A Survey about the Correlation between the Corporate Ethical Values and Understanding Earnings Management

(Case Study: Iranian Association of Certified Public Accountants)

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ABSTRACT: In the few recent decades the phenomenon of earnings management has been mentioned as one of the problems of accounting profession. The earnings management does not show the financial situation of the organizations and it hides the related information which the investors should be aware of them. Corporate bankruptcies and recent financial crisis have redirected the focus on the earnings management. Researchers believe that unethical behavior of earnings management could be the reason of ethical failure in corporates. The current research aims to study the correlation between these corporate ethical values on the earnings management of Iranian association of CPAs. In terms of aim this research is an applied research and the research methodology of this study is descriptive-correlative. 140 Iranian CPAs were chosen as the research samples and they answered the questions of two standard questionnaires of corporate ethical values or Elias et al (2004) work ethic inventory and Marquardt standard questionnaire of earnings management (1994). Results showed that a positive and significant correlation exists between the corporate ethical values and the earnings management, Furthermore, the earnings management could be predicted by the corporate ethical values. At the end of the article a few applied research suggestions are provided.

Keywords: Corporate ethical values, Earnings management, Association of CPAs.

INTRODUCTION

Discussion about the benefits in the ethical environment of the organization is not a new concept. In the current research the corporate managers have been interviewed in order to determine their perspective about the reasons of unethical behaviors. Managers showed that the higher authorities’ behavior, other managers at the same level, and organizational regulations are the main reasons for the unethical behaviors (Mintz & Morris, 2008). Also staffs consider the hidden, implicit and non-obvious forms of formalized ethics more effective than the explicit and obvious ones (such as regulations and ethical committees) in forming the ethical behaviors. The necessity of conducting this research is to determine the effect of ethical values on the corporate values at high level on exposing illegal and unethical activities to outside of the organization, organizational commitments, organizational conflicts, and ethical behavioral intentions on understanding the earnings management from the accountants’ point of view and provide solutions and suggestions for improving them (Baharifar et al., 2010).

Recent corporate scandals and creating crisis again attracted the focus of paying attention to culture and ethical values in big corporations. Accountants faced many criticisms about their failure in an alert toward the unethical behaviors of management and their unethical behaviors through incomplete records and making barriers for surveying and researching (Sridharan, 2002). This behavior is highlighted when the accounting internationally put considerable attention on the ethical matters (Farrel & Cobbin, 2000). Imposing the earnings management by some accountants is considered as a legitimate and appropriate action (Parfet, 2000) and by others it is considered as an illegitimate action.
Although there is a settlement that managers are faced with considerable pressure caused by the conflict of interest and representation theory for earnings management, so that this pressure causes some of them to be more exposed to unethical behaviors (Elias, 2004). Martin et al (2002) found out that Stock Exchange has increased its surveys about the earnings management activities in the recent years in accordance with the representation theory that these activities are truly fraudulent, so that during one month it has surveyed 260 frauds associated with earnings (Kin, 2008).

In the few recent decades the phenomenon of earnings management has been mentioned as one of the problems of accounting profession. The earnings management does not show the financial status of corporates, and it hides the related information which the investors should be aware of them. Corporate bankruptcies and recent financial crisis have redirected the focus on the earnings management. Researchers believe that unethical behavior of earnings management could be the reason of ethical failure in corporates (Libby, 2009). The main issue of the current research is to detect the unethical behaviors on understanding the management through providing different theories from financial accountants and detect the main accountants and investors in order to determine the quality of financial statements during time and the effect of earnings management on their quality through their perspective.

In an article named surveying the effective ethical factors on the earnings management Vadiei et al (2012) stated that a huge difference exists between the goals and importance of earnings management. This means that earnings management with personal goals is more unethical than the earnings management with corporate goals, and also it has been judged that significant earnings management is more unethical than the non-significant earnings management. Also no difference has been observed between the major and gender of university students in terms of effect on the ethical judgments. In an article named surveying the effect of corporate ethical values on the earnings management Etemadi et al (2010) concluded that accountants of high (low) ethical values understand the earnings management activities more unethical (ethical). Understanding of ethical values in women is significantly higher than men; in other words, Iranian women are more faithful to corporate ethical values. While within the community the young university students have higher understanding about the corporate ethical values. Also more educated individuals believe in the higher corporate ethical values, and furthermore in the community of professional accounting large corporates consider higher ethical values than smaller corporates. According to the achieved results it seems that corporate ethical values and in other words the corporate culture is an important criterion for understanding the earnings management. In an article named The Ethics of Managing Short-Term Earnings Giacomino et al (2006) stated that ethics are very important in accounting, because the same as other fields this field also has certain ethical obligations under the name of the code of professional conduct. Based on the achieved results the earnings management has a considerable effect on the ethical judgment. Etemadi and Rahmani (2009) also conducted a research and studied around the two motivations of earnings management and earnings management approach and they concluded that manager’s self-interested motives and method of manipulating the accruals are more unethical than the motive for increasing the corporate value and other earnings management methods. Belski et al (2008) conducted a research about the ethics in the earnings management matter. Their sample includes university students and their measuring tool was a questionnaire. Their research results indicate that the motivation for earnings management (self-interested or increasing the corporate value) has a considerable importance in earnings management.

Additionally, the earnings management method is also considered as an important factor in earnings management. Thus in terms of ethics the method of accounting changes are put at the lower level. In a research Balsam et al (2002) compared the ideas of managers and independent accountants about the common procedures and threads in earnings management. Their research results indicated that from the accountants’ perspective compared to the managers’ perspective the earnings management procedures are considerably less ethical. In an article Kaplan (2001) studied the correlation between the individuals’ ethical judgments about the earnings management activities and their role through the use of three scenarios. These scenarios were related to issues such as profit from operating activities, profit from accounting activities, and creating losses through accounting activities. Regarding the achieved results such prediction affirms the accounting activities of earnings management but they did not affirm the operating activities of earnings management. In the research conducted by Kin (2008) he sought to find the answer for this question that is the earnings management accepted or not? The research results showed that from the accountants’ perspective the earnings management through accounting methods was much more ethically inappropriate than earnings management through operating decision makings. In an article named ethical aspects of earnings management Fischer et al (1995) stated that during a survey research they asked the university students’ about their attitudes toward the ethical aspects of earnings management. The research results showed that the accounting curriculum and ethical curriculum may increase the sensitivity of university students and accountants about the earnings management.
In the current research regarding the theoretical concepts and extracting the earnings management indicators (manipulated earnings management activities, and real earnings management, management through accounting numbers) and corporate ethical values provided the below conceptual model, and the research hypotheses are formed based on this figure. So the current research question is that is there any significant correlation between the corporate ethical values and the understanding of earnings management? Do the corporate ethical values affect the understanding of earnings management?

![Conceptual Model Image]

**Figure 1.** Research conceptual model.

**METHODOLOGY**

Two matters including research goal and data collection method are being raised in this methodology, thus in terms of nature and goals the current research is an applied research and in terms of methodology it is a descriptive-correlative/survey. This research has been conducted in the survey method and in this method the traits are quantitatively measured and the variables are measured at four levels of nominal (binary and nominal), ordinal, interval, and ratio and also they are processed and analyzed at two parts of descriptive and inferential analysis. The current research population includes all of the members of Iranian association of CPAs working at Iran Audit Organization and they are 130 individuals. In order to determine the current research sample size the Krejcie and Morgan table was used and regarding the population including 235 individuals, 140 individuals were chosen. The individuals have been chosen through stratified random sampling. The research data collection tools are standard questionnaires of corporate ethical values or Elias et al (2004) work ethic inventory and Marquardt standard questionnaire of earnings management (1994). The Marquardt standard questionnaire of earnings management has two dimensions (6 items for manipulated earnings management activities and real earnings management, 5 items for management through accounting numbers including accruals) and it is formulated in the Likert 5-point scale (completely ethical, slightly ethical, neither ethical nor unethical, slightly unethical, completely unethical). The Elias et al (2004) standard questionnaire has been used in order to measure the corporate ethical values, and its aim is to measure the importance of ethical values related to work, and this questionnaire includes 27 questions and it is formulated in a 5-point scale (very important, important, nearly important, less important, unimportant). It should be pointed that the research tools have been surveyed in other studies, nevertheless its validity has been surveyed by experts and professors and its reliability has been achieved by the use of Cronbach’s Alpha and it was at an acceptable level (0.86). In data analysis part in addition to common methods and indicators of descriptive statistics, the Kolmogorov-Smirnoff test has also been used for studying the normal distribution of data and the correlation coefficient has been used for studying the correlation between variables at the inferential statistics part, and also the SPSS19 statistical software has been used as well.

**RESULTS**

Among the 140 examinees 119 individuals were male and 21 individuals were female. More than 75.7% of the examinees were at the age range of 30-50. More than 30% of the examinees had bachelor degree. Also more than 85% of the examinees were single. More than 55.7% of the examinees had 11 to 15 years of work experience. Descriptive
analysis of the main research variables also show that the variable of corporate ethical values had a mean of 3.24 and the variable of earnings had a mean of 3.03 (figure 2).

Results of Kolmogorov-Smirnoff test showed that the data have normal distribution thus the parametric tests are used. Table 2 is related to the correlation between the corporate ethical values and the earnings management. As it is observable, the correlation coefficient is 0.909 and it is significant. In other words, a positive and significant correlation exists between the corporate ethical values and the earnings management.

Table 1. The correlation coefficient between the corporate ethical values and earnings management.

<table>
<thead>
<tr>
<th>Variables</th>
<th>N</th>
<th>Correlation coefficient</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate ethical values and earnings management</td>
<td>140</td>
<td>0.909</td>
<td>0.000</td>
</tr>
</tbody>
</table>

Table 2. Predicting the earnings management from corporate ethical values.

<table>
<thead>
<tr>
<th>Model</th>
<th>Non-standard coefficients</th>
<th>Standard coefficients</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fixed coefficient</td>
<td>57.057</td>
<td>3.622</td>
<td>15.751</td>
<td>0.000</td>
</tr>
<tr>
<td>Earnings management</td>
<td>1.778</td>
<td>0.227</td>
<td>0.909</td>
<td>7.847</td>
</tr>
</tbody>
</table>

The simple regression has been used for surveying the variable of earnings management from the variable of ethical values. As it is observable in table 2, F=61.577 and it is significant for the regression equation (P= 0.0001). Also the coefficient of determining R2 showed that the regression equation used in ethical values (0.826) explains the variance in earnings management. In other words 82.6% earnings management could be explained through ethical values.

DISCUSSION AND CONCLUSION

The current research has been conducted in order to study the effect of corporate ethical values on understanding the earnings management among the Iranian CPAs. The current research population included the Iranian CPAs and its statistical sample was chosen according to the systematic random sampling among them. The research results showed that a positive and significant correlation exists between the corporate ethical values and the earnings management, and additionally the changes of earnings management could be explained through the corporate ethical values. These results closely match and they are supported with the research findings of Etemadi et al (2010), Jafaei (2008).

Although the researches came to this conclusion that earnings management activities are very extensive, in accounting profession no public settlement exists about their ethical acceptance. In one hand, U.S Securities and Exchange Commission and many other users believe that earnings management turns the facts that investors should know into vague and unclear concepts and any intentional behavior of the earnings management, regardless of importance is unaccepted. On the other hand, some accounting researchers pointed out that all of the activities of earnings management are not
disadvantageous for the corporate. Current shareholders are the applicants of earnings management in order to maximize their stock values through the expense of next shareholders. This matter creates a motive for the managers in order to perform earnings management. In a study this disagreement was tested among the Executive Management university students. The students made difference between the self-interested activities for the corporate which were not considered unethical and the personal self-interested activities which were considered unethical. Some earnings management activities which result in creating sustainable financial performance for the corporate are beneficial as long as they increase the shareholders’ wealth, yet this condition is only accepted through the acceptable and voluntarily business decisions such as surplus assets at end of year in order to maximize the earnings. The topic of ethical acceptability of earnings management activities intensified after revealing its negative consequences.

According to the current research results it is suggested that regarding the effect of variable of corporate ethical values on understanding the earnings management some criteria that are necessarily more important for the accountants should be extended at their work place, for example the leadership, manager partnership, and staff following their leader should be improved in order to have more effect, thus these criteria should be extended and also the managers should pay more attention to it. Also due to the significance of the correlation between the corporate ethical values and earnings management, it is recommended to the accountants to have schemes for the costs and have the report about the corporates’ delayed payment of bills, and if the managers pay the overtime at the right time and motivate the accountants to be more accurate about the invoices so the return on inventory decreases and the corporate will have more earnings. Also it is recommended to the future researchers to study the correlation between the ethical values and the real earnings management activities and the correlation between the ethical values and the earnings management through accounting items.

REFERENCES


