

Detecting income-smoothing behaviors of Turkish listed companies through empirical tests using discretionary accounting changes

Asuman Atik*

Marmara University, Faculty of Economics and Administrative Sciences, Department of Business Administration, Goztepe Campus, Goztepe/Istanbul, Turkey

Received 13 August 2006; received in revised form 12 August 2007; accepted 2 January 2008

Abstract

Flexibility when selecting accounting methods sometimes motivates managers to choose accounting methods or to change employed ones in order to increase, decrease or smooth income figures. In this study, income-smoothing behaviors of Turkish listed companies are detected through empirical tests using discretionary accounting changes (DACs). Parallel to the study conducted by Moses [Moses OD. Income smoothing and incentives: empirical tests using accounting changes. *The Accounting Review* 1987;11(2):358–77], income smoothing is accepted as one motivation of DACs and the sample firms are classified as smoothers and non-smoothers by using Moses' smoothing behavior index. Results show that possible motivations of DACs are income smoothing, economical characteristics of the periods in which the DACs are made, and the desire of Turkish firms to have net incomes close to zero. © 2008 Elsevier Ltd. All rights reserved.

Keywords: Income smoothing; Moses model; Discretionary accounting changes; Istanbul Stock Exchange

1. Introduction

Hepworth (1953, p. 32) says that “50 years ago principal attention of investors, financial analysts, employees, and the general public was on the balance sheet, however at the present time the focus is on the statement setting forth the periodic net income or earnings of businesses.” He talks about the first half of the 20th century. At the second half, besides

* Tel.: +90 216 336 52 73x122; fax: +90 216 345 86 29.

E-mail addresses: aatik@marmara.edu.tr, asuatik@yahoo.com.

balance sheet and income statement, some other statements such as cash flow statement and statement of changes in equity have also gained importance.

Together with the other statements, income statement continues to be a very important tool generating information about firms and showing the success of their operations. However, as pointed out [Kieso and Weygandt \(1997, p. 139\)](#), income statement has one important limitation. Income amount is often affected by the accounting methods employed. For example, one company may choose to depreciate its plant assets on an accelerated basis, another may choose a straight-line basis. Assuming all other factors are equal, the income of the first company will be lower than that of the second even though the companies are essentially the same.

Accounting managers should choose the method that will help to present faithful, timely and useful information about the real performance, risks and opportunities of their firms. In some situations, opportunity to alter income amount with the accounting method used may motivate managers to employ accounting methods or to change the employed ones in order to increase, decrease or smooth income figures. For example, a firm may want to decrease its income in order to decrease its tax liability, or another one that plans to make an initial public offering may try to increase its income in order to increase its share price. A manager who gains a bonus as a percentage of net income may give accounting and even operational decisions, such as postponing advertising campaign to the next period or decreasing R&D budget to increase the income.

On the long term, accounting manipulations that provide a smooth income over the years are the most preferable ones for a manager and the general public because a smooth income stream is an indicator of a strong and stable company. A firm with smooth income is deemed less risky and it has better relations with investors, creditors, suppliers, and workers.

The multiple incentives of income smoothing might also have motivated Turkish firms to manipulate their financial statements to have smoother incomes. Additionally, Turkish companies have been operating in a very risky economical environment. This high risk affects the operations and profitability of the firms and causes fluctuations in their income figures. Therefore the probability of attaining expected earnings levels and having naturally smooth income streams are very low.

Although much research has been conducted to detect smoothing behavior of the firms of several countries, there has been no previous research in Turkey. After recognizing the lack of research in this area and the suitable conditions in Turkey for income smoothing, “detecting income-smoothing practices of Turkish listed companies” was determined as the main objective of this study.

Before deciding on the research methodology, an extensive literature survey is conducted and summarised in the next section. The research methodology is explained in Section 3, and the findings of the study are presented in Section 4. The last section covers the conclusion and the limitations of the study.

2. Literature review

Financial reporting is communicating and sharing the financial information of a firm with users of that information. The most important products of a financial reporting system are

Download English Version:

<https://daneshyari.com/en/article/1000335>

Download Persian Version:

<https://daneshyari.com/article/1000335>

[Daneshyari.com](https://daneshyari.com)