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earnings management via manipulation of timing (recognition) of income, listed companies be obliged-considering the two digit inflation rate in Iran – to adjust their financial reports on the basis of International Standard Number 29. This is due to the fact that presently, the high inflation rate in Iran drastically reduce the usefulness of reports not adjusted for inflation.

2. It is suggested that because income smoothing behavior utilizing Iranian Accounting Standard Number 15 is observed in a number of listed companies, more disclosure regarding this by companies and more attention by auditors to vestiges of the mentiond standard should be provided. Furthermore, it is expected that Iranian Audit Organization, who is responsible for compiling accounting standards in Iran, should pay more attention to vestiges of Accounting Standard Number 15.

Discussion and conclusion

One interpretation for rejection of the second hypothesis in the main sample for all three tested years can be that income smoothing behavior utilizing the Examineat tool, is not used widely by managers. However, in interpreting the findings it should be noted that for all three tested years, many companies selected as a sample, did not have ganis resulting from sale of investments (or in other words had zero gains resulting from sale of investments). This lack of gains stemming from sale of investments can be interpreted in different ways. First, managers are not inclined to use the mentioned tool for income smoothing and, therefore are not after gaining non-operational gains in this way (and thereby income manipulation). But, it should be noted that since the main argument about income smoothing probability utilizing the freedom given by Iranian Accounting Standard Number 15 is that managers are able to maintain investments in trading securities at cost in books and at the appropriate time-when its gain is needed for income smoothing-sell them, it can also be interpreted, that the lack of gains resulting from sale of investments perhaps is not simply indicative of lack of inclination to use such tools for smoothing. Therefore, this probability also exists that companies tested have sold their investments in trading securities in a time span outside the tested span (1380 to 1382) and have in fact performed income smoothing. The factor which strengthens this possibility is re-testing of the second hypothesis among companies that had non-zero gains resulting from sale of investments. In these companies it is clearly observed that in all three years which the test was performed, ganis resulting from sale of investments constitute the major portion of reported income by companies.

The case of such a tool not being utilized by managers does not seem natural since, in companies that have gained from selling of their investments, in all three years tested, resulting gains are so large that they constitute the main portion of reported incomes. As a result it seems that for gaining more conclusive results, additional research should be done in this area.

Suggestions

1. It is suggested that for purpose of strengthening information transparency in capital market and reducing the probability of

Table 19. Testing of the second Hypothesis (1382) utilizing a smaller sample – other statistics

Year 1382	
Mann-Whitney u	28
Wilcoxon w	119.000
Z	-2.897
Significance level	0.004
Exact Sig[2*(2 tailed Sig.)]	0.003

Considering that the significance level is less than 5% at the confidence level of 95%, the equality assumption of the two income groups is rejected. Furthermore, by comparing the total ranks of the two groups, it can be concluded that total rank of the rest of income is less than the total ranks of gains by sale of investments. Therefore, also in the year 1382, in companies which had non-zero gains from selling of investments, the major part of reported income had been from gains resulting from selling of investments.

Summary of the Tests of Hypotheses

The first hypothesis was confirmed for all three years which the test was performed (1380, 1381, 1382). This means that there is a significant difference between earning per share and operating income per share.

Although the second hypothesis was rejected for all the three years which the test was performed, meaning in neither of these three years (1380, 1381, 1382) the major part of company incomes did not stem from gains resulting from sale of investments, but since in many selected companies in the sample, gains resulting from sale of investments was zero[1] and others had reported considerable numbers under this category, for the purpose of increasing the analytic and interpretative capability of data, tests were repeated again and this time for companies that had non-zero gains from sale of their investments. This time results in all three years tested (1380, 1381, 1382) indicated that in these companies gains resulting from sale of investments, constitute a major portion of reported incomes.

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[1]. This can be due to not having investments, zero gain and loss from its sale, or non-existence of sale in the period of study

Considering that the significance level is less than 5% at the confidence level of 95%, the equality assumption of the two income groups is rejected. Furthermore, by comparing the total ranks of the two groups, it can be concluded that total rank of the rest of income is less than the total rank of gains by sale of investments. Therefore, in the year 1381, in companies that gains from selling of investments has been non-zero, the major part of reported income has been from Gains stemming from selling of investments.

Testing of the second Hypothesis for the year 1382

Table 16. Testing of the second Hypothesis (1382)

	Groupings	Number	Ranking Mean	Total Ranking
Company Incomes in 1382	Gains from selling of investments	70	57.13	4065.00
	The rest of Income	70	85.07	5955.00

Table 17. Testing of the second Hypothesis (1382) – other statistics

Year 1382	
Mann-Whitney u	760.000
Witcoxon w	2530.000
Z	-5.476
Significance level	0.000

Considering that the significance level is less than 5% at the confidence level of 95%, the equality assumption of the two income groups is rejected. Furthermore, by comparing the total rankings of the two groups, it can be concluded that total rank of the rest of income is more than the total rank of gains by sale of investments. Therefore, in the year 1382 the major part of reported incomes by companies is not due to gains from selling of investments.

Test results for companies that in 1382 had non-zero gains from selling of investments is as follows:

Table 18. Testing of the second Hypothesis (1382) utilizing a smaller sample

	Groupings	Number	Ranking Mean	Total Ranking
Company Incomes in 1382	Gains from selling of investments	13	17.85	232.00
	The rest of Income	13	9.15	119.00

Testing of the second Hypothesis for the year 1381

Table 12. Testing of the second Hypothesis (1381)

	Groupings	Number	Ranking Mean	Total Ranking
Company Income in 1381	Gains from selling of investments	73	66.99	4890.00
	the rest of Income	73	80.01	5841.00

Table 13. Testing of the second Hypothesis (1381) – other statistics

Year 1381	
Mann-Whitney u	2189.00
Witcoxon w	4890.00
Z	-1.929
Significance level	0.054

Considering that the significance level is less than 5%, at the confidence level of 95%, the equality assumption of the two income groups is rejected. Therefore, in the year 1381, the major part of reported incomes by companies is not due to gains from selling of investments. Test results for companies that in 1381 had non-zero gains from selling of investments are as follows:

Table 14. Testing of the second Hypothesis (1381) utilizing a smaller sample

	Groupings	Number	Ranking Mean	Total Ranking
Company Incomes in 1381	Gains from selling of investments	12	18.92	246.00
	The rest of Income	12	6.58	79.00

Table 15. Testing of the second Hypothesis (1381) utilizing a smaller sample – other statistics

Year 1381	
Mann-Whitney u	1.000
Witcoxon w	79.000
Z	-4.188
Significance level	0.000
Exact Sig[2*(1 tailed Sig.)]	0.000

groups it can be concluded that total rank of the rest of income is more than the total rank of gains by sale of investments. Therefore in the year 1380 the major part of reported incomes by companies is not due to gains from selling of investments.

For the purpose of providing the possibility of more analysis, the test was repeated for companies that in the year 1380, their gains stemming from selling of their investments was non-zero. Results are as follows:

Table 10. Testing of the second Hypothesis (1380) utilizing a smaller sample

	Groupings	Number	Ranking Mean	Total Ranking
Company Incomes in 1380	Gains from sale of investments	11	16.91	168.00
	the rest of Income	11	6.09	67.00

Table 11. Testing of the second Hypothesis (1380) utilizing a smaller sample – other statistics

Year 1380	
Mann – Whitney u	1.000
Wilcoxon w	67.000
Z	-3.907
Significance level	0.000
Exact sig [2*(1-taliled sig)]	0.000

Considering that the significance level is less than 5%, at the confidence level of 95% the equality assumption of the two income groups is rejected. Furthermore, by comparing the total ranks of two groups it can be concluded that the total rank of the rest of income is less than the total rank from gains by sale of investments. Therefore in the year 1380, in companies that gains from selling of investments has been non – zero, the major part of reported income has been from the gains stemming from selling of investments.

Table 7. Kolmogrov – Smirnov test for examining the normality of distribution of data regarding the second hypothesis

	Gains from sale of investments 1380	The rest of income 1380	Gains from sale of investments 1381	The rest of income 1381	Gains from sale of investments 1382	The rest of income 1382
N	73	73	73	73	70	70
Mean	1388042214.2740	1331628583.4521	1611620526.8220	6065222391.2395	76126692.0143	33563704.0000
Standdard Deviation	6321740934.894	70622353933.55329	735282984.90433	30753708834.10479	18590770.30121	93489697.70538
Absolute Differences	0.470	0.478	0.456	0.440	0.294	0.268
Positive	0.470	0.389	0.456	0.440	0.294	0.221
Negative	-0.413	-0.478	-0.413	-0.422	-0.293	-0.268
Kolmogorov smirnov Z	4.017	4.082	3.892	3.892	3.711	2.456
Significance level	0.000	0.000	0.000	0.000	0.000	0.000

Considering that the significance level of all the above tests is less that 5%, in the confidence level of 95% the normality assumption of data distribution is rejected and parametric procedures cannot be utilized. Therefore, this hypothesis is tested by the use of non – parametric two sample Mann – Whitney U test.

Testing of the second hypothesis for the year 1380

Table 8. Testing of the second hypothesis (1380)

	Groupings	Number	Ranking Mean	Total Ranking
Company Income in 1380	Gains from sale of investments	73	63.32	4622.00
	The rest of income	73	83.68	6109.00

Table 9. Testing of the second hypothesis (1380) – other statistics

Year 1380	
Mann – Whitney u	1921.000
Wilcoxon w	4622.000
Z	-3.028
Significance level	0.002

Considering that the significance level is less than 5%, at the confidence level of 95% the equality assumption of the two income groups is rejected. Furthermore, by comparing the total ranks of two

Testing of first hypothesis for the year 1382

Table 5. Sample characteristics (1382)

	Mean	N	Standard Deviation
OPS82	1193.4262	77	1192.46975
EPS82	935.2223	77	1111.80052

Table 6. Results of t – test between sample pairs (1382)

	Paired Differences				T	Degree of Freedom	Significance Level
	Mean	Standard Deviation	Standard Error of Mean	95% Confidence Interval for Differences			
OPS81-EPS 82	-258.20398	411.24099	46.86526	164.86327 351.54423	5.509	76	0.000

Considering that the significance level is less than 5% with confidence level of 95% the equlity assumption of the two groups (OPS 82 and EPS82) is rejected, therefore a significant difference exists between EPS and OPS for the year 1382.

Considering the 95% confidence interval of paired differences, both of which are positive, level of OPS is more than EPS82(Mean of OPS 82 is 1193 which is more than EPS82 with a mean of 935).

As was observed, the first hypothesis in all three years tested is proved at 95% confidence interval, and a significant difference between EPS and OPS (in each of the three years) is verified.

Testing of the Second Hypothesis

The second hypothesis states "A major part of reported income of companies stems from gains resulting from sale of investments". Since probability of data distribution not being normal existed for this hypothesis, data relating to the distribution of gains from sale of investments and the rest of income[1] were investigated for three years (1380, 1381, and 1382) by utilizing Kolmogorov – Smirnov test. Results are as follows:

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[1]. For statistical testing of this hypothesis income of companies were divided into two hypothesized areas: 1) Gains from sale of investments and 2) The rest of income; The algebraic addition of these two, equals reported income of companies.

Table 2. Results of t – test between sample pairs (1380)

	Paired Differences					T	Degree of Freedom	Significance Level
	Mean	Standard Deviation	Standard Error of Mean	95% Confidence Interval for Differences				
OPS80-EPS 80	344.50587	634.78323	69.26053	206.74947	482.26228	4.974	83	0.000

Considering that the significance level is less than 5%, with a confidence level of 95%, the equality assumption of the two groups (OPS80 and EPS80) is rejected, therefore a significant difference exists between EPS and OPS for the year 1380. Considering the 95% confidence interval of paired differences, both of which are positive, level of OPS80 is more than EPS 80 (Mean of OPS 80 is 1598 which is more than EPS 80 with a mean of 1253).

Testing of first hypothesis for the year 1381

Table 3. Sample characteristies (1381)

	Mean	N	Standard Deviation
OPS81	1228.9824	82	1291.06747
EPS81	981.3989	82	1254.23223

Table 4. Results of t-test between sample pairs (1381)

	Paired Differences					T	Degree of Freedom	Significance Level
	Mean	Standard Deviation	Standard Error of Mean	95% Confidence Interval for Differences				
OPS81-EPS 81	247.58355	439.70887	48.55772	15096.892	344.19819	5.099	81	0.000

Considering that the significance level is less than 5%, with a confidence level of 95% the equality assumption of the two groups (OPS81 and EPS81) is rejected, therefore a significant difference exists between EPS and OPS for the year 1381.

Considering the 95% confidence interval of paired differences, both of which are positive, level of OPS81 is more than EPS 81 (Mean of OPS 81 is 1598 which is more than EPS 80 with a mean of 981).

Research Methodology

This research is a descriptive and applied research. The instruments used in this research was referral to notes and documents. The notes and documents used were mainly the financial statements of companies. Time domain of the research was 1380 to 1382[1] (3 years) and its place domain was Tehran Stock Exchange. Statistical population in this research was listed companies in Tehran Stock Exchange during the years 1380 to 1382. Statistical sample, which was selected by the method of simple random sampling encompassed 85 companies from a poputation of 288.

Data Analysis Method

Compiled data was tested by utilizing the SPSS package. Regarding the first hypothesis since EPS and OPS are not independent of each other, t – test relating to paired samples was used which is a parametric test. Regarding the second hypothesis, since Kolmogorov Smirnov test indicated that the data are not normally distributed, non – paramentric Mann – Whitney test was utilized in testing of the hypothesis.

Testing of the First Hypothesis

The first hypothesis "A significant difference exists between EPS and OPS can be stated in the following form:

$$H_\circ : \mu_{OPS} - \mu_{EPS} = \circ$$

$$H_1 : \mu_{OPS} - \mu_{EPS} \neq \circ$$

Testing of first hypothesis for the year 1380

Table 1. Sample characteristics (1380)

	Mean	N	Standard Deviation
OPS80	1597.6986	84	1978.62578
EPS80	1253.1927	84	1748.37845

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1. Selecting of this time domain was mainly because of the effective date of the Iranian Standards (1/1/1380).

was disclosing more information regarding procedures used by companies in footnotes accompanying financial statements [10]

Kanagaretnam et.al. (2001) in their research by relying on strong evidences assert that those managers who face problems relating to job security, use loan loss reserves for income smoothing [15].

Zarowin (2002) rendered empirical evidences confirming that income smoothing is correlated to share prices containing more informational content [28]. Arya et. al. (2003) suggested that instead of trying to eliminate earnings management which is something unattainable – it is more useful to emphasize on a set of accounting features which increase the value of accrual items.

Tucker and Zarowin (2005) showed that empirical evidences imply that one important effect of the managers use of their authority and discretions in financial reporting is revealing more information regarding earnings and future cash flows of the company [24].

Kusuma (2005) confirmed the existence of income smoothing in Japanese Companies and introduced it as a factor regarding the explanation of part of the difference in "earnings to price ratio" between American and Japanese companies [16].

Income smoothing Research in Iran

Existing accounting literature in Iran about income smoothing is very scant and most of the performed research about this topic is done within the framework of management research [21]. The main research performed in the area of income smoothing in Iran was a research by Ahmad Badri (1378) [4]. His research indicated that income smoothing behavior in listed companies in the TSE exists. Results of this research also indicated that profitability ratio is an effective factor for smoothing and that companies with low profitability are more inclined to perform income smoothing.

Research Hypotheses

1. There is a significant difference between EPS (earnings per share) and operating income per share (OPS).

2. A major part of reported profits of companies stems from gains resulting from sale of investments.

income smoothing can be useful for current shareholders and future investors [25]. Fern and Brown conclude that higher limitation of standards has resulted in smoothing becoming more difficult [11]. Ashari et. al. (1994) in one of the few performed research by that date- about income smoothing in developing countries- investigated income smoothing of Singaporian and Malaysian listed companies in the Singapore Stock Market which led to confirmation of existence of smoothing in these companies [2].

Michelson et. al. (1995) in investigation of the relationship between income smoothing and return on common stock found that annual return of smoother companies was significantly lower than non-smoothing companies. Their interpretation was that income smoothing had reduced the actual or presumed risk of the company and eventually resulted in lower return for investors of such companies [19].

Hermann and Inoue in their research on Japanese companies found that income smoothing by Japanese managers is significantly different on the basis of operational conditions [13]. Bitner and Dolan (1996) Showed that the market attaches value to income smoothing in addition to growth. Furthermore, they pointed out that market is sensitive to the way of income smoothing [7].

In 1997 Carlson and Bathala concluded that issues like dimensions relating to ownership differences, motivational structures of managers, and company profitability are important in explaining income smoothing behavior. Their research indicated that the lower the percentage of ownership by managers, the higher the probability of smoothing by the firm [8].

Healy and Wahlen (1999) concluded that literature relating to earnings management, do not lead to drawing up very useful guidelines by the users of the standards. They added that some research should be performed to answer questions like "Which accounting standards are used in earnings management?" and "Which factors can limit earnings management?" [12].

From the viewpoint of Dechow and Skinner (2000) "clearly" the solution of complete elimination of earnings mangement is not an optimal solution. They believe some earnings management behaviors are expected in capital market and therefore they should exist because in utilizing accounting, the accrual basis for using judgement and performing estimation is necessary. One of their suggested solutions

From one perspective, related elements of income smoothing can be categorized as goals and motives, tools, and influencing factors. This research addresses one of the probable existing tools for income smoothing in Iran, i.e. Iranian Accounting Standard Number 15. In this standard, with permitting the use of "market" or "lower of cost or net sales price" [3] for investing in trade securities, actually this opportunity has been given to company managers to show current investments at cost and by their sale at a discretionary time (with fulfilling non-operational gains stemming from maintenance) and perform income smoothing (or manipulation). In such case, it is possible that decisions based on unreal or manipulated information is made by users which can result in inappropriate allocation of resources and possible abuses.

Literature Review

In one of the first researches confirming the existence of income smoothing, Dasher and Malcolm (1970) concluded that conscious behaviors regarding income smoothing occurs by managers [9]. Regarding confirmation of income smoothing, White (1970) concludes that the existing evidences show that in companies that face with performance patterns with high fluctuations or with decreasing trend of earnings, it can be expected that discretionary accounting decisions of managers are toward systematic normalization of earnings [27]. Beidleman in (1975) says that empirical evidences show the existence of income smoothing [5].

Belkaoui and Picur (1984) in a research regarding the difference between two economic sectors (main sector and peripherial sector) using the smoothing phenomena, concluded that there exists significant difference between these sectors and that in the peripherial companies existing in the sector, more smooting is observed [6]. Lambert found that accounting accruals possess income smoothing effects [17].

Ma (1988) concluded that strong evidences indicate the use of loan loss reserves by the American commercial banks and also write-offs of lossed loans regarding income smoothing are reported [18]. Trueman and Titman (1988) mention that manager of a company can have a positive impact by smoothing on market value of the company [23]. Wang and Williams (1994) about the issue of the relationship of income smoothing and wealth of shareholders present the finding that

Introduction

In accrual accounting perhaps no issue is more controversial than the income and its measurement. Obviously the most important reason for this, is the impact that income has on economic decisions and consequently on allocation of resources. Considering this, it may be stated that profit possesses economical consequences.

Some believe that if we accept market efficiency, income and income reporting will not entail informational content and consequently does not impact on users decisions. But such claim is not acceptable due to two reasons. First, some research indicate that income and income reporting encompass informational content (and has an impact on individual's decisions and therefore share price). Second, the hypothesis of market efficiency, at least in Iran, cannot simply be accepted because in comparison to other capital markets, Iranian capital market, is less developed and from the perspective of informational efficiency (according to some scholars like Namazi and Shooshtarian) is inefficient.

In this way if income entails informational content and affects individual decision making and effective share price, it can be concluded that in its manipulation such traces would exist. Within such framework income smoothing can be noticed.

Description of the problem

According to a definition, income smoothing refers to a conscious behavior which occurs for the purpose of decreasing fluctuations of income cycles. About this subject, some scholars including Watts and Zimmerman [1978] reason that some evidences indicate that accounting incomes are good predictive elements for future cash flows and since on the basis of CAPM theory, the value is equivalent with discounted fature cash flows, then smoothed income (or income smoothing) can influence value [26].

Furthermore, since many empirical research show that managers of entities in various degrees (but continuously) are involved in income smoothing [16], [24], [1], [15], [7], [19], [25], [22], [4], and also considering that some research have evaluated TSE as inefficient, the importance of research regarding income smoothing in Tehran Stock Exchange becomes evident.

An Investigation of Income Smoothing in Tehran Stock Exchange Utilizing Accounting Standard Number 15 (Accounting for Investments)

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Kamran Tajik*****

Abstract

Under conditions that two-digit inflation rate in Iran creates ambiguity regarding the utility of financial reports that are not adjusted for inflation, income manipulation and smoothing can add more questions about the usefulness of such reports. In this research, income smoothing in listed companies in Tehran Stock Exchange utilizing Iranian Accounting Standard Number 15 (accounting for investments) was investigated. This standard which authorizes use of "market" or "lower of cost or net sales price" for investing in trading securities logically seems like a tool for income smoothing and income manipulation.

Performed statistical tests on listed companies in Tehran Stock Exchange for the years 1380 to 1382 indicates that although these tools have not been used extensively, but income smoothing is observed in companies that had non-zero gains resulting from sale of their investments.

Key words: Income Smoothing, Income Manipulation, Gains (Losses), Lower of Cost or Net Sales Price

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