

The Impact of CEO Power on the Accrual-Based Earnings and Actual Earnings Management¹

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INTRODUCTION

Several factors impact the management of earnings, and the power of the CEO is one of the mentioned factors. The interest in the CEO power and earnings management can function as a proper guide for investors and its neglect can result in the adoption of wrong long-term investment decisions by investors; thus, due to the importance of the investment and the stock market in the national economy, the impact of the CEO's power on the management of accrual-based earnings and actual earnings management is studied through manipulation of actual activities. Such characteristics, about their effect/s on the transparency of the financial reporting environment, reduction of the information asymmetry, and the quality of the disclosure done by the firm, create changes in the management of earnings. It has been shown by some research that the CEO's power, together with the improvement of the information environment and reduction of agency costs, can effectively prevent such inappropriate managerial decisions. These findings show that the creation of the CEO's power effectively helps the reduction of opportunistic managerial behaviors, thereby, the CEO's power can be associated with the decrease in management of the firm's earnings. As mentioned earlier, investors consider the accounting income as an important information source and adopt decisions based on this item. Therefore, the management of earnings has long been regarded as a significant factor. So far, some research has been conducted on the relationship among different financial, accounting, managerial, and control variables with diverse types of earnings management; however, the impact of the CEO's power, as a single variable, on accrual-based earnings management and actual earnings management, especially in the companies admitted to the Tehran Stock Exchange that makes the statistical society of the present study, has been neglected. This research is innovative as it argues that despite what past research maintains, the CEOs' power doesn't originate from their official power (structural power) or their power. Besides the CEO's structural power, the present study employs ownership power, specialty power, and prestige power to measure the CEO's power. Moreover, the CEO's tenure is also considered a personal criterion for her power.

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Accordingly, this work measures the CEO's power using multi-dimensional resources. And regarding the significance of investment and the stock market in the national economy, the impact of the CEO's power on the criteria for manipulation of actual activities (actual earnings management) and management of accrual-based earnings is explored.

MATERIALS AND METHODS

Three criteria are utilized by this research in measuring the amount of actual earning management, they include unusual discretionary expense, unusual production expense, and unusual operational cash flows. Thereby, the data of 108 firms, concerning their activities between 2010 to 2019, were analyzed. The research regression model was examined and tested using the combined data method, together with the integrated approach, panel data, and an immutable impacts approach.

RESULTS AND DISCUSSION

The obtained results suggest that the power of the CEO has a negative and significant impact on the management of accrual-based earnings. Furthermore, the results show that CEO's power has a negative and significant effect on the actual earning management (unusual discretionary expense, unusual production expense, and unusual operational cash flows).

CONCLUSION

The research results demonstrate that the power of the CEO lowers the accrual-based earnings management and actual earnings management; it means that powerful managers make appropriate and higher-quality judgments; and with a better understanding of the accounting system and existing laws, they usually direct decisions concerning accounting income, financial risk reduction, aims and plans of the firm towards long-term investment and productive activities (such as management of cash flows and using them in the production sector, etc.). As a result, bigger powers of managers can lead to more efficient management of the firm's operations. Also, powerful managers enjoy higher degrees of independence and play a bigger observatory part towards the board of directors; it prevents the violation of the rights of stakeholders, lowers agency costs; and, accordingly, the lower agency costs reduce the information asymmetry, enhance the transparency of financial information, and lowers the management of earning. In addition, a strong CEO also experiences a more transparent information environment, an issue that results in the conduction of some activities for the disclosure of more information; and the resulting information asymmetry will increase the price of the firm's share upon its establishment, an outcome that reduces the management of earning.

Keywords: Accrual-Based Earnings Management, CEO Power, Real Earnings Management.

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