

Studying the effect of management ability on profit quality in Stock Exchange in Iran

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Abstract: Estimates and judgments of management that may affect the quality of financial reporting should be reflected in accruals. Management insights and skills in the proper evaluation of future events are estimated to increase the quality of accruals. The purpose of the present study to elucidate the relationship between functional ability and quality of earnings management of listed companies in Tehran Stock Market. In this study, annual adjustments, accruals quality and earnings persistence, have been used as a measure of earnings quality. The study period of 2005 to 2010 for six years, and the research sample includes 104 firms listed on the stock market. The results showed that the past management ability reduced. In annual adjustments in the current period. This finding is consistent with theoretical research shows that managers with higher ability, lower figures have been adjusted to be in the past period. Also proved that the managers with higher ability to sustain losses reported losses in the tens of companies have helped. This finding is not consistent with the theoretical basis of research and expected that manager with higher capacity, higher accruals quality report. According to the research findings, the relationship between accruals quality management capabilities is reversed. Overall, the results indicate that the strength of corporate profits, quality management, there is a significant relationship and was proven management ability can be used as a factor in the quality of financial reporting is concerned.

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1. Introduction

Firm managers are among the group of organization's internal users of financial statements who are inside the company and thus have access to information other than financial statements which are considered to be confidential and are not accessible for the organization's external users. The investors, creditors and other users of financial statements in firms need historical information besides the needs to information about the future of economic units. In order to be responsive, the managers supply these data directly or indirectly due to their capabilities and make them available for the users.

Also the optimal appropriation of resources in capital markets deserves that the reported accounting profit to these markets should have an appropriate quality, because the minor investors, and the major (institutional) investors and the analysts rely on the ability of accounting profit to have an appropriate quality when they are making investing decisions or assessing the firm's stocks. The profit is considered as an index of performance and it is also used for stock pricing, assessing the expected return and predicting the future performance of the

company which is used by those who are active in capital market. The isolation of ownership from the management and information asymmetry and the moral hazards resulting from it concerns the owners that maybe the management having control over their assets will appropriate the resources incorrectly (Niu, 2006). On the other hand, accounting profit is one of the fundamental variables used in assessment models of the investors and analysts. Profit quality is a function of the difference between the accounting profit reported and firms' economic profits. This difference results from the recording and measuring the financial incidents based on the accepted accounting principles which may be affected by the judgments and estimations of the management (Francis & Schipper, 2003).

The estimations and judgments of management may affect the quality of financial reporting; and it is realized in accruals. The knowledge and capabilities of the management is estimated regarding the correct assessment of the future incidents which may result in increasing the quality of accruals. In the present research, by managerial capabilities, we mean his ability in exact

accounting estimations and utilizing the correct approaches in financial reporting (for example, in recording the depreciations and estimating the doubtful claims to receive) and it is presupposed that managers with high operational capabilities in utilizing the financial resources appropriately will do more accurate estimates and judgments. Thus, to measure the ability level of the management, we will consider the operational ability. Thus it is expected that managers be more accurate in their estimations and judgments. Therefore, it is possible that managers with higher operational capabilities will have more awareness about the future status of the company, the industry and economic trends. As a result it is expected that the estimated accruals by those managers be more accurate. For example, about estimating the dubious claims only the historical rates of the claims failed to realize will be used by a manager with weak assessment ability. Meanwhile a manager with a higher level of assessment ability will take into consideration some variables such as macro-economic variables, industry standards and changes in customers' structure besides the historical trend of claims' failures (Demerjian & et al, 2010).

In other words, managers with higher capabilities will present more accurate estimates which can decrease the difference between the reported accounting profits and the real performance. Furthermore, this group of managers is less probable to manipulate the profit due to the desirable efficiency of them in profitability of the profit entity. Also principally they do not feel any need to use optional accruals to show the status and the performance of the profit entity desirable. They are able to maintain the profitability of the company more probably and thus the reported profits by these managers are more consistent.

A group of researchers have noticed the managerial characteristics of the company as an effective factor on profit quality. In this field, Aier & et al (2005), Francis & et al (2008), and Demerjian & et al (2010) have studied the changes in profit quality in relation with managerial characteristics. Aier & et al found out that the more experience and specialization of the board of directors in a company, there would be the less probability of restatements in the reported profits. On the other hand, Francis & et al found out that there is a meaningful relationship between the fame and reliability of the management and profit quality (optional accruals). Also Demerjian & et al concluded in their research following the previously done researches that increasing the management ability will result in less restatements, higher efficiency and profit, decreasing the errors and more accurate estimation of accruals. In summary, the evidences show that managers with more

specialization and experiences will reduce the possibility of restatements and unreal financial reporting. The present research predicts that the assessment ability of managers is effective on the quality of the reported profit, because precision in managerial judgments and estimations is a function of these capabilities. The results of the present research can complement the theoretical foundations related to the effective factors in profit quality and can affect the determination of financial reporting strategies. Thus, it seems that the more natural managerial capabilities of a manager will result in a higher profit quality of the reported profit. As a result the main question in the present is posed as follows: What is the effect of management ability on profit quality?

2. Review of the related literature

Regarding the novelty in the present issue, especially in local researches, we could not find any evidences completely related to our research topic. The literature presented here entails researches which are almost related to the present topic. Dechow & Dichev (2002) studied the role of accruals in measuring the performances of the companies better during a time series. They finally concluded that the characteristics of any company such as the absolute amount of accruals, operation cycle length, and criterion deviation from the sales, cash flows of accruals and profit and firm size can be used as tools to assess profit quality. Ball & Robin (2003) remarked in a research paper entitled: "The characteristics of accounting profit" that the effect of the decisions made and implemented by the managers is more than reporting standards in determining the quality of accrual (profit quality). Kaplan & Minton (2004) studied about the role of the board of directors on firms' performances. They specifically focused on firms with losses, weak firms and firms with smaller sizes. The results of their research showed that when companies have weak performances and low profitability, financial managers are used to form board of directors. They also found out that altering the non-specialized members of the board of directors with financial managers had had desirable effects on firms' performances in short-term. Zhang (2009) studied the relationship between the incumbency period of the board of directors and profit quality. He found out that on the whole by increasing the time period of incumbency of the board of directors the financial reporting approach will tend more towards conservatism. The results showed that managers with more experiences use optional accruals to manipulate the profit less. Zhang interpreted these findings in a way that firstly, managers with more experiences have fame and credibility in a company and in professional community and they are reluctant to lose

this fame with profit management and secondly, this group of managers achieve a desirable level of profitability due to the experiences and knowledge they have in the operational field and do not tend to utilize optional accruals.

Bhagat & et al (2010) studied the effect of the education level of the managers on the incumbency period of them and the firms' efficiency. Their results showed that the education level does not have an important role on the incumbency period of the members of the board of directors and generally speaking, managers with weaker efficiencies are altered without regarding their education levels. But educational level is considered as a criterion to choose new managers. Also the results showed that managers' educational level has a direct and meaningful relationship with firms' performances in short-term. Demerjian & et al (2010) studied the relationship between managers' ability and profit quality. They found out that there is a direct and meaningful relationship between managers' ability and profit quality. The results showed that increasing the ability of managers will result in less annual adjustments and higher profits, decreasing the mistakes and having more accurate estimations in accruals and this is the result of the powerful enforcement of the perspectives of the manager in assessing the situations and different business and industry states. Erickson & et al (2011) studied the relationship between the scholarship of the board of directors and firm value of Canadian companies. They used Q Tobin ratio in their research to measure firm value and focused on technical characteristics and educational levels of the members of the board of directors. The results of their research showed that the board of directors which has the financial and accounting knowledge will have a more efficient and effective control over company management and will result in potential increases in firm value.

Mashayekhi & Esmaeeli (2006) studied the relationship between profit quality and some aspects of leadership principles including the ownership percentage of the board of directors and the number of not on duty managers. The results of this research showed that in %95 assurance levels there is not any relationship between profit quality and the ownership percentage of the board of directors and the number of not on duty managers. But there was a non-linear relationship between accruals and the ownership percentage of the board of directors. Also the number of not on duty managers and the ownership percentage of the board of directors which are considered as the foundations of leadership structures in firms, do not have an important role in promoting the profit quality of the firms accepted in Stock Exchange.

3. Research Hypotheses

Based on the literature presented, it is expected that the managers' capabilities will have a meaningful effect in reporting atmosphere of the companies. We have studied this issue by designing three main hypotheses including the effects of the managers' capabilities on three criteria of restatements, earning power, and quality of accruals. Restatements occur because of correction of the errors in previous estimates. It seems that managers with a higher level of operational capabilities will have less restatement in their financial reporting. Thus, the first hypothesis of the research will be stated as follows: *Management ability affects restatements of the firms' profit.*

Earning power is one of the profit quality criteria. Generally it is believed that those companies that the reported profit follows a consistent pattern will have more ability to maintain the current profits. Therefore, it is expected that there is a meaningful relationship between management ability and earning power. Thus, the second hypothesis of the research will be stated as follows: *Management ability affects firms' earning power.*

The accruals are resulted from the differences between cash flows and the reported profit. The more amounts of this item will show a lower profit quality. In the present research, optional accruals are posed as one of the profit quality criteria. Regarding the theoretical foundations of the present research, it is expected that there is a reverse relationship between management ability and optional accruals. Thus, the third hypothesis of the research will be stated as follows: *Management ability affects firms' accruals quality.*

4. Research Methodology

The present research is capital market research type regarding accounting researches and regarding the goal it is considered to be applied. The methodology regarding the research title is descriptive and correlation type. It is descriptive because the goal is to define the conditions or phenomena under investigation and it is used to know more about the current situation and it is correlation because our aim is to investigate the relationships between the variables. The present research will study the relationships between the variables and is trying to approve the existence of this relationship in the current situation based on historical data. In this type of researches the relationship between the variables is analyzed based on the research goal. These researches have a dependent variable and one or some independent variables and the effect amount of the independent variables on the dependent one is balanced through regression tests.

To choose the statistical population we referred to firms accepted in Tehran Stock Exchange in different industries (basic metals, automobiles and equipment manufacturing, medical materials and products, cement, lime, plaster, chemical products, vehicles and instruments, food products). The time period for the present research is the financial information related to the performances of the years between 2005 and 2010 of the firms above for 6 years. Our statistical sample is selected by deletion method and the conditions were as follows:

- 1) They should be present in Stock Exchange during the years between 2005 and 2010.
- 2) The end of fiscal year should be end of Esfand (21 March).
- 3) The companies should not have changed the fiscal year during the experiment.
- 4) The trademark for the company should be active and it should not have stopped for more than 4 months during a year.
- 5) The financial information of the company for the study period should be accessible.

After considering the limitations and conditions above 104 companies were selected as our statistical sample from among the firms accepted in Tehran Stock Exchange. Finally regarding the 6 years period of the research the integrated information used in testing the hypotheses were calculated for 624 years-companies.

5. Research Variables and the type of their measurement

1) Independent variables

The basic independent variable of the present research, management ability, is measured by the model presented by Demerjian & et al (2009). This model is a quantitative scale which shows the ability amount of management in effective and efficient use of the firm resources. The model is basically related to studying the ratio of claims to the inputs of a company and it is presupposed that managers with higher abilities can achieve more earnings by using a definite amount of resources (such as capital, work force, and intangible assets). Also it is supposed that this is due to the innovative perspectives of the manager in using superior business systems, innovative manufacturing processes, staffs rewarding system, financing chains and Accordingly, managerial efficiency criterion is measured as follows.

$$\text{Efficiency} = \frac{\text{Sales}}{\text{COGS} + \text{SGA} + \text{PPE} + \text{R\&D} + \text{IA}}$$

Sales= the amount of sales' money

COGS= cost of goods sold

SGA= sales and official costs

PPE= property, machinery and equipments

R&D= research and development accumulations

IA= intangible assets

The efficiency criterion mentioned above reflects the overall performance of the company which may be affected by many factors such as the special characteristics of any company and its operational environment. Thus we should first balance the effects of these factors in the criterion above to use as a criterion for management ability (Demerjian & et al, 2010). Thus according to Demerjian & et al (2009), we have used a regression pattern in which the efficiency measure above is a function of variables which represent the special characteristics of the companies.

$$\text{Efficiency}_i = \beta_0 + \beta_1 \text{Ln Assets}_i + \beta_2 \text{MarketShare}_i + \beta_3 \text{CF}_i + \beta_4 \text{LnCash}_i + \varepsilon_i$$

Ln Assets: the natural logarithm of book value of firm assets
Marketshare: the market share of companies (the ratio of firm's sales to total sales of the whole companies which are active in the related industry).
CF: firm's net cash flow divided by assets
LnCash: the natural logarithm of cash residuals
The residuals resulting from the regression pattern (ε_i) above are considered to be management ability criterion which is shown in hypotheses' test pattern by MgrlAbility.

2) Dependent Variables

The scales and elements of profit quality are the dependent variables in research hypotheses' testing patterns. In this research three scales were used to measure profit quality which are as follows:

2-1) Restatement: they are the corrections of the errors related to the previous periods and the deletion of the effects resulted from the incorrect estimations of the managers of the accumulated profit of the company. This variable is related to unintended errors in recognizing and reporting the net profit of the company and the more restatements will result in lower profit quality in companies.

2-2) Earning Power: Earning Power means the continuity (repetition) of the current profit. In this research following Penman (2001) and Dastgir & Rasteghar (2011), earning power is measured through profit regression of period t on the profit of the period t-1.

$$\text{Earnings}_t = \beta_0 + \beta_1 \text{Earnings}_{t-1} + \varepsilon_t$$

In the regression pattern above, the coefficient β_1 shows the amount of the relationship between the current period profit and the previous period profit which reflects earning power. If coefficient β_1 is statistically meaningful, there would be a consistent pattern in profits reported for the statistical sample companies during our research period.

2-3) The Quality of Accruals: net profit can be divided into two parts of cash and accruals. The accrual part of the profit entails and reflects the

estimates and judgments of management. If these estimates are accurate and without any biases on the part of a manager, they can be better criteria for predicting future cash flows and thus they benefit from a higher quality. In the present research, optional accruals are measured through Jones's model which has been balanced by Dechow & Dichev (2002). In this regression model, optional accruals are calculated by the residuals of the regression of total accruals divided by sales and properties and machinery (independent variables).

$$\frac{TACC}{TA_{i,t-1}} = \alpha_1 \left(\frac{1}{TA_{i,t-1}} \right) + \alpha_2 \left(\frac{\Delta REV_{it}}{TA_{i,t-1}} \right) + \alpha_3 \left(\frac{PPE_{it}}{TA_{i,t-1}} \right) + \varepsilon_{it}$$

Where,

TACC: total accruals which are calculated by the difference between operational profit and operational cash flow.

ΔREV : the change in sales earnings compared to the previous period

PPE: total properties, machinery, and equipments

TA: total assets

ε : the residual of regression pattern and reflecting optional accruals shown by profit management level for every year-company (Kothari & et al, 2005).

Since in the present research we focus on profit quality; based on Kothari & et al (2005) we calculate the absolute amount of the residuals resulted from the regression model above and then multiply them by (-1) and the resulted amounts as the quality level of accruals (AQ) for every year-company are utilized in the hypotheses' test pattern (Demerjian & et al, 2010).

$$AQ_t = -1 * |\varepsilon_t|$$

6. Research Hypotheses' testing method

In this research we have used minor regression tests to test the hypotheses and to analyze the raw data and change them into needed data format. These tests are administered through using SPSS software and in an assurance level of %95. The patterns used in testing the hypotheses are extracted from Demerjian & et al (2010) as follows.

6.1. First hypothesis test method

$$Restatement_t = \beta_0 + \beta_1 MgrlAbility_t + \beta_2 MgrlAbility_{t-1} + \beta_3 Size_t + \beta_4 Sales_t + \beta_5 Cash Flow_t + \beta_6 Losses_t + \beta_7 Earnings_t + \varepsilon_t$$

Restatement: the absolute amount of restatement of net profit

MgrlAbility: management ability criterion

Size: firm size (natural logarithm of a firm's assets)

Sales: firm sales' earnings divided by book value of assets in the beginning of the period (controlling variable)

Cash Flow: net cash flow divided by book value of assets in the beginning of the period (controlling variable)

Losses: net loss incurred by the company divided by book value of assets in the beginning of the period as the controlling variable (when there is the loss report for the intended period)

Earnings: net profit of the company divided by book value of assets in the beginning of the period as the controlling variable (when there is the profit report for the intended period)

In the regression pattern above the coefficient β_1 shows the relationship between management ability and restatement levels of profits for the statistical sample companies. The coefficients β_2 to β_6 show the relationship between restatements and controlling variables.

6.2. Second hypothesis test method

$$Earnings_t = \beta_0 + \beta_1 Earnings_{t-1} + \beta_2 Earnings_{t-1} * MgrlAbility_t + \beta_3 Earnings_{t-1} * DMgrlAbility_t + \beta_4 Earnings_{t-1} * DNegEarn_t + \beta_5 Earnings_{t-1} * MgrlAbility_t * DNegEarn_t + \beta_6 Earnings_{t-1} * DMgrlAbility_t * DNegEarn_t + \beta_7 MgrlAbility_t + \beta_8 DMgrlAbility_t + \beta_9 DNegEarn_t + \beta_{10} Size_t + \beta_{11} Sales_t + \beta_{12} CashFlow_t + \varepsilon_t$$

DMgrlAbility: it is a virtual variable which equals 1 when the criterion of firm management ability is higher than the average amount of this criterion for the total companies of our statistical sample, or it would be 0 in any other case.

DNegEarn: it is a virtual variable which equals 1 when the company under investigation in the period is losing money, or it would be 0 in any other case.

Other variables present in the regression model above were identified before.

In the regression pattern above, β_1 coefficient shows earning power in the whole statistical sample companies. Coefficient β_2 shows the effect of management ability on earning power level and β_3 shows earning power of companies which have a higher level of management ability. The coefficient β_4 reflects earning profit in firms incurring losses and β_5 shows the earning power in losing companies and with high management ability.

6.3. Third hypothesis test method

$$AQ_t = \beta_0 + \beta_1 MgrlAbility_t + \beta_2 MgrlAbility_{t-1} + \beta_3 Size_t + \beta_4 Sales_t + \beta_5 Cash Flow_t + \beta_6 Losses_t + \beta_7 Earnings_t + \varepsilon_t$$

AQ: quality level of firm's accruals

Other variables present in the regression model above have been identified before.

In the regression pattern above, β_1 and β_2 coefficients show the relationship between management ability level and accruals' quality.

7. Research findings

7.1. Descriptive statistics and correlation coefficient tables of the variables are shown in Table 1.

Variable	Number of observation	minimum	maximum	average	Standard deviation
Efficiency	728	.13556	4.567	.99711	4.9918357
Ln Assets	728	10.5655	18.3212	13.130124	1.3798905
MarketShare	728	.00451	16.367	1.1228	4.3547055
CFO	728	-.7548	1.8234	.124330	.1626621
LnCash	728	4.6347	15.1434	9.335690	1.6643779
MgrlAbility	728	-1.13682	25.33559	.0000000	.99817684
$\frac{TACC}{TA_{t,t-1}}$	624	-1.6861	.88124	-.048388	.1764826
$\frac{1}{TA_{t,t-1}}$	624	.0000	.0000	.000004	.0000046
$\frac{\Delta REV_{it}}{TA_{t,t-1}}$	624	-.9573	1.7740	.110265	.2673954
$\frac{PPE_{it}}{TA_{t,t-1}}$	624	.0013	1.6940	.252412	.2083950
ACC	624	-9.96366	6.06226	.0000000	.99840468
AQ	624	-9.9637	-.0029	-.607568	.7920098
Restatement	624	-.30684	.05842	-.01063	.0125441
Size	624	10.6620	18.3212	13.197793	1.3831308
Sales	624	.0091	5.0226	.893951	.5419472
CF	624	-.7315	2.1955	.146798	.1949624
Loss	624	-.4183	.0000	-.010308	.0415463
Earn	624	.0000	1.5290	.147695	.1532358
EARN	624	-.7179	.6274	.109188	.1322076
DMgrlAbility	624	0	1	.33	.471
DNegEarn	624	0	1	.10	.305

The descriptive analysis of the variables in management ability measurement pattern which was presented in the first part of table (1), shows that the number of observations for the variables of this pattern is 728 year-company and this is due to the fact that management ability level is calculated for the time period t-1, too. Also the average efficiency for the statistical sample of the companies is 1 and therefore on the whole the optimization of these companies is less than the resources utilized in their operational activities. The variable MgrlAbility (the residuals of the regression pattern of management ability measurement) shows the level of management ability for every year-company which is restated based on certain characteristics of the companies.

The average calculated for this variable equals 0. This finding implies that one of the primary conditions is realized and the regression is valid to

approve the average of residuals to equal 0. Also it shows that the figures gained for the management ability has negative numbers. The negative amount of the residual of the regression pattern of management ability measurement means that the company has not been able to achieve the expected efficiency level based on the accessible resources. In other words, the expected level of the efficiency of a company is a level which is expected regarding the resources and characteristics of the same company. Managers with higher ability can promote this expected level by appropriate management of the resources and the positive residuals can reflect this situation. On the contrary, managers with lower level of ability use the current resources inappropriately and even can not achieve the expected level of efficiency which results in negative residuals.

The number of observations related to variables used for optional accruals' measurement and also testing the hypotheses is 624 year-company. The variable ACC reflects the descriptive statistics related to the residuals of optional accrual measurement pattern. Because in the present research we need profit quality level to test the hypotheses, the reverse of the residuals gained (AQ) is calculated and used in regression pattern of hypotheses' test. Regarding the descriptive results of the data, profit quality level of the companies is low, on the whole because the average gained is far from the maximum amount. Also the amount of restatements is closer to its maximum amount. This finding also approves the low profit quality of the companies in our statistical sample. The variables Loss, Earnings, reflect net loss level and net earnings of the companies in our statistical sample, respectively.

7.2. The results of testing first hypothesis

In the first hypothesis it was predicted that management ability affects restatements in companies' profits. The testing pattern for this hypothesis is a regression model in which restatements are functions of management ability during period t and t-1, and controlling variables. The results of testing the second hypothesis are presented in table (3).

Table (2): The first main hypothesis test results

$$Restatement_t = \beta_0 + \beta_1 MgrlAbility_t + \beta_2 MgrlAbility_{t-1} + \beta_3 Size_t + \beta_4 Sales_t + \beta_5 CashFlow_t + \beta_6 Losses_t + \beta_7 Earnings_t + \epsilon_t$$

R ²	D-W	Statistic F	P-value
0.187	1.627	13.773	0.000
Variable	statistic t	β	P-value
MgrlAbility _t	-0.121	-0.004	0.904
MgrlAbility _{t-1}	-2.055	-0.015	0.039
Size	9.605	0.309	0.000
Sales	0.214	0.007	0.831
Cash Flow	-0.462	-0.017	0.644
Losses	-0.782	-0.026	0.343
Earnings	0.114	0.004	0.909

The results show that among the controlling variables, only the coefficient estimated for firm size variable is statistically meaningful and the meaningfulness level of other variables is higher than 0/05. These findings show that firms with bigger sizes have more restatements and sales' amount, net cash slow, and net income did not have a meaningful relationship with restatements. The coefficients resulted for the controlling variables of sales, cash flow, loss and profitability of the company, are not meaningful statistically. This shows that the variables above did not have any effect on the level of restatements of the companies in our statistical sample. On the whole, the results showed that management ability affects restatements and reduced

it. Thus, we can accept the claim posed in first hypothesis of the research and this hypothesis is approved with a %95 assurance level.

7.3. The results of testing second hypothesis

In the second hypothesis of the present research, the effect of management ability on earnings power was taken into consideration. The testing pattern of this hypothesis is the developed model of measuring earnings power level which is adjusted by increasing the variable of management ability and controlling variables. The results of testing the second hypothesis are presented in table (4). The coefficient gained for the variable Earnings_{t-1} which shows earning power for the whole companies in our statistical sample is positive and meaningful. This finding shows that, on the whole the companies in our statistical sample have reported powerful earnings during the research period. The coefficient estimated for the interactional variable Earnings_{t-1}*DNegEarn_t which shows the loss consistency in companies is also meaningful and this shows that firms incurring losses have had a consistent pattern in loss reports like profitable companies. The variable coefficient Earnings_{t-1}*MgrlAbility*DNegEarn which shows the effect of management ability on earning power in firms incurring losses is positive and meaningful. This finding shows that management ability is only realized in firms incurring losses in maintaining consistency and probably managers with higher abilities will try to maintain the losses incurring situation in a company.

Table (3): The Second main hypothesis test results

$$Earnings_t = \beta_0 + \beta_1 Earnings_{t-1} + \beta_2 Earnings_{t-1} * MgrlAbility_t + \beta_3 Earnings_{t-1} * DMgrlAbility_t + \beta_4 Earnings_{t-1} * DNegEarn_t + \beta_5 Earnings_{t-1} * MgrlAbility_t * DNegEarn_t + \beta_6 Earnings_{t-1} * DMgrlAbility_t * DNegEarn_t + \beta_7 MgrlAbility_t + \beta_8 DMgrlAbility_t + \beta_9 DNegEarn_t + \beta_{10} Size_t + \beta_{11} Sales_t + \beta_{12} CashFlow_t + \epsilon_t$$

R ²	D-W	Statistic F	P-value
0.0761	1.919	250.61	0.000
Variable	β	statistic t	P-value
Earnings _{t-1}	0.563	23.704	0.000
Earnings _{t-1} *MgrlAbility _t	-0.022	-1.25	0.212
Earnings _{t-1} *DMgrlAbility _t	-0.035	-1.275	0.203
Earnings _{t-1} *DNegEarn _t	0.36	14.74	0.000
Earnings _{t-1} *MgrlAbility _t *DNegEarn _t	0.122	6.937	0.000
Earnings _{t-1} *DMgrlAbility _t *DNegEarn _t	-0.143	-6.775	0.000
MgrlAbility _t	0.061	3.316	0.001

DMgrlAbility _t	0.047	1.929	0.054
DNegEarn	-0.098	-4.198	0.000
Size _t	-0.014	-0.811	0.417
Sales _t	0.067	3.887	0.000
CashFlow _t	0.181	9.72	0.000

These findings do not accord with theoretical foundations of the present research because it was expected that managers with more abilities will report more consistent profits. Also the results show that the coefficient estimated for the variable MgrlAbility is positive and meaningful which shows that there is a direct relationship between management ability and firm's profitability. The coefficients estimated for the variables Earnings_{t-1}*MgrlAbility_t and Earnings_{t-1}*DMgrlAbility_t are not statistically meaningful. These findings show that management ability has not affected earning power in the whole statistical sample. The variable DMgrlAbility_t is meaningful in a %95 assurance level which shows that in firms with high ability managers the reported profit is higher and the variable DNegEarn has had a negative and meaningful effect on the reported profit. On the whole, the claim posed in second research hypothesis is approved in a %95 assurance level.

7.4. The results of testing third hypothesis

The third research hypothesis predicts that management ability affects accruals' quality. The testing pattern of this hypothesis is a regression model in which accruals' quality is a function of management ability in period t and t-1 and controlling variables. The results of testing the third hypothesis are presented in table (5).

Table (4): The Third hypothesis test results

$AQ_t = \beta_0 + \beta_1 MgrlAbility_t + \beta_2 MgrlAbility_{t-1} + \beta_3 Size_t + \beta_4 Sales_t + \beta_5 CashFlow_t + \beta_6 Losses_t + \beta_7 Earnings_t + \varepsilon_t$			
R ²	D-W	Statistic F	P-value
0.103	1.626	16.487	0.000
Variable	β	statistic t	P-value
MgrlAbilit _{y_t}	-0.087	-2.581	0.010
MgrlAbilit _{y_{t-1}}	-0.007	-0.218	0.827
Size _t	-0.042	-1.319	0.187
Sales _t	-0.126	-3.806	0.000
CashFlow _t	-0.261	-7.329	0.000
Losses	0.117	3.606	0.000
Earnings	-0.051	-1.354	0.176

The coefficient gained for the variables MgrlAbility_t which show the effect of management ability in the current period on accruals' quality is negative and meaningful. This finding does not accord with the theoretical foundations of the present research and shows that managers with higher abilities have reported accruals with a lower quality. While it was expected that by increasing the ability of managers, the quality of accruals reported by them should increase, the results about controlling variables showed that net cash flow and sales earnings have had a reverse and meaningful relationship with accruals' quality. In other words, companies with cash flow and higher sales have reported accruals with a lower quality. Also the results showed that there was a direct relationship between net loss and accruals' quality. This finding showed that probably the financial reporting quality of companies incurring losses has been better than other companies. On the whole, regarding the results we can accept the claim posed in third research hypothesis which emphasizes that management ability affects accruals' quality. Thus, the third research hypothesis is approved with a %95 assurance level.

8. Conclusions

The knowledge level and abilities of managers will result in appropriate assessment of the future incidents and increasing accruals' quality estimated in companies. The main goal of the present research was to identify the relationship between operational ability of managers and profit quality in firms accepted in Tehran Stock Exchange. In this research, restatements, earning power, and accruals' quality were noticed as the criteria for profit quality.

The results of statistical testing showed a negative and meaningful relationship between management ability in the previous period (t-1) and restatements. This finding accord with the theoretical fundamentals and the claim declared in first hypothesis and the amount of profit restatement decreases by increasing management ability. Managers with higher abilities will do more accurate estimations and the reported profits will need less restatement in future periods. The reverse relationship between management ability and profit restatement approves the theoretical foundations that manager's ability improves his insights and power in more appropriate assessment of the future incidents and future trends and results in more accurate estimates. Thus we can infer that even if a company has a higher efficiency due to its special characteristics (and not due to the characteristics of its manager), this efficiency may not affect its financial reporting area. Accordingly, Demijian & et

al (2010) differentiated between firm efficiency and manager's efficiency and adjusted the overall efficiency level of the company.

In second hypothesis it was claimed that management ability affects earning power in companies. Earning power means the ability of a company to maintain current profits which finally will lead to a consistent growth in the reported profit and is considered as a criterion for the reported profit quality by the researchers. The results of statistical tests showed that managers with higher ability have helped maintaining and consistency of loss reports in firms incurring losses. This finding does not accord with theoretical foundations of the present research because it was expected that more able managers will try to maintain profitability in a company. About findings of this hypothesis and the reasons for why it does not accord with the theoretical foundations of the present research, we can refer to the following items:

1). The experimental evidences show that managers in corporate companies have different stimuli to manipulate the reported profits (Dechow & Dichev, 2002; Talker & et al, 2006; Hemmati, 2003). For example, Talker & et al (2006) posed three motives of reward, operational changeability, and taxation avoidance as the main motives of managers in unreal financial reporting. They found out that agency issues and governance mechanisms determine managers' motives in manipulating the reported profit. Accordingly, Hemmati (2003) showed that taxation avoidance is one of the main factors in unreal reporting among firms accepted in Stock Exchanges in Iran and firms under investigation specifically had tried to show the profit less in order to achieve taxation goals. Thus, it seems that the finding in second hypothesis claiming that management ability affects loss maintaining meaningfully reflects the opportunistic motives of managers in this type of companies to report losses to favor the company when it confronts taxation.

2). Earning power reported is affected by operational efficiency besides reflecting financial reporting behaviors of companies. In other words, managers can help consistent profit in two ways. Firstly, they can smooth the profit and manipulate the reported profits by using optional financial accounting approaches and create a consistent growth trend in the profit. Secondly, managers can approve earning power by increasing the efficiency level of the company and correct utilization of the resources. The results of the second hypothesis show that probably the managers of profitable companies did not have any efforts to report consistent profits and did not use any of the methods mentioned in their companies.

3). The third research hypothesis has focused on the effect of management ability on accruals' quality. Accruals' quality reflects the amount of utilizing optional accruals in the reported profit and in fact represents the opportunistic motives of managers for unreal financial reporting. The statistical analysis results show that there is a negative and meaningful effect between managers' ability and accruals' quality. We should notice that accruals' quality is a concept derived from the manager's insights about accounting estimates. The findings of the third hypothesis showed that managers with higher ability have reported accruals with a low level of quality. These findings can be interpreted through the present evidences about the motives of managers for unreal financial reporting. Therefore, managers having higher ability to assess and identify the future incidents related to the company have used this ability to enforce their ideas about optional accruals. In other words, unlike the expectations and on the contrary to the theoretical foundations of the present research, managers with higher ability have reported profits with lower quality and this financial reporting behavior is probably derived from the opportunistic motives of them in order to enforce their ideas on the reported profit.

8.1. Applied suggestions resulted from research results

1. Based on the findings of the first hypothesis, it is suggested that managers in corporate companies use the previous experiences or their specialization in operational fields to estimate the future incidents correctly and consider the accurate assessment of the effective factors important to prepare reports in order to decrease restatements in their financial reports.
2. Based on the findings of the second hypothesis, it is suggested that the investors and creditors should consider financial reporting environment of the companies as an effective factor in assessing the companies and making decisions and consider the opportunistic motives of the managers in unreal financial reporting in investment decisions and conferring the credits.
3. Based on the findings of the third hypothesis, it is suggested that the capital suppliers of the companies should consider ability level of managers as a factor which can threaten the quality of financial information. Therefore, we can study the trend of the previous financial reporting besides managerial experiences, educational level and the job experiences of managers in the industry and judge about the reliability of the reports broadcast by the company and make decisions related to the appropriate capital supplying for the company.

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