POLITICAL COSTS FACTORS AFFECTING INCOME SMOOTHING EVIDENCE FROM TEHRAN STOCK EXCHANGE (TSE)

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Abstract
Earnings management deals with, among all others, the political costs that firms may bear due to information, trading, and negotiation costs imposed by the decision making and legislating authorities, the most important which is governmental agencies. Hence, there was an attempt to analyze political costs with a view to their effect on income smoothing in the Tehran Stock Exchange (TSE) in a five-year period (2006-2011). A 158-firm sample was taken from a population of 8 different industries by the systematic method. One main hypothesis and four subsidiary ones guided the study. For hypothesis testing, regression analysis, Durbin-Watson test, and kolmogorove-smirnov test were used. The findings indicated that there is a significant relationship between firm size, number of employees, public ownership, and income tax as political factors and income smoothing at a 95 percent confidence level.

Keywords: POLITICAL COSTS, FIRM SIZE, NUMBER OF EMPLOYEES, PUBLIC OWNERSHIP, INCOME TAX, INCOME SMOOTHING.

1. Introduction
Earnings management is one of the most questionable issues in today’s accounting studies because investors pay special attention to earnings amount as an important decision making factor. Studies indicate that earnings fluctuations are closely related to earnings quality. Therefore, investors make investments in those stocks which enjoy a steady earnings flow. When companies experience adverse economic circumstances, their managers ask their accountants to improve the last line of income statements (i.e. earnings) and hence change their information content. Accounting, however flexible, does not seem to provide managers with desirable information (Hope & Hope, 1996). There are diverse information needs as there are many different parties needing different information such as investors (who need to know about the firm’s profitability rate and financial stability), managers (who need to know about the firm’s financial status), and banks and suppliers (who need to know about the firm’s ability to pay back loans).

One method which is used to report a desirable status for companies is earnings management. Earnings management refers to the process of management involvement in the determination of earnings which is often in line with the desirable goals set by management (Wild et al., 2001). It aims to manipulate the data. For example, income smoothing which is employed to assure investors of steady earnings flow is an instance of data manipulation. Such acts may significantly affect the data in the financial statements.

Investors in their investment decision making rely upon the financial information presented in the financial statements of business entities especially the reported earnings (George & Furstenberg, 2006). Investors generally believe that steady earnings in comparison to fluctuating earnings secure a higher dividend rate. Earnings fluctuations are considered an important criterion for the firm’s total risk and those firms with a more smoothed income are exposed to fewer risks. Therefore, those firms with a more smoothed income are more appealing to investors and are more suitable for investments.
There are two approaches to income smoothing: one deals with the effect of income smoothing on the firm, but the other deals with the factors affecting income smoothing. In this study, political costs factors affecting income smoothing are investigated.

2. Literature Review

Political costs theory was proposed for the first time by Watts and Zimmerman. Godfrey and Jones in their investigation of the effect of political costs factors on income smoothing used the market share basis. Income smoothing levels out net income fluctuations so that the firm’s earnings seem natural (Hashemi & Samadi, 2009). Political parties need to bear political costs to gain lobbying power in the political process. They launch election campaigns and support politicians in order to satisfy their demands and hence bear many costs, some of which are born by firms. Such political costs can affect the pricing of goods and services and tax policies, which are represented in the form of accounting figures.

This study aims to investigate the motives to manipulate earnings in the firms listed in the TSE. Identifying the motives for income smoothing and earnings management on the part of the firm’s management can contribute to better decision making by different parties (Noravesh et al., 2005). Earnings management is a deliberate action to present the firm’s earnings as natural and desirable. Managers can manage earnings by various methods. Income smoothing can be conducted with a view to operational, financial, and investment decisions (Cheni et al., 2009). Earnings manipulation can be conducted by the selection of accounting procedures which is done by the use of GAAPs by managers (Nourani, 2007). Other methods of earnings manipulation include making changes in the expected and unexpected accruals, and R&D costs (Astat & Tower, 2006). This study focuses on expected accruals as an income smoothing criterion. Larger firms are politically more sensitive than smaller ones because larger firms contribute more to the national economy; therefore, an increase in the reported earnings of larger firms creates greater sensitivity, and larger firms should bear greater bargaining costs in order to survive (Poorheidari & Hemmati, 2004).

Some of the firms with better financial status are subject to strict rules and regulations imposed by the government or other legislating authorities and bear great costs. Hence, they attempt to evade such costs and are more motivated to report less earnings. The costs borne by the firm is a function of its size. Smaller firms are less important and hence are less subject to political wealth distribution (Huang et al., 2009).

Government as the main supporter of the national economy plays a protecting role for business entities. Due to their decision making authority in the corporate arena and their macro policies, governments play the role of major investors in the developing countries especially in Iran. Regardless of the advantages and disadvantages of such ownership, it is worth noting that the firm’s accounting and auditing system is influenced by its corporate governance structure which is in turn influenced by its ownership structure. One can argue that government-owned firms bear fewer costs imposed by the government because of their political attachment (Black & Coffee, 1994). Indeed, government ownership consists of the sum of stocks owned by governmental firms, organizations, and institution.

Huang et al. (2009) investigated the relation of income smoothing with the return on investment (ROI) and, stock price. They selected 500 companies as their study sample and collected such information as net income, equity, assets, and stock price for the period between 2000 and 2008. They found that there is a negative significant relation between ROI and income smoothing. In their investigation of the relation of income smoothing with stock price, they made stock prices homogenous. Because stock prices is a raw data and income smoothing not directly usable, hence stock prices were made homogenous with the assets in the beginning of the period. Later on, they found that steady and smoothed earnings flows along with the firm’s growth rate contribute to stockholders’ satisfaction. This reduces the firm’s investment risks and raises stock prices.

Yip et al. (2011) in their study, “Corporate social responsibility and earnings management: the role of political costs,” cited Francis et al. (2008) as claiming that earnings quality affects information disclosure. They explored the issue that whether corporate social responsibility has something to do with earnings management and that whether this relation is adjusted by the firm’s considerations of political costs and ethical background. They believed that the relation between the corporate social responsibility and earnings management relies upon specific conditions: political environment. They tested their hypothesis by the regression analysis of earnings management in the disclosure of the corporate social responsibility and controlled other factors that may have possibly affected earnings management. They found that there is a significant relation between the corporate social responsibility and earnings management and found evidence of negative relation in the oil and gas industries and evidence of positive relation in the food industry. The findings confirm this view that the relation between the corporate social responsibility and earnings management is affected by the environment rather than the political considerations.

Mills et al. (2012) investigated the effect of political sensitivity and bargaining power on taxation. They explored the issue that whether politically sensitive agents pay higher tax rates and that whether they reduce tax costs by their bargaining power. Using agents’ information, they developed a new eclectic criterion for political sensitivity which included both the political view from public contracts and the importance of public contracts.
They found that the politically sensitive firms, given equal circumstances, pay higher tax rates to the government. Their study found new evidence of the interplay of the firm’s political sensitivity and bargaining power with a view to the political costs related to taxation. Poorheidari and Hemmati (2004) in their study of factors affecting earnings management in the TSE concluded that there is a positive significant relation between debt-to-equity ratio and earnings manipulation. With an increase in the firm size, management is more motivated to present a better picture of the organization’s performance to stockholders and authorities. And those firms with a higher number of employees are subject to greater political pressures. Therefore, management decides to reduce earnings in order to reduce such pressures. Given total sales variable representing political costs, they found a positive significant correlation between firm size and earnings reduction tendency. And given the number of employees representing political costs, they found a negative significant correlation between firm size and earnings reduction tendency.

Al’a’ameh Haeri (2008) in his study concluded that there is a positive correlation between income smoothing and an increase in stock prices. He also showed that there is a positive correlation between profitability and income smoothing; that income smoothing, those firms with higher profitability rates perform greater income smoothing. But no positive correlation existed between firm size and industry type and income smoothing.

Ibrahim Kurdullur and Shahriari (2009) investigated the relationship between political costs and conservatism and showed that there is a negative correlation between investment volume and conservatism, and a positive correlation between competition degree in the industry and conservatism, and no significant relation between tax rates and risks and conservatism.

Muradzadeh Fard et al. (2011) studied the effect of financial leverage on actual earnings management focusing on increasing financial leverage. They took into account three forms of financial leverage (based on book value and equity market and actual outstanding long term debts) and dividing up business entities undergoing an increase in debts. The findings indicated that with an increase in the financial leverage, management tends towards actual earnings management through manipulating earnings flows; that is, there is a higher likelihood of actual earnings management in those companies with higher outstanding long term debts.

Ansa’ari and Kha’ajavi (2011) investigated the relation between income smoothing and stock prices and financial ratios. They initially set out to measure the extent of income smoothing performed by the firms listed in the TSE. To do so, they assumed a negative correlation between changes in expected accruals and changes in pre-determined earnings. Their study aimed to determine whether the firms listed in the TSE smoothed their income because of their role in setting stock prices. Therefore, the main hypothesis dealt with the effect of income smoothing on stock prices. Moreover, the factors affecting firms’ income smoothing behaviors were taken into account. And in the subsidiary hypotheses, cash flow ratio, debt ratio, and profitability rate (return on equity) were taken as independent variables, and income smoothing as a dependent variable. The population consisted of 163 companies studied in a 12-year period (1997-2008). The findings indicated that income smoothing contributes to an increase in stock prices, and that there is a negative correlation between cash flow ratio, debt ratio, and profitability rate (return on equity) and income smoothing.

3. Hypotheses:

Hypothesis 1: There is a significant relation between political costs and income smoothing.
Hypothesis 2: There is a significant relation between the firm size and income smoothing.
Hypothesis 3: There is a significant relation between government ownership and income smoothing.
Hypothesis 4: There is a significant relation between income tax and income smoothing.
Hypothesis 5: There is a significant relation between the number of employees and income smoothing.

4. Research Methodology:

This study is a practical study in terms of the purpose and a cross-correlational one in terms of the method. The study period was 5 years from 2006 to 2011 based on information collected from the TSE (population). Systematic sampling was employed with a view to the continuing operations, and consistency of reporting was taken into account to remove seasonal effects. But investment companies and intermediaries were excluded. In this way, a sample of 158 firms listed in the TSE was selected.

4.1. Research Variables:

The independent variables include:
Firm size: This study used the natural logarithm of total assets at the end of the period.
Government Ownership: It consists of the sum of stocks owned by governmental firms, organizations, and institution (Astam & Tower, 2006). To mark a firm which is governmentally owned, it receives the number 1, and other firms receive the number zero (Bani Mahd & Baghmani, 2009).
Income tax: To measure income tax, income tax costs ratio was used before tax deduction.
The number of employees: The number of the firm’s employees is one of the politically sensitive indicators because employees represent a major political group for the firm. The higher the number of the firm’s employees, the greater the pressure the firm receives from the employees.

The dependent variables include:

Income smoothing: According to the research, the expected accruals represent income smoothing. This study adapted the Jones’ 1991 model. The sum of the expected accruals is calculated as follows:

\[ \sum_{i=1}^{n} \text{expected accruals} = \sum_{i=1}^{n} \Delta \text{REV}_i \]

Where, \( \Delta \text{REV}_i \) represents the change in year \( t \)’s revenue amount less previous year’s revenue amount.

The unexpected accruals are calculated as follows:

\[ \text{unexpected accruals} = \text{total assets at year } t \cdot \frac{\Delta \text{REV}_i}{\text{total assets at year } t} + \text{machinery at year } t \times \text{firms' specific parameters calculated by the following model:} \]

\[ \text{unexpected accruals} = \alpha \left( \frac{1}{A_{t-1}} \right) + \beta_1 (\Delta \text{REV}_i / A_{t-1}) + \beta_2 (\text{PPE}_i / A_{t-1}) + \epsilon \]

The expected accruals are calculated as follows:

\[ \text{expected accruals} = \delta(\text{R}) \]

Where, \( \delta(\text{R}) \) represents the firm’s ROI fluctuations in the period \( t \), which income smoothing used to control the firm’s risks and equals ROI standard deviation to mean ROI ratio for the years 2006 to 2010.

4.2 Regression model

Model Hypothesis 1:

\[ \text{CORR}_{it} = \beta_0 + \beta_1 \text{SIZE}_{it} + \beta_2 \text{GOVOWN}_{it} + \beta_3 \text{ETR}_{it} + \beta_4 \text{EMPLOY}_{it} + \beta_5 \text{BM}_{it} + \beta_6 \text{Volat}_{it} + \beta_7 \text{Age}_{it} + \beta_8 \text{Lev}_{it} + \beta_9 \text{INDUSTRY}_{it} + \epsilon_i \]

Model Hypothesis 2:

\[ \text{CORR}_{it} = \beta_0 + \beta_1 \text{SIZE}_{it} + \beta_2 \text{BM}_{it} + \beta_3 \text{Volat}_{it} + \beta_4 \text{Age}_{it} + \beta_5 \text{INDUSTRY}_{it} + \epsilon_i \]

Model Hypothesis 3:

\[ \text{CORR}_{it} = \beta_0 + \beta_1 \text{GOVOWN}_{it} + \beta_2 \text{BM}_{it} + \beta_3 \text{Volat}_{it} + \beta_4 \text{Age}_{it} + \beta_5 \text{INDUSTRY}_{it} + \epsilon_i \]

Model Hypothesis 4:

\[ \text{CORR}_{it} = \beta_0 + \beta_1 \text{ETR}_{it} + \beta_2 \text{BM}_{it} + \beta_3 \text{Volat}_{it} + \beta_4 \text{Age}_{it} + \beta_5 \text{INDUSTRY}_{it} + \epsilon_i \]

Model Hypothesis 5:

\[ \text{CORR}_{it} = \beta_0 + \beta_1 \text{EMPLOY}_{it} + \beta_2 \text{BM}_{it} + \beta_3 \text{Volat}_{it} + \beta_4 \text{Age}_{it} + \beta_5 \text{INDUSTRY}_{it} + \epsilon_i \]

Where: \( \epsilon_{it} \) represents the regression error and \( \beta_0 \) and \( \beta_i \) values are constant and coefficients of variables in the regression equation respectively.

5. Data Analysis Method and Hypothesis Testing:

In analyzing the collected data, correlation analysis was used to measure the intensity of the relation between two or more variables, partial correlation analysis was used to measure the intensity of the relation between two variables given that one of the variables were constant, and multiple regression analysis was used to determine the degree of the interdependence of the variables. To perform calculations, Excel 2010 and SPSS 17 were used. Before performing hypothesis testing and determining the fitness of the final model, the adequacy of the model in terms of the normal distribution of the residuals and the existence of no correlation between the residuals...
6. Findings:

Since some variables were not fit to the first data model, the insignificant variables were each back eliminated, and then the fitness of the model was again determined so that all the remaining variables were in a significant relation with the dependent variables. Such back elimination and was performed in 10 steps, and finally the final regression model was determined, as shown in the figure 1.

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The coefficient of determination: 0/104      significance: 0/000

Watson’ durbin: 1/914   correlation: 0/322   statistic F : 14/424

According to the significant relations between the independent variables (political costs) including the number of employees (sig=0.000<0.05), the firm size (sig= 0.003<0.05), government ownership (sig=0.011<0.05), and income tax (sig=0.033<0.05) and the dependent variable (income smoothing) in the tenth step of the stepwise regression analysis, H.1 is approved at the 95 percent confidence level. Therefore, there is a significant relation between political costs and income smoothing. In determining the fitness of the model, according to the statistical result of Durbin-Watson Test (1.552), which is at the confidence levels between 1.5 and 2.5, the assumption that there is a correlation between errors is rejected; that is, the method adopted in this study does not have a self-correlation, and the regression model can be used to test this hypothesis. The regression correlation coefficient determined in the final step of the stepwise regression analysis is indicative of a positive significant relation between the political costs and income smoothing. The coefficient value for the political costs and income smoothing variables equals 0.104, which indicates that approximately 0.104 percent of changes in the dependent variable results from the independent variables.

The results of H.2 testing, according to the stepwise regression analysis in the tenth step, are illustrated in the figure 2. According to the significant relation between the independent variable (the firm size) (sig= 0.000.0/05) and the dependent variable (income smoothing) in the tenth step of stepwise regression analysis, H.2 is rejected at a 95 percent confidence level. Therefore, there is a significant relation between the firm size and income smoothing. In determining the fitness of the model, according to the statistical result of Durbin-Watson Test (1.857), which is at the confidence levels between 1.5 and 2.5, the hypothesis that there is a correlation between errors is rejected; that is, the method adopted in this study does not have a self-correlation, and the regression model can be used to test this hypothesis. The regression correlation coefficient determined in the final step of the stepwise regression analysis is indicative of a positive significant relation between the firm size and income smoothing. The coefficient value for the firm size and income smoothing variables equals 0.022, which indicates that approximately 0.022 percent of changes in the dependent variable results from the independent variables, which is an insignificant value. Moreover, the positiveness of the coefficient for the independent variable indicates that an increase in the firm size in the model contributes to an increase in the income smoothing for the firms listed in the TSE.
The results of H.3 testing, according to the stepwise regression analysis in the tenth step, are illustrated in the figure 3. According to the significant relation between the independent variable (government ownership) (sig=0.000<0.05) and the dependent variable (income smoothing) in the tenth step of stepwise regression analysis, H1 is approved at a 95 percent confidence level. Therefore, there is a significant relation between government ownership and income smoothing. The results of the variance analysis tables indicate that the fitness regression is statistically significant (0.05<0.001). According to the probability value (p_value=0.271), the statistical value of kolmogorove-smirnov Test (K-s=0.999), and the result of Durbin-Watson Test (1.909), the assumption that there is a correlation between residuals and their distribution is natural is not rejected. In analyzing the stability of the residuals, residuals plot against the predicted values was used. No trend in the plot was detected, which is indicative of the stability of the residuals variance. In the residuals natural distribution plot, it was found that regression residuals are placed around a straight, which indicates that the assumption of the residuals natural distribution income smoothing not rejected. The regression correlation coefficient (0.127) in the final step of the stepwise regression analysis shows a positive correlation between government ownership and income smoothing. The coefficient value for government ownership and income smoothing variables equals 0.016, which indicates that approximately 0.016 percent of changes in the dependent variable results from the independent variables. Moreover, the positiveness of the regression coefficient (0.026) indicates that an increase in government ownership in the model contributes to an increase in the income smoothing for the firms listed in the TSE.The results of H.4 testing, according to the stepwise regression analysis in the tenth step, are illustrated in the figure 4.

According to the significant relation between the independent variable (income tax) (sig=0.000<0.05) and the dependent variable (income smoothing) in the tenth step of stepwise regression analysis, H1 is approved at a 95 percent confidence level. Therefore, there is a significant relation between income tax and income smoothing. The results of the variance analysis tables indicate that the fitness regression is statistically significant (0.05<0.001). According to the probability value (p_value=0.646), the statistical value of kolmogorove-smirnov Test (K-s=0.739), and the result of Durbin-Watson Test (1.889), the assumption that there is a correlation between residuals and their distribution is natural is not rejected. In analyzing the stability of the residuals, residuals plot against the predicted values was used. No trend in the plot was detected, which is indicative of the stability of the residuals variance. In the residuals natural distribution plot, it was found that regression residuals are placed around a straight, which indicates that the assumption of the residuals natural distribution income smoothing not rejected. The regression correlation coefficient (0.080) in the final step of the stepwise regression analysis shows a positive correlation between income tax and income smoothing. The coefficient value for income tax and income smoothing variables equals 0.006, which indicates that approximately 0.006 percent of changes in the dependent variable results from the independent variables. Moreover, the positiveness of the regression coefficient (0.011) indicates that an increase in income tax in the model contributes to an increase in the income smoothing for the firms listed in the TSE.The results of H.5 testing, according to the stepwise regression analysis in the tenth step, are illustrated in the figure 5.

Table 3: Test results hypothesis 3

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The coefficient of determination: 0/016  significance: 0/001
Watson’ durbin: 1/909  correlation: 0/127  statistic F : 6/745

Table 4: Test results hypothesis 4

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The coefficient of determination: 0/006  significance: 0/000
Watson’ durbin: 1/889  correlation: 0/080  statistic F : 2/406

Table 5: Test results hypothesis 5

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The coefficient of determination: 0/079  significance: 0/000
Watson’ durbin: 1/994  correlation: 0/282  statistic F : 64/673
According to the significant relation between the independent variable (the number of employees) (sig=0.000<0.05) and the dependent variable (income smoothing) in the tenth step of stepwise regression analysis, \( H_1 \) is approved at a 95 percent confidence level. Therefore, there is a significant relation between the number of employees and income smoothing. The results of the variance analysis tables indicate that the fitness is approval at 95 percent confidence level. According to the probability value (p_value=0.703), the statistical value of kolmogorov-smirnov Test (K_s=0.705), and the result of Durbin-Watson Test (1.994), the assumption that there is a correlation between residuals and their distribution is not rejected. In analyzing the stability of the residuals, residuals plot against the predicted values was used. No trend in the plot was detected, which is indicative of the stability of the residuals variance. In the residuals natural distribution plot, it was found that regression residuals are placed around a straight, which indicates that the assumption of the residuals natural distribution income smoothing not rejected. The regression correlation coefficient (0.282) in the final step of the stepwise regression analysis shows a positive correlation between the number of employees and income smoothing. The coefficient value for income tax and income smoothing variables equals 0.079, which indicates that approximately 0.079 percent of changes in the dependent variable results from the independent variables.

6. Conclusion:

The first hypothesis suggests that there is a significant relation between political costs and income smoothing. According to the main hypotheses in Darough et al. (1998), Fridson and Alvara (2002), Yoon and Miller (2002), the main motive for earnings management is to reduce debt contracts and political costs and to increase management compensation.

The second hypothesis suggests that there is a significant relation between the firm size and income smoothing. The firm size is another factor which affects income smoothing. The larger the firm, the more it gets into the political spotlight (government pays more attention to it) because it plays a more significant role in the national economy. But it should be noted that the firm size variable can be indicative of other effects other than the political sensitivity. For example, smaller firms are characterized by less risk taking, which is largely different from the political sensitivity. This indicates that the larger the firm gets, the higher the management tendency towards income smoothing becomes. Positive important earnings fluctuations in the larger firms can cause more doubts over monopoly profits. In other words, a significant increase in a large firm’s income can cause the suspicion that it has gained such earnings through its mere monopolistic power. On the other hand, negative important earnings fluctuations in the larger firms can cause concerns about their likely closedown and impair their image in the business environment. Moreover, significant earnings fluctuations in the large firms can raise the unwanted political costs including higher employee compensation rates and more governmental restrictions. Therefore, larger firms are more motivated to smooth their income. The findings of this hypothesis are in line with those of Albrecht and Richardson’s (1990), Mullanazari and Karimi Zand’s (1997), and Noravesh et al.’s (1994). In addition, the results of the effect of the financial leverage control variable on income smoothing in this hypothesis are in agreement with those of Muradi’s (1997).

Also in relation with the significant financial leverage control variable in this hypothesis it can be concluded that an increase in the financial leverage (debts) contributes to the firm’s higher tendency towards income smoothing. Managers are more motivated to present a satisfactory picture of the profitability of their businesses and satisfy creditors through income smoothing. If an increase in financial leverage reduces the opportunistic behavior of managers, an increase in financial leverage reduces income smoothing. Moreover, when managers have access to more cash flows, they show such opportunistic behaviors as investing in projects with less net cash inflows, making fewer efforts for producing income, having excessive expenditures, wasting earnings and so on. But an increase in the financial leverage disciplines managers and reduces their opportunistic behaviors because debt payback leaves them less excessive cash.

The third hypothesis of the study suggests that there is a significant relation between government ownership and income smoothing. Therefore, privatization authorities are advised, under article 44 of the constitution, to pay more attention to the effect of government ownership as a political costs factor on managerial decision making. Policy makers now consider the mere privatization of public entities, expecting that such a fundamental change would result in greater productivity of private businesses and a reduction in the wasting of resources. Moreover, the effect of relative prices on the decisions of investors to buy public enterprises focuses in a way on the government interference in the marketplace, and in most cases, economic liberation is a prerequisite for privatization. The results of this hypothesis tallies with those of Ding et al.’s (2007), a study of Chinese public and private firms. They found out that there is a U form relation between earnings management and ownership structure, so that the private entities show a higher tendency towards their profit maximization. On the other hand, the pursuit of self-interests on the part of major owners or the effect of ownership centralization on income smoothing is less frequent in private enterprises than public ones.
The fourth hypothesis suggests that there is a significant relation between income tax and income smoothing. The tax rate is another factor which affects earnings management. Managers at larger firms use the accruals to reduce tax. The motive for earnings management through taxation results from tax rates. The higher the tax rates, the higher the management tendency towards the use of methods of reducing earnings. The results of this hypothesis tally with those of Kasanen, et al.’s (1996), Herrmann and Inoue’s (1996), Garoud et al.’s (2007), and Noravesh et al.’s (2005). The tax system in Iran plays a significant role in the firms’ financial reporting and tax laws are an important factor in the selection of accounting methods and procedures. The firms attempt to smooth their income in order to minimize the effect taxation in the long run. Since greater earnings lead to higher tax payments and greater cash outflows, Iranian firms are motivated to do income smoothing especially when they have substantial tax debts in order to minimize their cash outflows.

The fifth hypothesis suggests that there is a significant relation between the number of employees and income smoothing. The positiveness of the regression coefficient indicates that an increase in the number of employees leads to an increase in income smoothing in the firms listed in the TSE. The findings of this study are in agreement with those of Mura and Sabather’s (2008), Poorheidari and Hemmati’s (2004) and are against those of Daarough et al.’s (1998). The results indicate that the firms with a higher number of employees face greater political pressures, and the management attempts to reduce such pressures, accordingly. Such pressures are mainly from labor councils who ask for more compensation and benefits for the workers. In this way, management attempts to reduce earnings to gain more bargaining power against labor councils.

7. Research Limitation:

1. With respect to the population, it is suggested that the results of this study be generalized with caution about the inactive firms or those not listed in the TSE.

2. Gaining access to the firms’ information was difficult and time consuming. The TSE lacks a comprehensive database, and even in some cases the firms’ financial statements are inconsistent and out of order, and there are errors when transferring information from the financial statements to the databases.

3. One of the limitations was the assumption that the difference in the accruals behavior is due to income smoothing. Therefore, the external (interfering) factors such as inflation, investors’ behaviors, etc. were taken as constant. This study adapted Jones’ model for estimating the expected accruals. Thus, if others models could have been used, the results had been different.

8. Suggestions for further research:

Income smoothing can be dealt with from different angles other than the political one. In other words, research can be done with respect to the firm’s characteristics such as ownership structure, auditors’ reporting, capital structure combination, etc. Also the relation between the significant factors affecting income smoothing and the political costs factors can be studied in similar research. It is suggested that other models in addition to Jones’ be used for estimating the expected accruals.

It is suggested that other political factors, studied in earlier research, which affect the management motives towards income smoothing, be taken into account given the current economic and political atmosphere prevailing in the firms listed in the TSE.

It is suggested that the political costs factors affecting income smoothing be studied and be compared during economic boom and recession periods.

It is suggested that the relation between income smoothing based upon actual activities and the current year earnings, future operating profits, and the future return on the firms’ stocks be studied.

It is suggested that the effect of the cultural and economic factors as well as the political factors on income smoothing in the firms listed in the TSE be analyzed and the relations between the cultural, economic, and political factors affecting firms be determined.
References


