΔPME_{it} = changes in Profit beforeearningmanagement for firm i and t year

E_{it} =Net profit that is homogenizationusing totalassets inthe firstyear

ΔE_{it} =changes in net profit that is homogenization using totalassets inthe firstyear

$Adj(DA)_{it}$ = Adjusteddiscretionary accrualsfor firm I in I year

Then,Transversedistanceof managementearningsandearnings beforeearningsmanagementis calculated using this relationship:

$$2(IQR)n^{-1/3}$$

Wherenis equalsto the number of observationsandIQRis theinter-quartilerange.

Then depending on the amount of transversedistanceCLUSTER_Nitis classified to fourcategoriesas follows:

$CLUSTER\_N_{it}$ takes four constrained form as follows:

$CLUSTER\_1_{it}$ = 1 if (PME_{it} <0 OR ΔPME_{it}<0), 0 otherwise;

$CLUSTER\_2_{it}$ = 1 if (PME_{it} <0, E_{it} ≥0 OR ΔPME_{it} <0, ΔE_{it} ≥0), 0 otherwise;

$CLUSTER\_3_{it}$ = 1 if (−0.07≤PME_{it} <0 OR −0.07≤ΔPME_{it} <0), 0 otherwise;

$CLUSTER\_4_{it}$ =1 if (−0.07≤PME_{it} <0, 0≤E_{it} <0.07 or −0.07≤ΔPME_{it} <0, 0≤ΔE_{it} <0.07), 0

Control variables:

Firm size: this item is equal to natural logarithm oftotalassets

$$SIZE_{i,t} = Ln(TA_{i,t})$$

In this relationship TA is equal to total assets.

Growth opportunities(Growth): Inthis study, growth opportunitiesis measuredby thepercentagegrowth insales.

Profitability (ROA): profitability is measured byreturn on assetsratio. In this relationship OI is operating profit in firm I and TA is total asset.

$$ROA_{it} = \frac{OI_{it}}{TA_{it}}$$

Capital turnover ratio (WC): In this research, capital turnover ratio is calculated using the difference between current assets and current liabilities and is homogenization using the total debt.

Financial Leverage (LEV): In this study the capital structure is calculated and control using financial leverage ratio. The financial leverage ratio is equal total debt to assets. In this model DEPT is equal to sum of total debt for firm I in the end of t year and TA is equal to total assets for firm year at the end of t year.

$$LEV_{i,t} = \frac{DEBT_{i,t}}{TA_{i,t}}$$

Descriptive statistics for variables

In general, the methods by which data can be processed and summarized, called descriptive statistics. These statistics describe the population or sample only and its purpose is calculating the parameters or sample research (Azar and Momenie, 2010, p 8). In descriptive statistics, data analysis is done using central index such as mean and dispersion index such as standard deviation, skewness and stretching.

Figure4.1) theadjusteddiscretionary accruals for sample firmsduring the years2006-2011

According to this chart, adjusted discretionary accruals of sample firms have a downward trend until 2010 but since 2011 has an increasing trend.

Figure 4-2) the status of the Earning before earnings management for sample firm during the years 2006 to 2011

The models estimation:

Considering to that in the present study the status of the loss before the earnings management has been studied in four levels, therefore, this hypothesis will be tested through the following four regression models and using panel data methods:

$$Adj(DA)_{i,t} = \alpha_0 + \beta_1 CLUSTER\_1_{i,t} + \beta_2 SIZE_{i,t} + \beta_3 GROWTH_{i,t} + \beta_4 ROA_{i,t} + \beta_5 WC_{i,t} + \beta_6 LEV_{i,t} + \varepsilon_{i,t} \quad (1)$$

$$Adj(DA)_{i,t} = \alpha_0 + \beta_1 CLUSTER\_2_{i,t} + \beta_2 SIZE_{i,t} + \beta_3 GROWTH_{i,t} + \beta_4 ROA_{i,t} + \beta_5 WC_{i,t} + \beta_6 LEV_{i,t} + \varepsilon_{i,t}$$

$$Adj(DA)_{i,t} = \alpha_0 + \beta_1 CLUSTER\_3_{i,t} + \beta_2 SIZE_{i,t} + \beta_3 GROWTH_{i,t} + \beta_4 ROA_{i,t} + \beta_5 WC_{i,t} + \beta_6 LEV_{i,t} + \varepsilon_{i,t} \quad (3)$$

(2

$$Adj(DA)_{i,t} = \alpha_0 + \beta_1 CLUSTER\_4_{i,t} + \beta_2 SIZE_{i,t} + \beta_3 GROWTH_{i,t} + \beta_4 ROA_{i,t} + \beta_5 WC_{i,t} + \beta_6 LEV_{i,t} + \varepsilon_{i,t} \quad (4)$$

In figure 4.6 the results of the estimation of the four models and classical regression model assumptions are presented.

Figure4-6), the first research hypothesis test results

Independent variables	Model 1	Model 2	Model 3	Model 4
C T-statistics P-Value	**8526/0- (976/4-) (0000/0)	*2508/2- (022/2-) (0434/0)	**3993/7- (259/6-) (0000/0)	**5328/7- (446/6-) (0000/0)
CLUSTER_1 T-statistics (P-Value)	**5396/1 (502/48) (0000/0	-	-	-
CLUSTER_2 T-statistics (P-Value)	-	**5366/1 (605/33) (0000/0	-	-
CLUSTER_3 T-statistics (P-Value)	-	-	1681/0 (921/1) (0549/0)	-
CLUSTER_4 T-statistics (P-Value)	-	-	-	1846/0 (494/1) (1353/0)
SIZE T-statistics (P-Value)	0014/0- (126/0-) (8997/0)	0943/0 (133/1) (2573/0)	**4656/0 (469/5) (0000/0)	**4756/0 (655/5) (0000/0)
GROWTH T-statistics	*0900/0- (231/2-)	*1615/0 (122/2)	*1565/0 (974/1)	**4548/0- (748/6-)

(P-Value)	**(0258/0)**	**(0341/0)**	**(0486/0)**	**(0000/0)**
ROA **T-statistics** **(P-Value)**	**0321/0** **(901/0)** **(3678/0)**	****1775/1** **(922/2)** **(0036/0)**	****1293/5** **(579/13)** **(0000/0)**	**1504/0** **(887/1)** **(0594/0)**
WC **T-statistics** **(P-Value)**	**0321/0** **(901/0)** **(3678/0)**	***1615/0** **(122/2)** **(0341/0)**	***1565/0** **(974/1)** **(0486/0)**	**1504/0** **(887/1)** **(0594/0)**
LEV **T-statistics** **(P-Value)**	**0890/0** **(902/0)** **(3670/0)**	**4155/0** **(128/1)** **(2595/0)**	****8957/0** **(647/5)** **(0000/0)**	****9015/0** **(694/5)** **(0000/0)**
The coefficient of determination	**6758/0**	**6023/0**	**2982/0**	**2990/0**
F-statistics **(P-Value)**	****31/350** **(0000/0)**	****270/7** **(0000/0)**	****039/2** **(0000/0)**	****047/2** **(0000/0)**
Jarque-Bera -statistics **(P-Value)**	**931/2** **(0750/0)**	**841/1** **(1523/0)**	**344/4** **(1139/0)**	**685/2** **(2611/0)**
statisticsBreusch-Pagan **(P-Value)**	**262/4** **(0003/0)**	**865/0** **(5332/0)**	**162/4** **(0004/0)**	**023/2** **(0598/0)**
Watson-Durbin - statistics	**949/1**	**045/2**	**889/1**	**893/1**

****Indicates significant at the 1% error level and * indicates significance at the 5% error.**

At reviews of overall model according to that the probability of (P-VALUE) F statistics in all four models is lower than 0.05 (0000/0) with a 95% significance of overall model is confirmed. The coefficient of determination on the models also indicate that the first model with the rate of 58/67%, the second model with the rate of 23/60%, the third model with the rate of 82/29% and the fourth model with the rate of 90/29% explain the changes in adjusted discretionary accruals. Also to evaluate the validity of the model and the assumptions of classical regression it should be done tests in related to residues normality, homogeneity of variance and independence residuals. In this research Jarque-Bera test was

used to evaluate normality of error terms. The results of this test indicate residuals obtained from the estimated in each four models have normal distributions at % 95 confidence interval. So that the probability (P-VALUE) in this test is greater than 0.05 for all four models. Other assumptions of classical regression are homogeneity of residual variance. In this study the Breusch-Pagan test has been used to evaluate homogeneity of residual variance.

In thisRelevance,theprobability(P-VALUE) related tothesecondand fourthmodelsare greater than0.05 and homogeneity of residual variance is approved. But in thefirst and thirdmodelstheprobability(P-VALUE) of Breusch-Pagan is less than0.05 andindicatesa lack ofconsistency in residual variance between the twomodels. Inthis study weaddress thisproblembyusingthe generalizedleast squaresmethod and inestimationweighting coefficientsare given to the modelbystatistical software.

Inthis connection,theprobability(P-VALUE)of CLUSTER_1Variable of t-statistic is less than 0/05 (0/0000). Therefore, we can saywith 95%confidence there is significant correlationbetween being choking for firm, the earning before applying earning management and adjusted discretionary accruals. .Also according to that thecoefficient of variable (CLUSTER_1)ispositive(1/6935), It can be saidthat there is a direct relationshipbetweenloss before applying earning management and adjusted discretionary accruals. Thusitcan beconcluded that when the company has losses before applyingearnings management, the possibility of usingdiscretionary accruals in order to being profitable for firm increase. Therefore, the first hypothesis is confirmed at the level of 95%. Inthis study the subject has beenstudied to examine theissue. In the second level, the status for firms when they have losses before applying earning management and have earnings after applying hasbeenconsidered(the second model). Inthis connection,theprobability(P-VALUE) for t-statistic related toCLUSTER_2Variable is less than 0/05(0000/0) and the coefficientispositive (1/6635). So we can say with 95%confidence levelwhen the firm has lossesbefore applying earning management and has earning after applying, the possibility of usingdiscretionary accruals in order to being profitable for firm increase. In thethird and fourthlevels(models III and IV) being achokingcompany beforeapplyingearnings managementhasbeen studiedina smallerrange. In other words,atthelevel the possibility of using discretionary accrualswhen the lossis small has been explored. According totheprobabilityvalue(P-VALUE) for t-statisticsrelated toboth variables (CLUSTER_4 and CLUSTER_3) are greater than0/05, thus we can say has a lowloss before applying earning managementeffect on thepossibility of usingdiscretionary accrualssignificantly andthe possibility of usingdiscretionary accruals in order to being moreprofitable is appeared when the losses before applying earningsmanagementis high.

The model estimation:

Accordingtothestudycarried out the status of earning before earning managementatfour levels, so this hypothesis has been tested through following models and by using panel data method:

$$Adj(DA)_{i,t} = \alpha_0 + \beta_1 \Delta CLUSTER\_1_{i,t} + \beta_2 SIZE_{i,t} + \beta_3 GROWTH_{i,t} + \beta_4 ROA_{i,t} + \beta_5 WC_{i,t} + \beta_6 LEV_{i,t} + \varepsilon_{i,t}$$

$$Adj(DA)_{i,t} = \alpha_0 + \beta_1 \Delta CLUSTER\_2_{i,t} + \beta_2 SIZE_{i,t} + \beta_3 GROWTH_{i,t} + \beta_4 ROA_{i,t} + \beta_5 WC_{i,t} + \beta_6 LEV_{i,t} + \varepsilon_{i,t}$$

$$Adj(DA)_{i,t} = \alpha_0 + \beta_1 \Delta CLUSTER\_3_{i,t} + \beta_2 SIZE_{i,t} + \beta_3 GROWTH_{i,t} + \beta_4 ROA_{i,t} + \beta_5 WC_{i,t} + \beta_6 LEV_{i,t} + \varepsilon_{i,t}$$

$$Adj(DA)_{i,t} = \alpha_0 + \beta_1 \Delta CLUSTER\_4_{i,t} + \beta_2 SIZE_{i,t} + \beta_3 GROWTH_{i,t} + \beta_4 ROA_{i,t} + \beta_5 WC_{i,t} + \beta_6 LEV_{i,t} + \varepsilon_{i,t}$$

The results of theestimation ofthe four models and classic regressionassumptionsare presented infigure4.9.

Figure4-9) the secondhypothesistest results

Independent variables	Model 5	Model 6	Model 7	Model 8
C T-statistics P-Value	**5879/2- (237/3-) (0012/0)	**4458/3- (151/4-) (0000/0)	**6781/7- (994/5-) (0000/0)	**6839/6- (188/4-) (0000/0)
CLUSTER_1 T-statistics (P-Value)	**5403/1 (461/44) (0000/0)	-	-	-
CLUSTER_2 T-statistics (P-Value)	-	**4710/1 (529/40) (0000/0)	-	-
CLUSTER_3 T-statistics (P-Value)	-	-	0652/0 (698/0) (4852/0)	-
CLUSTER_4 T-statistics (P-Value)	-	-	-	0660/0 (443/0) (6575/0)
SIZE T-statistics (P-Value)	1063/0 (789/1) (0738/0)	*1318/0 (165/2) (0306/0)	**4868/0 (267/5) (0000/0)	**4231/0 (592/3) (0003/0)

GROWTH T-statistics (P-Value)	**1358/0- (325/3-) (0009/0)	**1171/0- (699/2-) (0071/0)	**4603/0- (076/6-) (0000/0)	**4005/0- (808/4-) (0000/0)
ROA T-statistics (P-Value)	**1046/2 (706/7) (0000/0)	**4811/2 (391/8) (0000/0)	**1607/5 (397/12) (0000/0)	**6419/4 (073/9) (0000/0)
WC T-statistics (P-Value)	0282/0 (566/0) (5711/0)	**1253/0 (705/3) (0002/0)	1443/0 (641/1) (1009/0)	1439/0 (320/1) (1870/0)
LEV T-statistics (P-Value)	2420/0 (238/1) (2160/0)	**1019/1 (628/5) (0000/0)	**8960/0 (719/4) (0000/0)	7591/0 (782/1) (0750/0)
The coefficient of determination	7479/0	7098/0	2939/0	1669/0
F-statistics (P-Value)	**240/14 (0000/0)	**742/11 (0000/0)	**997/1 (0000/0)	*961/1 (0310/0)
Jarque-Bera -statistics (P-Value)	637/3 (0903/0)	366/3 (0861/0)	857/3 (1453/0)	576/2 (2757/0)
statisticsBreusch-Pagan (P-Value)	516/0 (7963/0)	718/4 (0001/0)	296/4 (0003/0)	224/2 (0386/0)
Watson-Durbin -statistics	310/2	225/2	898/1	866/1

****Indicates significant at the 1% error level and * indicates significance at the 5% error.**

According totheprobabilityvalue(P-VALUE) of F statisticsin all fourmodels are lower than 0/05, theoverallmodelis confirmedwithconfidence interval of 95%. The coefficient of determination in models alsoindicate that the first model58/67%, the second model23/60%, the third model82/29% and the fourthmodel90/29percenttoaccount forchanges in adjusted discretionary accruals. Also in examining of thevalidityof the model andthe assumptions ofthe classicalregression the results of **Jarque-Bera**indicatetheestimated residual in

fourmodels have normal distribution in95%. So thattheprobability(P-VALUE)for all fourmodelsis greater than 0/05. Also in examining thehomogeneityof varianceusing**Breusch-Pagan**, theprobability(P-VALUE) in thefirst model is greater than 0/05 andhomogeneityofresidual varianceis approved. Butthe probability(P-VALUE) in **Breusch-Pagan** isless than0/05inmodelsII,III and IV andindicatesa lack ofconsistencyofthese three modelsin theresidual variance. Inthis study weaddress thisproblembyusingthe generalizedleast squaresmethod and weighting coefficientsare given to the model in estimation bystatistical software. Moreover,considering that the Durbin-Watson statistic are between 1/5 and 2/5in all fourmodels, therefore,the lack ofcorrelationbetween theresiduals are acceptedasone of thebasic assumptionsof regressionin all fourmodels.

The results of the first research hypotheses testing

The purposeof testing first hypothesis is showingthe statusofdiscretionary accruals in order tothe profitable firm whenthefirm isbefore applyingearnings management and the statisticalhypothesisis definedas follows:

H0: Whenthe firm has losses before applying earnings management, Possibility of using the discretionary accruals to show positive changes in profitability don't increases.

H1: Whenthe firm has losses before applying earnings management, Possibility of using the discretionary accruals to show positive changes in profitabilityincreases.

H1: Whenthe firm has losses before applying earnings management, Possibility of using the discretionary accruals to show positive changes in profitabilityincreases.					
VARIABLE	Coefficient	Statistics	The value of Statistics	Significance level	results
CLUSTER_1	1/6935	T	84/205	0.0000	accept

As you see, there is direct relationship between the losses before applying earnings management and adjusted discretionary accruals. So the effect of having losses on earning management in active firms in capital markets has been verified as a majordriver ofearnings management.

The results of the second research hypotheses testing

The purpose of testing the second **hypothesis in** this study was to showing the status of discretionary accruals for profitable showing whenthatcompanyprofits in current yearislower thanthe previousyear'sprofit and the statisticalhypothesisis definedas follows:

H0: When the company's earnings in the current year are lower than the previous year, Possibility of using the discretionary accruals to show positive changes in profitability don't increases.

H1: When the company's earnings in the current year are lower than the previous year, Possibility of using the discretionary accruals to show positive changes in profitability increases.

H2: When the company's earnings in the current year are lower than the previous year, Possibility of using the discretionary accruals to show positive changes in profitability increases.					
VARIABLE	Coefficient	Statistics	The value of Statistics	Significance level	results
ΔCLUSTER_1	1/3054	T	44/164	0.0000	accept

There is direct relationshipbetweenlower earnings beforemanagement from the previous earning and adjusted discretionary accruals.Therefore,lowerprofit in current yearcompared to the yearbefore thecompanycan bethe secondmajor reasonforearnings managementin the capital marketsofIran.

Interpretation of the results of the second hypothesis

Based on the results presented in figure 4-9, the variable CLUSTER_1Δ represents that the current earning is lower than previous earning before applying earnings management (the first model). In this connection, the probability (P-VALUE) for CLUSTER_1Δ Variable in t-statistic is less than 0.05. Therefore, we can say with 95% confidence level there is a significant association between low earning before earning and previous earning and adjusted discretionary accruals. Also, according to coefficient of variable for CLUSTER_1Δ (positive , 1/3045), we can say there is positive relationship between low earning before applying earning management and adjusted discretionary accruals. Thus it can be concluded that when the current earning is lower than previous earning, the possibility to use discretionary accruals to show positive changes in profitability increases. Consequently, the second hypothesis is confirmed in the 95% confidence level. More in this study we examine the issue in three levels. In second level we consider the status that the current earning is lower than previous earning before applying earning management (the second model). In this connection, the probability (P-VALUE) for CLUSTER_2Δ Variable in t-statistic is less than 0/05 (0000/0) and the coefficient is positive. So we can say in the 95% confidence level when before earnings management the current earning is lower than the previous earning and after earning management current earning is greater than previous earning the possibility of using discretionary accruals increases. In the third and fourth levels (models III and IV) the changes of earning before and after applying earning management has been studied in a smaller range. In the other words, in this level we try to examine the possibility of using discretionary accruals when the changes of earning before and after earning management are low. According to the probability value (P-VALUE) of t-statistics related to both variables(ΔCLUSTER_4 & CLUSTER_3Δ) are greater than 0/05, So we can say that small changes of earning before and after applying earnings management does not significantly affect the possibility of using discretionary accruals and the possibility of using discretionary

accruals in order to profitable firm is more seen when the rate of earning changes before and after applying earnings management is high.

Recommendations for future research

•It is recommended in future research positive and negativeeffects of earning management on the investment marketswill be investigated.

•It is recommended the place ofhighconcentration on earnings in explain of abnormalaccrualswill be evaluated.

•It is suggestedthat in future researchtopics about earning chainare examined.

•The researchcould conducted by emphasize on certainindustry and other characteristics of companies.

•It is recommendedthe applying ofearnings managementthrough the changes of classification in income statement including cost items and financialcost will be evaluated**.**

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