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ANALYZING THE RELATIONSHIP BETWEEN ACCOUNTING CONSERVATISM AND PROFIT MANAGEMENT AND ITS IMPACT ON PROMOTING SUSTAINABLE DEVELOPMENT: AN APPLIED STUDY FOR A SAMPLE OF IRAQI COMMERCIAL BANKS LISTED IN THE IRAQ STOCK EXCHANGE

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ABSTRACT

This study aims to test the extent to which Iraqi banks practice accounting conservatism, and measure their profit management practices, in addition to testing the relationship between accounting conservatism and profit management, by applying to a sample of 15 banks that constitute about 80% of the total Iraqi private banks listed in the Iraq Stock Exchange. For the years 2014 and 2015. The model (Miller) was relied on to measure profit management practices, and the book value to market value model was used to measure the accounting conservatism.

A set of statistical methods were used to analyze the data and reach the results, such as the Pearson correlation coefficient test, the coefficient of variance analysis, the arithmetic mean, and the standard deviation, using the SPSS statistical program.

The results showed that all banks in the study sample had used accounting conservatism in varying proportions, as well as that they had practiced profit management, except for the Bank (Baghdad). And that there is an inverse relationship between the use of accounting conservatism and the practice of profit management, as accounting conservatism contributes to limiting profit management, which contributes to increasing investor confidence and encouraging them to invest and thus promoting sustainable development.

The study recommends the necessity of educating users of financial reports in general, and lenders and investors in particular, of the dangers and effects of the practice of profit management in their economic decisions, and its role in the spread of manipulation and opportunistic practices, through the establishment of media programs, courses and educational seminars. And the necessity for the external auditors to adopt one of the indicators for measuring the accounting conservatism in the statements they audit, and the necessity to include in their audit reports a paragraph that includes measuring the level of accounting conservatism in the financial statements of the banks they have audited.

INTRODUCTION

Financial reports are the effective means in achieving the communication function in accounting, and it meets the needs of its users of accounting information that accurately depicts the economic events that occurred in the company during the period of activity.

Using their expertise to beautify the financial statements, and as a result of these practices, many major financial crises and scandals appeared in international companies that shook the

reliability and fairness of the published financial statements and the credibility of their preparers and auditors, such as what happened in companies (Enron, Parmaslsr, World Com, Tel and Harris), and this led to a decrease in the wealth of investors and a decrease in investment, which has a negative impact on sustainable development.

Accounting conservatism or what accountants used to call (cautiousness) is one of the accounting determinants that affect the measurement and evaluation of

items included in the financial statements. In which the accountant faces the problem of choosing between a set of alternatives, he chooses the alternative that agrees with the accounting conservatism, which is one of the basic concepts on which the accounting theory has been based for a long time as a basic constraint on the application of accounting principles when preparing the financial statements in the light of the uncertainty faced by the accountant. (Mayank Yuvaraj, 2015, p.1)

THE FIRST TOPIC: THE SCIENTIFIC METHODOLOGY:

First : Study problem :

The study problem can be summarized in the following questions:

- 1.How common is the use of accounting conservatism in the Iraqi banks, the study sample listed in the Iraq Stock Exchange?
- 2.What is the level of accounting conservatism in the Iraqi banks, the sample of the study listed in the Iraq Stock Exchange?
- 3.What is the extent of profit management practices in the Iraqi banks, the sample of the study listed in the Iraq Stock Exchange?
- 4.What is the extent of a relationship between accounting conservatism and the practice of profit management in the Iraqi banks, the

study sample listed in the Iraq Stock Exchange?

Second: Objectives of the study: The study seeks to achieve a set of objectives:

- Measurement of profit management in sample banks.
- A statement of the extent to which the accounting conservatism is exercised in the sample banks.
- A statement of the intellectual and applied relationship between accounting conservatism and profit management

Third :The importance of study:

The issue of accounting conservatism and profit management is one of the research areas that accountants have been interested in in the recent period, and the importance of this study stems from the seriousness of manipulation practices in the financial statements and the complicity of auditors with corporate management, as the study contributes to providing clear visions and useful information for those interested. On the topics of accounting conservatism and profit management, the increasing interest in the issue of profit management in the accounting literature was due to what the profit management lacks from the scientific and practical basis in addressing it and laying the foundations and concepts

for it, as the profit management process surrounds some gaps and shortcomings in understanding and erroneous conclusions, so there emerged a lack of confidence in the executive directors of organizations and members of the board of directors, where The relationship between accounting conservatism and profit management has become one of the main issues of contemporary accounting research.

Fourth: The hypotheses of the study:

The study consists of the following hypotheses:

The first hypothesis: the common use of accounting conservatism in the Iraqi private banks listed in the Iraqi Stock Exchange.

The second hypothesis: that there is a rise in the level of accounting conservatism in the Iraqi banks, the sample of the study listed in the Iraq Stock Exchange.

The third hypothesis: the existence of profit management practices in the Iraqi private banks listed in the Iraqi Stock Exchange.

Fourth hypothesis: There is a statistically significant relationship between the degree of accounting conservatism in financial reports and the degree of profit management practice.

Fifth: Study Methodology

The researcher used the deductive approach with regard to the theoretical aspect of the study using the specialized accounting literature, while the inductive approach was used in surveying the data of the practical side of the study sample banks and then arriving at the overall results that can be generalized.

THE SECOND TOPIC: THE RELATIONSHIP BETWEEN ACCOUNTING CONSERVATISM AND PROFIT MANAGEMENT:

The relationship between accounting conservatism and profit management is one of the important matters in the accounting literature because accounting conservatism is concerned with the decrease in the book value of net assets below their market value, and this is due to the asymmetric treatment of losses and gains for the same period or the cumulative financial impact of accounting choices from the beginning of the operation of the company (Kabir & Laswad 2014:268). While profit management arises in two ways, the first is profit management with real activities through which managers can manage their profits by manipulating decisions related to operational, financing or investment activities in terms of the strategic timing of selling part of the assets at a time that meets their expectations or by increasing

production For the purpose of reducing the cost per unit (Mulford, and Comiskey, 2002: 39). The second is the management of earnings by receivables in which managers use the discretionary power in the accrual accounts through their choice of accounting policies and methods for the purpose of changing the accounting values in the financial statements for the purpose of showing an incorrect image for stakeholders of the real economic reality of the company (Guay & Vreccchia, 2006: 158). Also, profit management does not only affect the actual performance of companies during the period, but may affect the general trend of revenues and growth rates that help in building the company's future expectations (McNichols and Stubben, 2008: 1586). This may lead not only to misleading the stakeholders outside the company, but may lead to misleading the company's management when making its decisions (Marai & Pavlovic, 2013: 217). As the deliberate reduction in the company's net assets in the statement of financial position may enable the management to manipulate and inflate profits through the subsequent repercussions of these estimates in the future income statement, on the other hand, the exaggeration in the values of the provision for doubtful debts works to create the so-called secret reserve in the statement the financial position during

successive financial periods, allowing the company's managers to manage its profits through opportunistic exploitation of these values and liberating reserves at a time that suits their desires. (Jakson & Liu, 2010: 586). Therefore, the accounting literature indicates that the accounting conservatism is in the opposite position to profit management (Kothari and Skinner, 2010: 261). It works to reduce managers' motives in inflating earnings estimates (Gormley and Martin, 2012: 167). Because of their fear of losing the competitive advantages achieved by the accounting reservation when concluding contracts with suppliers and lenders at the lowest possible cost and maintaining their job positions (Jayaraman and Shivakumar, 2013: 98). And punishment. (Alsakini&Alawawdeh,2015:108)

First: measuring the study variables:

1: The first variable (accounting conservatism):

The measure of the book value entrance to the market value was adopted, and this approach is known as the net assets measure, as the ratio of book value to market value is used to examine the value of the company's stock by comparing the book value with the market value until the decrease in the ratio of book value to market value is less than the correct one for a period of time Refers to the bank's use of a conservative accounting

policy towards recognizing profits and higher asset values against their market value in the sense that the company is undervalued than it should be, which is the essence of the accounting conservatism that the accounting theory called for, while if the ratio of the book value to the market value rises higher than the correct one for a period of time, it indicates the company's use of conservative accounting policies towards recognizing profits and higher values of the bank's assets, meaning that the bank is overvalued, and the reservation can be measured according to the following equation:

Accounting conservatism = book value / market value (share market price).

Book value per share = (Capital + Retained Earnings) / Number of shares

This scale was used to measure the accounting conservatism in the local environment for the following reasons:

1. Availability of appropriate information for the application of this entry in the trading bulletins issued in the Iraq Stock Exchange.
2. The ease of applying this approach, which leads to the ease of making investment decisions by current and prospective investors.
3. It exceeds the difficulties and estimates available in the previous entries, due to the difficulty of obtaining negative stock returns, as

well as it is not possible to know the hidden reserves without resorting to the banks themselves, and the banks cannot give any information about the hidden reserves.

4. Gives, measures the overall cumulative effect of conservative policies.

2: The second variable (profit management):

The model (Miller2009) has been adopted, which includes a ratio of the relationship between the change in working capital (ΔWC) as an element subject to manipulation and cash flow from operating activities (CFO) as an element that is not subject to manipulation. This ratio was called Miller's ratio. This relationship will be characterized by stability, and this ratio can be used to discover profit manipulation, as its value is zero in the absence of manipulation, but if its value differs from zero, then this is an indication of manipulation in the profit number. According to the following model:-

$$EM = (\Delta WC / CFO)_t - (\Delta WC / CFO)_{t-1}$$

$$EM (\Delta WC / CFO)_t - (\Delta WC / CFO)_{t-1} = 0$$

$$EM (\Delta WC / CFO)_t - (\Delta WC / CFO)_{t-1} \neq 0$$

where it indicates:

EM: Profit Management.

ΔWC : to change in net working capital.

CFO: Refers to cash flow from operating activities.

t: current year.

t-1: the previous year.

Whenever the Miller ratio differs from zero (either negative or positive), this is an indication of manipulation in the number of profits prepared according to the accrual basis.

Working Capital $WC = \text{Current Assets} - \text{Current Liabilities}$.

Change in working capital $\Delta WC = \text{working capital for the current year} - \text{working capital for the previous year}$.

This model is used for the following justifications:

1. It is objective because it relies on actual data, and does not include making estimates of expected income or some other variables necessary for measurement, as it relies on actual data to avoid the possibility of error, and personal judgments that may accompany

making estimates, that is, it provides a clear measure of profit management.

2. Accounting practitioners and regulators can easily verify and discover the use of banks in their practice of profit management.

3. It is considered the latest among the profit management models, in addition to that it is distinguished by giving an annual indicator and for its ease of application, i.e. it provides at the level of a company / year.

Second: the hypothesis test results:

After completing the measurement of the study variables, the results of which are shown in the two appendices of the study, we provide herewith descriptive statistics, as shown in the table below:

Table No. (1) Descriptive statistics for the study variables.

Variables	N	Minimum	Maximum	Mean	Std. Deviation
Profit management	30	-3.656	13.636	.02317	2.927458
Accounting reservation	30	.172	1.325	.59805	.279668
Valid N (listwise)	30				

The most important thing that the table above shows is that the total values of the study variables amounted to 30 observations, which means that there are no outliers in the measurement results.

Before testing the hypotheses of the study, the researchers made sure that the data collected for the study sample banks follow a normal distribution - because this is one of the conditions for conducting correlation analysis, through the

Colmgrove -Smirnov test and using the SPSS statistical program, the results were as follows:-

Table No. (2) the normal distribution test for the study variables;

Normal distribution test			
		Accounting reservation	Profit management
N		30	30
Normal Parameters ^{a,b}	Mean	.59797	.02317
	Std. Deviation	.279612	2.927368
Most Extreme Differences	Absolute	.092	.254
	Positive	.092	.254
	Negative	-.067-	-.148-
Kolmogorov-Smirnov Z		.505	1.393
Asymp. Sig. (2-tailed)		.960	.061

It is noted from the above table that the data for both variables follow a normal distribution, as the signal level was greater than 0.05

1- Results of the first hypothesis test:

For the purpose of testing this hypothesis, T-Test analysis was used, and

the average value of the accounting reservation of the sample banks was adopted, which amounted to 0.598 as a test value for conducting the aforementioned analysis and using the SPSS statistical program, the results were as follows:-

Table No. (3) Results of the first hypothesis test:

One-Sample Statistics					
		N	Mean	Std. Deviation	Std. Error Mean
Accounting reservation		30	.59797	.279612	.051050
Test Value = 0.598					
T	df	Sig. (2-tailed)	Mean Difference	95% Confidence Interval of the Difference	
				Lower	Upper
11.713	29	.000	.597967	.49356	.70238

It is noted from the above table that the level of test significance reached 0.00, which is much less than the accepted level of error in social sciences, which was predetermined with a value of 0.05. This means that the calculated T value is greater than the tabular T value, so the study hypothesis is accepted.

2- The results of the second hypothesis test:

For the purpose of testing this hypothesis, the sample banks were divided in terms of high or low level of accounting

conservatism into two parts, depending on the average level of conservatism, into two proxy types:

- 1-Banks with a high level of accounting conservatism, numbering 17, and giving the number one.
- 2-Banks with a low level of accounting conservatism, numbering 13 ten and given the number zero.
- 3-Binomial statistical analysis was carried out using the SPSS statistical program, the results were as follows:-

Table No. (4) Results of the second hypothesis test:

	Category	N	Observed Prop.	Test Prop.	Asymp. Sig. (2-tailed)	
Low level of Profit High level of Profit	Group 1	0	13	.43	.50	.585 ^a
	Group 2	1	17	.57		
	Total		30	1.00		

It is noted from the above table that the level of significance of the SIG test was 0.585, which is much greater than the acceptable and predetermined error level in social sciences by 0.05, so the hypothesis of the study is rejected.

- 3- Results of the third hypothesis test:
For the purpose of testing this hypothesis, T-Test analysis was used, and the zero value was adopted as a test value for conducting the aforementioned analysis, since the mentioned number constitutes the boundary between the presence or absence of profit management according to the Miller Index and using the SPSS statistical program, the results were as follows:-

Table No. (5) Results of the third hypothesis test:

One-Sample Statistics					
	N	Mean	Std. Deviation		Std. Error Mean
profit management	30	.02317	2.927368		.534462
Test Value = 0					
T	df	Sig. (2-tailed)	Mean Difference	95% Confidence Interval of the Difference	
				Lower	Upper
3.699-	29	.001	-1.976832-	-3.06993-	-.88373-

It is noted from the above table that the level of test significance reached 0.01, which is much lower than the accepted error level in the social sciences, which is pre-determined with a value of 0.05. This means that the calculated T value is greater than the tabular T value, so the study hypothesis is accepted.

4- Results of the fourth hypothesis test:

For the purpose of testing the hypothesis of the study, Pearson correlation analysis was conducted to test the relationship between the study variables, and using the SPSS statistical program, the results were as follows:

		Accounting reservation	Profit management
Accounting reservation	Pearson Correlation	1	-.49-
	Sig. (2-tailed)		.007
	N	30	30
Profit management	Pearson Correlation	-.49-	1
	Sig. (2-tailed)	.007	
	N	30	30

It is noticed from the above table that the value of the correlation (relationship) between the two variables was - 49% and the negative sign indicates the inverse relationship between the two variables, and that the value of the test morale level amounted to 0.007, which is much less than the accepted level of error in the social sciences, which is predetermined

with a value of 0.05, so the hypothesis of the study is accepted .

STUDY CONCLUSION:

1- Conclusions

1-It was found through the results of measuring profit management practices according to the Miller 2009 model that all the banks of the

study sample included in the Iraqi financial market practiced the practice of profit management at different rates during the study period (2014-2015), but it varied between managing positive profits and managing negative profits. It also showed that there was no high level of accounting conservatism in the sample banks.

2-Measuring the level of accounting conservatism in financial reports and the factors affecting it is of importance to many parties related to banks, which depend on published financial reports in making their decisions among these government agencies supervising the work of banks and the application of accounting standards.

3-Through the application of the market value entrance model to the book value, it was found that all the banks of the study sample included in the Iraqi financial market practice accounting conservatism when measuring and disclosing the results of activity and financial position, except for the Bank of Baghdad, which practices unconservative policies during the study period.

4-The increasing interest of accountants in accounting conservatism as it is one of the

generally accepted accounting principles, as it helps all parties to have a broader understanding of the accounting numbers, and enhances the honesty and quality of the financial statements and helps protect their interests from fraud and manipulation of the financial statements and contributes to increasing the confidence of investors and pushing them towards hiring and investing money, which it contributes to increasing cash circulation and attracting more capital that contributes to activating the economic movement and promoting sustainable development.

5-The results of the study showed that there is a relationship between the level of accounting conservatism in the financial reports of a sample of private banks listed in the Iraqi Stock Exchange and the degree of their practice of profit management. In the Iraqi Stock Exchange, and accordingly, increasing the level of accounting conservatism leads to a decrease in the degree of profit management.

2- Recommendations:

1-The necessity for the management of the Iraq Stock Exchange to publish the financial reports of private banks whose shares are listed in the market

within the period specified in accordance with the legislation and instructions and not to delay in reporting them, in order to help external parties access appropriate and transparent information related to the bank's activity with all relevant parties interest in a timely manner.

2-The necessity for the external auditors to adopt one of the indicators for measuring the accounting conservatism in the statements they audit, and the necessity to include in their audit reports a paragraph that includes measuring the level of accounting conservatism in the financial statements of the banks they have audited.

3-Educating the users of financial reports in general, and lenders and investors in particular, of the dangers and effects of the practice of profit management in their economic decisions, and its role in the spread of corruption and opportunistic practices, through the establishment of media programs, educational courses and seminars.

4-Emphasis on educating users of financial statements in general, and investors and lenders in particular, of the effects and repercussions of the

proper practice of accounting conservatism on their economic decisions. And courses to illustrate the importance of a sound exercise of accounting conservatism.

5-Activating legal and judicial systems to protect the rights of investors and other parties from opportunistic practices followed by banks, by imposing physical and moral penalties on those banks.

6-It is necessary that the bodies regulating the work of the accounting profession in Iraq oblige them to follow conservative accounting practices while mentioning those practices in their financial reports, because this would help the parties concerned in rationalizing their economic decisions and improving the performance of banks.

7-It is necessary to carry out studies that include:

- A. Experimenting with other measures to measure accounting conservatism and profit management and compare results
- B. Using the same standards, but applying them to sectors other than the banking sector.

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