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Role of Audit in Detecting Practices of Profit Management and Reporting at Iraqi Stock Exchange

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Abstract— *In this study, the relationship between accruals profit management and the real profit management with independent audit quality is studied. Three independent variables of the study include Audit Tenure, The Auditor Industry Specialization, and Auditor Size while two dependent variables include Accruals Earnings Management as well as Real Profit Management. Statistical society of the study is selected from valid companies in the Iraqi stock exchange between 2010 and 2015. The study has six hypotheses processed in the form of two regressions. The models of the study are analyzed with E views statistical software version 8. The results of the study proved a meaningful relationship between audit tenure and accruals earnings management while the same meaningful relationship is seen between the auditor industry specialization, a meaningful relationship is seen between auditor size and accruals earnings management yet no meaningful relationship is seen between audit tenure and the real profit management and the same is true for the auditor industry specialization and the real profit management as well as auditor size and the real profit management. Practical suggestions are mentioned at the end of the article*.

Keywords— *The real profit management, accruals earnings management, audit tenure, the auditor industry specialization, auditor size, Iraqi stock exchange..*

I. INTRODUCTION

Previous studies in the field of profit management prove two main approaches for such a management. CEOs are able to manage benefits through accruals as well as actual activities manipulation (Hilly et al., 1999). Profit management literature mostly insist on profit management based on accruals. However, quantitative studies regarding actual profit management had been carried out. Actual profit management is accompanied by change in timing or the structure of actual activities. Therefore, the researchers of actual profit management look for detecting abnormal levels of entity's activities (Legni et al., 2009).

CEOs take advantage of two management methods based on accruals and real profit management to manipulate benefit. In the first approach, management is done through manipulating accruals to accounting numbers in accordance with its required goals. In this method, the CEO manages the profit through accelerating income recognition as well as delay in recognition of expenses to present a better performance in the current period. However, the CEO turns to the actual profit management through adopting some operational decisions, i.e. manipulating real activities, reaches the required benefit. Studies such as Hilly and Wellen (1999), (kordlar and ali,2010), (Ebrahimi, 2008) and (ardekkani, and Hussein, 2009) point to approaches such as sales through discount, changes in shipping table, reduction in discretionary spending, for instance expenses of research and development, as well as overproduction as management methods.

In spite of expenses related to manipulating actual activities, it is unlikely that managers confine themselves to manipulating accruals to manage benefits. The results of studies such as (Babajani & pvryansb, 2003) and (Bulow, 2006) reveal the great tendency of executive managers to manage profit through actual activities compared with manipulating accruals since profit management based on accruals is mostly paid attention to by auditors and executives while real profit management is often similar to usual decisions of business units, whose recognition is more difficult. Secondly, manipulating accruals poses a risk because it is likely that the amount of interest required for manipulation is higher than the available discretionary accruals. Hence, using discretionary accruals at the end of the year may lead to not meeting the related goals. Such remarks limit profit management based on accruals. However, manipulating actual activities comes with lesser exposure toward such limitations. Even though activities of profit management based on accruals comes with no direct effect on cash flow, actual profit management directly affects cash flows (pourheydar, 2004).

Problem Description

The reported benefits of companies are considered as a highlighted decision-making criterion as well as the most important criteria to evaluate performance and value of businesses used by a wide range of consumers, such as shareholders, investors, stockbrokers and so on. Since estimating profits of businesses is affected by methods of accounting estimation while the business president accepts preparing financial statements, the president may manage profit for different reasons. A large number of accounting researches believe that profit management is a form of manipulating financial statements requiring selection of accounting methods and/or reporting rules framed by a specific pattern, which leads to the reduction in deviation of reported benefits (Hall and Mohsen, 2015). The impact of stock prices, salary rise and benefits management and avoiding violation of loan agreements are among motives leading to profit management. A majority of such motives are related to future benefits, such as rewards, or preventing future losses, such as drop in stock prices (Hosseini and Venus, 2009).

On the other hand, other analytical models show that a rise in opportunistic profit management leads to a rise in the level of information asymmetry. For instance, (Hampa, 2009) analytically show that the asymmetry between management and shareholders is the main condition for management. (Rahmani et al., 2014) believe that auditing could be one of the ways to prevent and reduce profit management since it is widely believed that the companies which present audited financial statements own information content and profit of higher quality. Accruals depend of CEOs' judgments yet auditing the companies with more accruals is more difficult. (Raisi,2008) believe that higher quality auditing detects auditing performances with a higher chance since auditing institutions of high quality own more expertise, resources and motives to detect mistakes and cheats. In this regard, a single and skillful auditing institution is able to recognize misrepresentation of addressed financial statements items as well as affecting true presentation to the employer so that reliable financial data is reported. Reaching such a desirable objective is very dependent on the features of auditing institutions. However, (Sajadi et al., 2012) notes that the method and approach of profit management may influence the auditor into doubtful recognition and eventually not recognized as well. Therefore, the study surveys whether different methods of profit management (including manipulating voluntary accruals and actual profit management) have a meaningful relation with independent auditing of financial statements.

II. Literature Review and Hypotheses Development

A. Definition of Profit Management

(Saeedi et al., 2013) present a general definition for profit management. According to them, profit management (profit manipulation) happens when CEOs modify financial reports and structure of exchanges through judgment (recognition) to mislead some beneficiaries (including shareholders, creditors, staff, government, investors etc.) about economic performance of the company through influencing the results of the contract reported to accounting numbers. (Slmn and Eris, 2005) notes that profit management is usually caused by CEOs using the benefits of information asymmetry. He expressed, at least, two main problems: firstly, profit is manipulated to increase CEOs compensations provided by investors; secondly, actual investors tend to have the market derives a better understanding of value. Therefore, a potential wealth transfer from new investors to old ones, who are local demand creators', for profit management.

B. Differences between Accruals Management and Actual Activities Manipulation

There are main differences between management of accruals and manipulation of actual activities. Any form of manipulation in actual activities compared with management of accruals should happen in periods during the year. Manipulation of actual activities happen when managers predict that profit may fail in fulfilling their targets except when they get involved with activities originating from the company's normal method and/or some other factors (Strict Accounting Standards) restricts management of accruals. The other advantage of modifying actual activities to manipulate profit is that the auditors and executives notice such behavior less. The other difference between these two forms of profit management is that management of accruals in the year of happening is that it is almost clear, however, manipulation of actual activities is not easily notices (Kashani, Amir, 2009). Actual profit management directly influence company's cash flows. In this method, cash is sacrificed by interest accruals whose most important loss is losing value of the company due to reduction of cash flows in future periods. Management of accruals is not without costs. Detecting manipulation of accruals may cause the possibility of the need to specially considerations from auditors' sides. Additionally, it may lead to financial penalties by legal professional societies (such as stock exchange and securities), the need for re-profit as well as surveying the matter in the civil courts (Karami, 2007).

The main difference is between management of accruals and manipulation of actual activities in scheduling profit management. Manipulation of actual activities happen when CEOs predict that profit fails in meeting objectives except that they perform activities originating from the company's normal procedures and/or when some other factors (Strict Accounting Standards) restricts management of accruals. In order to fulfill benefit-related objectives, the managers are able to wait to the end of the year and use voluntary accruals to manage reported benefits. The method owns the risk that the required profit for manipulation is larger than the available voluntary accruals because the existing authority related to accruals is restricted by general principles of accounting (Madura, 2009). Fundamental economic events of a company exposes management ability to report profit based on accounting numbers. Hence, using voluntary accruals at the end of the year may not lead to benefit-related objectives. Considerations of such restricts management of voluntary accruals. Comparatively, manipulation of actual activities is less restricted. The other advantage of modifying actual activities to manipulate profit is that auditors and executives barely notice such behavior. Relative clarity of voluntary accruals management, however, manipulation of actual activities is not easily recognized which is among other differences of these two forms of management. It should be noted that manipulation of actual activities is not the means to change the formation of accounts. In this method, the CEOs modify the time to operate, form of resources allocation and/or the time to perform investment projects. Activities of profit management based on accruals comes with not direct consequence of cash flow (Pour & Mohsen, 2015). Actual profit management directly influences company's cash flows. In this method, cash is sacrificed by accruals interest whose biggest loss is losing the value of the company due to reduction of cash flows in future periods. Management of accruals is not without costs. Discovering manipulation of accruals may cause the possibility of the need for specific measurements from auditors' sides. Additionally, it may lead to financial penalties by professional legal societies (such as stock exchange), the need to present profit once more as well as surveying the topic in legal courts (Salteh, 2010).

The results of studies of (elders, 2006) confirms the negative relation between quality of auditing and profit management in IPO process. (Elders and rhymy, 2013) concluded in their study that the existence of auditing committee and its size reduces profit management. (Mehrani, 2009) concludes in his study that companies with more tendencies toward accruals use the services of six great auditing institutions to validate profit with more possibility. The results of (Mhrnsb et al., 2011) study depict that companies audited by five great auditing companies have less profit management. (Prayer, 2008) in his study on state companies conclude that auditing quality reduces the possibility of occurrence of profit management. (Nvrvsh, 2009) concluded that auditing quality restricts profit smoothing. (Yazdanian,2011) and (Nykvmram et al. 2010) also studied the effect of auditing quality on profit management in private companies and concluded that auditing quality has a reverse relationship with profit management. (Alves, 2012) concluded that continuity of an auditing institute's audit increases the usage of accruals as well as profit management. (Azibi & Rajhi, 2008) surveyed the effect of auditing institute's size (5 great institutes) and existence of auditing committee on accruals. The results of their study reveal that the auditing institute's size does not reduce the amount of voluntary accruals whereas existence of an active auditing committee in the company reduces their activity. (Azinfar and Mohammadi, 2015) conclude that the number of hours to audit for the employer has a negative relationship with voluntary accruals and profit management. (Azibi & Rajeev, 2008) conclude that auditing five great companies has no effect on reduction of accruals. The results of (Bannister & Wiest, 2001) study also reveal that the existence of auditing committee, its number of sessions and its size does not influence profit management. Furthermore, (Bartov, 2000) studies Chinese companies and concludes that 10 great auditing companies in China cause more profit management those other companies. (Beasly, 1996) in a study titled "Auditing Quality and Profit Management" surveyed in Indonesia on state-owned supplying companies conclude that auditing quality restricts the amount profit management in such companies providing more exact information leading managers to have less motive to manage benefit. In addition, cash flows resulted from operational activities and company's size have a negative and meaningful effect on current accruals. (Chiang, 2005) in a study titled "Auditing Quality and Profit Management in Nigerian Oil Companies" conclude that auditing institute's size and auditor's industrial expertise have negative but meaningful effects on profit management of sample companies. Furthermore, evidences of negative but meaningful effects of the auditor on profit management was observed. (Coppens & Peek, 2005) in a study titled "Difference in Profit Management in Audited and Unaudited Private Companies in Greece" conclude that private companies which are bound to present unaudited financial reports have higher levels of voluntary accruals during management of high profits compared with audited private companies. Besides, some unaudited companies take advantage of auditing criteria to manage benefits, which help them forget auditing related to such criteria. Furthermore, the results opposed our expectations, which are the low level of financial transparency led by non-publication of financial reports, reduces companies' motives to manage benefits at the times of debt capital increase. (Cornett et al., 2008) in a study titled "Studying the Effect of Profit Management and Auditing Quality on Efficiency of Companies' Investors Present in Tehran Stock Exchange" conclude that there is a direct and meaningful relationship between sales growth and overinvestment yet not such a relationship operational cash flow and company's overinvestment was not observed and no meaningful relationship between stocks value to office value of stockholders' equity and overinvestment was not observed. (Dasher and Malcom, 1970) in a study considers the effect of actual profit management considering the return from R & D expenses and general, office and sales expenses on operational performance of the companies. They conclude that actual profit management based on each of R & D expenses, general, office and sales expenses have a meaningful effect on operational performance of the companies and the manager whose does actual profit management reduces his operational performance in returning costs for the reasons of secrecy. (Davidson et al., 1987) did a study titled "Studying Motivations for Smoothing Income in the Valid companies in Tehran Stock Exchange" and concluded that smoothing income via voluntary accruals is done by Iranian companies and income tax in operational activities is the main motive to smooth income via voluntary accruals. (Dechow et al., 1996) surveys motives for profit management in valid companies in Tehran Stock Exchange related to oil, chemical and iron industries. For the same reason, voluntary accruals as a criterion to register profit management from 1992 to 1995 were calculated. The results prove that the size of the company and debt contracts are motives from profit management in are considered in the companies of both industries. (Dechow et al, 1995) in their dissertation study the role of the auditor industry specialization on profit management of the valid companies in Tehran stock exchange. The results of the study reveal that the companies whose auditor is an industry expert have lower level of management of accruals as well as a higher level of actual profit management compared with the companies whose auditor is not an industry expert, however, their future operational performance does not reduce. (Defond and Jiambalvo, 1994) did a study title "The Effect of Auditing Quality and Auditor's Characteristics on Profit Management." In this study, level of profit management is used as a symbol of opportunistic management practices and the relation between profit management and auditing quality is studied. Consistent with previous studies in this field, auditing quality is considered as a two-dimensional variable and it is assumed that some auditors with specific characteristics present higher quality. Since auditing quality is defined as independent auditor's ability to discover present distortions and anomalies in financial statements in addition to reporting them to the beneficiaries, the characteristics influencing professional competence (such as expertise) affecting the ability to detect cases of distortion as well as characteristics affecting independence (such as auditing company's size and income) enables the auditor to transfer the detected cases to the beneficiary; additionally, the auditor's type of comment is surveyed in this study. Findings of the study show that in cases of condition clause absence the level of profit management is lower with the effect of gain and loss in auditor's report as well as auditor's specialization and auditing by auditing institutions whose are members of official auditing society. Hence, there is not meaningful relationship observed between the auditing company's level of income and level of profit management. (Gul et al, 2012) study the relationship between profit management and auditor's report in an article. 101 valid companies in Tehran stock exchange were selected to test the hypotheses. Study's hypothesis was tested through regression and variance analysis; the results show there is a direct link between voluntary accruals with the conditioned report while a reverse relationship is observed between involuntary accruals with conditioned auditing report. (Rahamni et al., 2014) wrote an article titled "The Relation between Profit Management and Auditor's Type of Report in Companies with Financial Crisis." The data of the study was obtained from valid companies in the stock exchange in a five-year period between 2008 and 2012. The study is done on 92 companies in stock exchange the results of which are expressed via a statistical model of mixed data based on logistics as follows: there is a positive relationship between variables of profit management and auditor's type of report, i.e. a rise in voluntary accruals makes auditing reports inclined to conditioning. The second hypothesis is based on the existence of a relationship between financial disaster and auditor's type of report, which is positive and shows that companies with financial disaster mostly receive conditioned auditing reports. The third hypothesis is based on the stronger relationship between profit management and type of auditing report in the companies with financial disaster compared to the companies without a financial disaster. Thus, based on the achieved results it is claimed that the existence of financial disaster in companies makes the managers to manage profit due to motives such as protecting investors and their positions. In other words, a financial disaster causes profit management yet reports are inclined toward conditioning with a rise in profit management. (Gumanti, 2015) in a study survey the relationship between auditor's comments and profit management in the valid companies in Tehran stock exchange. The findings of the study show no meaningful relationship between auditor's comments and profit management. Additionally, financial characteristics of the client company, such as great auditing institutions, previous year's modified report, complexity of the client company as well as asset returns influence auditor's decision on modifying his report. In other words, profit management plays no role in this regard. (Hashi,2003) in their dissertation study the relationship between auditing committee, internal audit and profit management in member companies of Tehran stock exchange. The results of the study show a meaningful relationship between existence of auditing committee and profit management as well as a negative meaningful relationship between internal audit and profit management. Furthermore, no meaningful relationship is observed between members of auditing committee and profit management. (Hua and Hsiang, 2007) in a study survey the relationship between profit management of current performance and future performance with CEO's occupational security. In this study, profit management is measured using Jones's modified model and CEO tenure is extracted from financial statements. Statistical society of the study are the valid companies in Tehran stock exchange. 431 valid companies in Tehran stock exchange are selected through national sampling with test of mixed data regression used for hypotheses. The results of the study show a meaningful relationship between profit management and CEO tenure. Besides, a meaningful relationship is present between profit management as well as current and future performance of the companies. (Leuz et al., 2001) in a study survey the relationship between profit management and independent auditing quality. They concluded that there is a negative and meaningful relationship between factors of external audit quality (independent) such as the auditor industry specialization, audit tenure, size of audit firm, auditor's independence and auditor's expertise with profit management that companies whose auditors have such conditions and factors show less profit management. (Lobo and Zhou, 2001) in a study surveys the relationship among accruals, manipulation and profit management in Iraq; they take advantage of (Maher, 2000) model of total accruals, voluntary accruals and involuntary accruals. Finally, they conclude that there is a meaningful relationship between accruals and profit management in Iraq. Thus, according to the aforementioned literature review as well as the provided background and relationship of profit management based on accruals and elements of audit quality, first, second and third hypotheses are mentioned as follows:

Hypothesis 1: There is a meaningful relationship between voluntary accruals profit management and independent audit industry allocation.

Hypothesis 2: There is a meaningful relationship between voluntary accruals profit management and independent audit tenure.

Hypothesis 3: There is meaningful relationship between voluntary accruals profit management and independent auditor's size.

(Mashayekhi, 2008) in a study show that managers try to reduce the net price of the goods sold through additional production. The results of their study show that manipulation of actual activities lead to the reduction of normal level of operating cash flows.

(Mashayekhi, 2007) in a study surveys profit management through manipulating actual activities realizing that companies take advantage of activities such as discounts in prices to increase sales, overproduction to reduce net price of the goods sold and reducing voluntary costs to prevent loss report and a better profit margin presentation although such activities does not add to the value of the companies in long terms. However, the existence of institutional shareholders reduces the usage of such activities. (Ming, 2007) studied both kinds of management and concluded that at the time of seasonal stock offerings, the managers are busy with actual profit management through accruals because manipulation of actual activities comes with actual economic results. (Nawaiseh, 2016) in a study found that companies are mostly occupied with profit management through manipulation of actual activities. The results of the study show that the reduction in the costs of R & D as well as overproduction has a positive relationship with the profit resulted from manipulation of the actual activities. Additionally, the profit resulted from management of actual profit created has a reverse relationship with the future performance of the company. (Hashi,2003) showed that companies in the years of shares supply are occupied with both kinds of profit management and using management of actual activities has a positive correlation with the costs of accruals management in these companies. (Hashi,2003) in study show that auditors of great companies are positively related to actual management of profit proposing that more influential scrutiny may urge the companies for profit management through techniques whose detection is difficult. (Teoh et al., 1998) believe that presence of great auditing companies with great fame is accompanied by an increase in actual profit management. They confirm that a rise in auditing scrutiny by great auditors reduces flexibility of company's accounting. Therefore, companies audited by great auditing institutions are likely to resort to manipulation of actual activities. (Tyokoso and Tsegba, 2015) study show that companies in the final three-month of the year fulfill profit targets through manipulation of actual activities such as price reduction to accelerate sales temporarily. Furthermore, in competitive situations, the companies react more to profit management incentives. (Zisis and Sorros, 2015) examined pre-evaluation as an incentive for profit management. He realized that in the period of pre-evaluation, the managers use firstly management of accruals and, in the following years, management of actual activities and, finally, profit management out of GAAP (Fraudulent Methods). He believes that the length of pre-evaluation period is an important factor to select methods of profit management; however, he did not model replacing relationship between two approaches of profit management based on their relative costs. (Leuz et al, 2001) in a study examine the relationship among audit quality, change of auditor and supplier's market share with profit management. In this study, the size of auditing institution is used as a criterion to measure quality. In order to determine profit management, Jones's modified model is measure voluntary accruals. The results of descriptive statistics, correlation and regression analysis in a sample of the valid companies in Tehran stock exchange show a negative and meaningful relationship between auditing quality and profit management while a negative meaningful relationship between change of auditor and level of applied profit management in financial statements. In addition, the results of the study show that there is no relationship between market shares with the items of managed profit in financials statement of valid companies in Tehran stock exchange in contrast to some similar studies. The results reveal that quality audit is more likely to detect opportunistic behavior of profit management. Additionally, saving an auditor in an audit position, the company minimizes the grounds for activities of unpleasant profit management in addition to more efficient audit operations. Therefore, the role of auditing as a foundation for evaluating quality of financial statements is approved. (Defond and Jiambalvo, 1994) in a study examine the relationship between manipulation of actual activities and salary costs of shareholders. The results of the study in a period between 2008 to 2014 show that there is a direct relationship between profit management criteria based on actual activities (abnormal cash flow, abnormal production and abnormal voluntary costs) and shareholders' rights costs. (Defond and Jiambalvo, 1994) survey the relationship between actual financial events and profit management. In their study, they found there is a meaningful relationship between operating cash and changes in an inventory, on the one hand, and profit management, on the other hand. Rahpeima & Nemati (2014) in their dissertation examined the relationship between actual financial events and profit adjustment in the valid companies in Tehran stock exchange. The sample includes 110 valid companies in Tehran stock exchange in 2012 and 2013. The hypotheses are based on Levine, Lin & Cho, Shapiro-Wilk tests, correlation matrix, Lagrange test, F Limer test and multivariate multiple regression. The independent variable of the study is the audit committee's accounting and the dependent variable of the study, profit management, reduction in profit management and avoiding and non-negative profit adjustment. The results of the study show there is a meaningful relationship among audit committee's accounting and profit management, reduction in manipulation of company's accruals interest, avoiding non-negative profit adjustment and prevalence of profit management. Expertise in audit committee could affect the company's profit management leading to its reduction. Thus, existence of such expertise may act as a deterrent. Talari & Mohseni Melki (2015) in their study titled "The Relationship between Free Cash Flow, Audit Quality and Profit Management" figured out there is a meaningful relationship among various components of free cash flows, audit quality and profit management and that audit quality is able to modify the relationship between free cash flows and profit management. Muhammad Mattar et al. (2012) in a study examined the relationship between profit management and reliability of provided data in financial statements provided for the majority of shareholders in Jordan. They concluded that financial statements with managed profit are less reliable in shareholders' viewpoints. Therefore, according to the provided literature review and background of the study, the relationship of profit management based on accruals and elements of audit quality, the fourth, fifth and sixth hypotheses of the study are as follows:

Hypothesis 4: There is a meaningful relationship between actual profit management and auditor's industry specialization.

Hypothesis 5: There is a meaningful relationship between actual profit management and audit tenure.

Hypothesis 6: There is a meaningful relationship between actual profit management and auditor's size.

III. Research Methodology

A. *Statistical Society and Samples*

It intended society in this study are all valid companies in Iraqi stock exchange. Since examining and testing research hypotheses in master's dissertations in bound with time limitations surveying all members of the society is not possible, selection of statistical sample is done with the help of sampling methods so as to collect, survey and test hypotheses. The members of sample must have specific features, which are mentioned in the following. The information of the companies are examined in a five-year period between 2011 and 2015.

B. Sampling method

The sample in this study is selected from the valid companies in Iraqi stock exchange. Random companies are omitted through systematic elimination in a manner that the members of the society with the following characteristics access the sample:

The statistical society in this study is made up of all valid companies in Iraqi stock exchange in a period between 2011 and 2015 (a five-year period) with the following conditions:

1. They must be validated in Iraqi stock exchange up to the end of 2010.
2. The companies should have changed their fiscal year in the intended course.
3. The intended companies must be continuously active during the research course and their shares must be traded.
4. The required financial information for the study during research period shall be thoroughly presented.

In this study, method of screening (omission) is used to determine the sample that qualified companies are selected and studied as the sample and other companies are omitted.

78	Total number of companies to end of 2010
11	Omitted companies due to a change in fiscal year
9	Omitted companies due to activity cessation
21	Omitted companies due to lack of data presentation
23	Omitted companied due to inaccessibility to the previous 5 years financial statements
14	Number of Available Sample Companies

The sample is achieved after enforcing limitations on the statistical society. Then, the information related to the variables of the companies is achieved.

Research Analytical Model

The relationship between profit management based on accruals with independent audit and the relationship between actual profit management with independent audit is surveyed. Equation 1 is used to examine hypotheses 1 to 3:

$$AMit=\alpha1+\beta1\ AudTenureit + \beta2\ Industry\text{-}Specializationit + \beta3\ Aud\text{-}SIZEit+ \beta4\ SIZEit+ \beta5\ LEVit+ \beta6\ CFOit + \varepsilon i,\ t+k$$

Equation (1)

In which:

AM: profit management based on accruals of company i in the year t

AudTenure: Audit tenure of company I in the year t

Audit Tenure means the number of the years in which audit institute is responsible to inspect the intended company. In order to measure audit tenure, the number of the years in which audit institute is responsible to inspect a company as the familiar criterion with the audit institution; provided the institute's auditor is appointed in this position more than 4 years increases audit quality and familiarity with financial statements and accounts of the company, which eventually causes detection of sections with the possibility to manage benefit. Therefore, if a company has an auditor with more than 4 years in this position number 1 is allocated for it or else number 0.

Industry Specialization: Audit industry specialization of company i in the year t

Audit industry specialization introduces the focus and expertise of auditor in the industry under investigation as well as the ability to detect threats and risks related to every industry. Audit industry specialization is introduced by the market share approach. In this method, the higher share for the auditor leads to a higher specialty of audit firm. Auditors' market shares is measured with the following equation (Etemadi et al., 2009):

$$\text{Auditors' market share} = \frac{\textit{Total properties of all employers of each audit institute in a specific indsutry}}{\textit{Total properties of all employers in this industry}}$$

Institutes are introduced as industry experts whose market shares are more than $[1 / (an\ existing\ industry\ companies\ all) \times (1/2)]$. All employers of audit institutes in a specific industry means all companies in every industry audited by an audit institute. The denominator also introduces all properties of an industry, which is the sum of properties of all companies that exist in an industry.

Aud-SIZE: Audit size of company i in the year t, which is shown by 1 if company of Court of Audit or else 0 is.

SIZE: The size of the company i in the year t which is achieved through natural logarithm of total sales of the company.

LEV: Financial leverage of company i in the year t, which is achieved through debts, divided by total assets of the company.

CFO: Operational cash flow of company i in the year t

B: Regression coefficients

εt: The remaining of the model reduced with an increase with the sample size

In order to fit models into hypotheses, firstly, Jones does Dichu et al. (1995) is used to evaluate profit management based on accruals (AM) modify model (1991). The model is based on Eq. 3 as follows:

$$TAccrt / Assetst\text{-}1 = \alpha + \beta0\ (1 / Assets\ t\text{-}1) + \beta1\ (\Delta Salest - \Delta RECit) / Assetst\text{-}1 + \beta2PPEt / Assetst\text{-}1 + \beta3\ ROAt\text{-}1+ \beta4\ SGt + \varepsilon i,t+k$$

Equation (2)

In which:

TAccr: Total properties at the beginning of financial period and cash flows resulted from operational activities of company i in the year t

Assets: Total properties at the beginning of financial period of company i in the year t

ΔSales: Changes in sales of company i in the year t

ΔREC: Changes in the accounts received of the company i in the year t

ROA: Net profit divided by total properties of company i in the year t

SG: Current growth in sales of company i in the year t
εt: The remaining of the model introducing voluntary accruals of company i in the year t

Then, Eq. 3 is used to fit hypotheses four to six:

RMit=α1+β1 Audtenureit + β2 Industry-Specialization it + β3 Aud-SIZEit+ β4 SIZEit+ β5 LEVit+ β6 CFOit +εi, t+k Equation 3

In which:

RM: Actual profit management of company i in the year t achieved as follows:

This study similar to the studies of Rochodehri (2006) and Kohen et al. (2008) uses three criteria of abnormal level of operation cash flow, abnormal level of production costs and abnormal level of voluntary costs are used to measure manipulation level of actual activities. The following regression models are used to measure these criteria and the raining component of regression equation (ε) as well as equations (4), (5), (6) depict abnormal level of fulfilled variable:

CFOit / Assetsi, t-1=K1t (A / Assetsi, t-1) + K2t (Salesit / Assetsi, t-1) + K3t (ΔSalesit / Assetsi, t-1) + εi, t Eq.4

PROUDit / Assetsi,t-1=K1t (A / Assetsi,t-1) + K2t (Salesit / Assetsi,t-1) + K3t (ΔSalesit / Assetsi,t-1) + εi,t Eq. 5

DiscExpit / Assetsi,t-1=K1t (A / Assetsi,t-1) + K2t (Salesit / Assetsi,t-1) + K3t (ΔSalesit / Assetsi,t-1) + εi,t Eq. 6

In which:

CFO: Operational cash flow of company i in the year t

PROUD: Production costs of company i in the year t including total cost of sold goods and changes in the inventory.

DiscExp: Voluntary costs of company i in the year t including total costs of advertising, general costs of sales and administrative ones.

Assett-1: Initial period assets of company i in the year t

Sales: Sales of company i in the year t

The remaining of three aforementioned regression equations (ε) is standardized and summed together so that variable of actual profit management is gained.

Descriptive Statistics

Descriptive statistics of research variables including average, standard deviation etc. on basis of variables and annual basis is presented:

TABLE 1. Descriptive statistics of all year – company

Standard Deviation	Average	Maximum	Minimum	
47693196113	20381699195	226907311687	555137931	Total Assets
21381733427	6449721589	174788648332	5139752	Total Debts
56449687221	18635143295	239911217297	46942100	Operational Cash Flow
8498108404	1867469937	46690243158	4906665453-	Operational Gain & Loss
55996390069	17718160983	238420907852	210190	Sales
48/0	64/0	1	0	Auditor's Size
23/0	94/0	1	0	Audit Tenure
46/0	71/0	1	0	Auditor Industry Specialization
4410282828	2799388684	24656138550	1811177	Received Accounts
5998638957	889411992	30137221927	5246848631-	Net Gain & Loss
2250098565	1186860090	11160484240	17679183	Sales General & Organizational Costs
170/3	269/1	49/26	026/0	Jones's Accruals Profit Management
59/10	66/3-	99/36	06/80-	Actual Profit Management

D. Fitting Research Models

Entering research data into Views software, the models are fitted. In such analyses, the p-value of final output shall be paid attention to figure out significance or insignificance of hypotheses; if p-value of a variable is less that 0.05 the hypothesis equals 0 and is rejected.

E. Testing First, Second & Third Hypotheses

In these hypotheses, the relationship between independent audit quality and profit management based on accruals is surveyed. Initially, Chow test or F Limer test is used to determine using panel data against integrated data.

F. Limer Test

Hypothesis Zero: Regression model is suitable
Hypothesis One: Panel model is suitable

TABLE 2: Chow Test – Hypotheses 1, 2 & 3

Degree of Freedom	Test Statistics	p-value
4	004/4	045/0

Since significance of Chow Test is less 0.05, hypothesis Zero is rejected and using panel model with fixed effects is prioritized.

A. Housman Test

Hypothesis Zero: Panel model with random effects is suitable
Hypothesis One: Panel model with fixed effects is suitable

TABLE 3: Housman Test – Hypotheses 1, 2 & 3

Degree of Freedom	Test Statistics	p-value
4	78/1	77/0

Since significance of Housman, test statistics is less that 0.05 using panel model with fixed effects is prioritized to panel model with random effects. Now, the model with fixed panel effects is fitted. The results of features of fitted model are presented in Table 4 as well as significance of model variable are presented in Table 5.

TABLE 4: Model features of Hypotheses 1, 2 & 3 (Dependent variable: Accruals profit management)

Durbin Watson Statistics	Model Significance	F Statistics	Modified Determination Coefficient	Determination Coefficient
26/2	002/0	06/1	02/0	15/0

TABLE 5: Fitness Coefficients of model hypotheses 1, 2 & 3 – Dependent variable: Accruals Profit Management

$AM_{it}=\alpha_1+\beta_1$ AudTenure$_{it}$ + β_2 Industry-Specialization$_{it}$ + β_3 Aud-SIZE$_{it}$+ β_4 SIZE$_{it}$+ β_5 LEVERAGE$_{it}$+ β_6 CFO$_{it}$ + $\varepsilon_{i,t+k}$				
P-VALUE	**t Statistics**	**Standard Deviation**	**Coefficient**	**Variable**
113/0	611/1-	556/11	615/18-	Intercept
035/0	816/1-	901/1	452/3-	Audit Tenure
047/0	447/0	590/17	863/7	Auditor Industry Specialization
018/0	404/0-	474/17	051/7-	Auditor's Size
102/0	660/1	279/1	122/2	Company's size
363/0	917/0-	327/0	300/0-	Financial Leverage
537/0	620/0-	001/0>	001/0>	Operational Cash Flow

According to Table 4, determination coefficient shows that 15 percent of changes in dependent variable are explained by independent variables. Significance of model is also less than 0.05, which is a proof for significance of research model. Furthermore, Durbin Watson statistics is 2.26; if it is between 1.5 and 2.5 it show lack of autocorrelation among error remaining, which is true in this model.

As seen in Table 5, intercept variables, audit tenure, auditor industry specialization, auditor's size, company's size, financial leverage and operational cash flow are – 18.615, -3.452, 7.863, -7.051, 2.122, -0.300, and >0.001, respectively, whose level of significance are 0.113, 0.035, 0.047, 0.018, 0.102, 0.363 and 0.537, respectively; hence, there is a meaningful relationship among variables of audit tenure, auditor industry specialization and auditor's size with profit management of accruals.

Testing Hypotheses 4, 5 & 6

These hypotheses survey the relationship between independent audit quality and actual profit management. Firstly, Chow Test or F Limer Test is used to determine panel data against integrated data.

F Limer Test

Hypothesis Zero: Regression Model is suitable
Hypothesis One: Panel Model is suitable

TABLE 6: Chow Test – Hypotheses 4, 5 & 6

Degree of Freedom	Test Statistics	p-value
4	86/7	01/0

Since significance of Chow Test is less 0.05, hypothesis Zero is rejected and using panel model with fixed effects is prioritized.

Housman Test

Hypothesis Zero: Panel model with random effects is suitable
Hypothesis One: Panel model with fixed effects is suitable

TABLE 7: Housman Test – Hypotheses 4, 5 & 6

Degree of Freedom	**Test Statistics**	**p-value**
4	41/0	98/0

Since significance of Housman, test statistics is less that 0.05 using panel model with fixed effects is prioritized to panel model with random effects. Now, the model with fixed panel effects is fitted. The results of features of fitted model are presented in Table 8 as well as significance of model variable are presented in Table 9.

TABLE 8: Model features of Hypotheses 1, 2 & 3 (Dependent variable: Accruals profit management)

Durbin Watson Statistics	**Model Significance**	**F Statistics**	**Modified Determination Coefficient**	**Determination Coefficient**
2.69	0.02	1.31	0.04	0.18

TABLE 9: Fitness Coefficients of model hypotheses 1, 2 & 3 – Dependent variable: Accruals Profit Management

$AM_{it}=\alpha_1+\beta_1$ AudTenure$_{it}$ + β_2 Industry-Specialization$_{it}$ + β_3 Aud-SIZE$_{it}$+ β_4 SIZE$_{it}$+ β_5 LEVERAGE$_{it}$+ β_6 CFO$_{it}$ + $\varepsilon_{i,t+k}$				
P-VALUE	**t Statistics**	**Standard Deviation**	**Coefficient**	**Variable**
0.941	-0.074	37.194	-2.752	Intercept
0.277	-1.098	6.120	-6.720	Audit Tenure
0.377	-0.890	56.616	-50.387	Auditor Industry Specialization
0.327	0.989	56.243	55.632	Auditor's Size
0.993	0.009	4.115	0.039	Company's size
0.270	1.115	1.054	1.175	Financial Leverage
0.355	0.933	001/0>	001/0>	Operational Cash Flow

According to Table 8, determination coefficient shows that 18 percent of changes in dependent coefficient changes are explained by independent variables. Significance of model is also less than 0.05 which shows significance of model of study. Durbin Watson statistics is also 2.69; if it is between 1.5 to 2.5--it shows lack autocorrelation among remaining error, which is true in this model.

As seen in Table 9, variables of intercept, audit tenure, auditor industry specialization, auditor's size, company's size, financial leverage and operation cash flow are -2.752, -6.720, -50.387, 55.632, 0.039, 1.175 and > 0.001, respectively, whose level of significance are 0.941, 0.277, 0.377, 0.327, 0.993, 0270 and 0.355, respectively; thus, there is no meaningful relationship between none of the variables with actual profit management.

A. Results of Hypotheses

First Hypothesis Test Results

The first hypothesis of the study says: "There is a meaningful relationship between Audit Tenure and Accruals profit management of the companies."

In this equation, the first hypothesis of the study expresses that there is a meaningful relationship between audit tenure and accruals profit management of the companies, which is accepted by the results of the hypothesis as changes in audit tenure influence accruals profit management. The subject shows that a rise in the audit time in the company enables the auditors to have higher focus in accounts and company's activities. Having gained the advantage of more audit time, Iraqi auditors are more focused points of risk in the company as well as higher diversion ability; as the result, more audit and wider scrutiny enable them to discover financial distortions of the employer, report them and prevent CEO's opportunistic actions in distorting financial statements and profit management. Generally, more audit by auditors increases their knowledge of employer's financial system and the ability to detect distorted accounts, such as profit management. Thus, the auditors may reduce profit management through more audit. The findings of the study is similar to those of Gore, Pope & Saign (2001), Tondlu & Van Strilin (2005), Kamran et al. (2008), Gumanti et al. (2015), Sedigh et al. (2010), Mehrnasab, Hasasyeganeh & Babajani (2011), Kamyabi & Mansub Nasiri (2015), Talari & Mohseni-e-Melki (2015), Maham & Bekmuhammadi (2016) and in contrast with Tiokozo & Tisegba (2015).

Second Hypothesis Test Results

Second hypothesis states, "There is a meaningful relationship between auditor industry specialization and accruals profit management."

In this equation, the second hypothesis states that there is a meaningful relationship between auditor industry specialization and accruals profit management of the companies, which is accepted according to the results of the hypothesis in a way that changes in auditor industry specialization affect profit management of accruals. This shows that auditors who audit companies with features like being more major in the industry (having assets which are more than other companies in the industry), complexity of activities and other features causing more scrutiny and being involved in the activities of employing companies causes learning and more control of auditors. A rise in the ability and scrutiny of auditors in the activities of the company and therefore a rise in professionalism in audit industry leads to detection of fields such as financial statements of employing company who own risks and dangers that professional auditors of the industry are able to discover. On the other hand, CEOs in different industries take advantage of various methods of management. Therefore, the auditor must be a professional in the industry to identify and detect such distortions and have a comprehensive understanding of transactions process, profit detection, registration and reporting financial statements so that profit management of the company is prevented. Thus, industry specialist auditors may detect profit distortions more and as the result the second hypothesis is accepted; therefore, there is a meaningful relationship between auditor industry specialization and profit management of accruals. The results of the study matches those of Capenz & Peik (2005), Burstaler et al. (2004), Chen (2005), Gumanti et al. (2015), Tiokuzo and Tisegba (2015), Novaiseh (2016), Ardakani, Etemadi & Azar (2009), Sedigh et al. (2010), Talari & Mohseni-e-Melki (2015), Mehrnasab, Hasasyeganeh & Babajani (2011), Kamyabi & Mansub Basiri (2015), Maham & Beck Mohammadi (2016).

Third Hypothesis Test Results

The third hypothesis states, "There is a meaningful relationship between independent auditor's size and companies' profit management of accruals."

In this equation, the third hypothesis states that there is a meaningful relationship between auditor's size and companies' profit management of accruals, which is accepted according to the results of the study as changes in auditor's size, affects profit management of accruals. This subject proves that major auditors are able to gain specific ability in detecting potential fields of risk in audit and distortion of financial statements through abilities gained by being higher. Auditors with more auditing partners, or have more auditors, or have different branches, antiquity and great experiences (e.g. the first institute founding auditing in the country) and/or a reputation covering the audit market prevalently generally own abilities who can detect intentional or unintentional mistakes. The auditors who are known as major auditors detect profit management with specific skills in financial report as well as profit management. Based on the results of the study, more major auditors are more able to detect profit management in the companies. Therefore, the third hypothesis of the study is accepted and there is a meaningful relationship between auditor's size and profit management of accruals. The findings of the study matches with those of Ilder & Zhao (2001), Zhao & Ilder (2002)l Farozoa & Rashideh (2006), Ming (2007), Tiokozo & Tisegba (2015), Sedigh et al. (2010), Mehrnasab, Hasasyeganeh and Babajani (2011), Muhamadzadeh, Kamyabi & Mansub Basiri (2015), Talari & Mohseni-e-Melki (2015), Maham & Beck Muhammadi (2016) and in contrast with Tupsamut & Jikenkit (2008).

Fourth Hypothesis Test Results

Fourth hypothesis states, "There is a meaningful relationship between audit tenure and actual profit management."

In this equation, the fourth hypothesis states that there is a meaningful relationship between audit tenure and actual profit management, which is rejected according to the findings of the study as changes in audit tenure, does not affect actual profit management. This subject proves that a rise in independent auditor tenure in the employer's company does not cause a reduction in actual profit management since the nature of actual profit management and influenced by expenses such as promotion, general expenses, organizational and sales expenses as well as operational costs such as final price of the goods, a rise in independent audit years cannot prevent actual profit management. Therefore, the fourth hypothesis is rejected and there is no meaningful relationship between audit tenure and actual profit management. The findings of the study matches those of Gumanti et al. (2015), Tiokuzo & Tisegba (2015), Novaiseh (2016), Ardakani, Etemadi & Azar (2009) and in contrast with those of Kuhen & Zarvin (2010), Chi et al. (2011) and Etemadi et al. (2010).

Fifth Hypothesis Test Result

The fifth hypothesis states that: "There is a meaningful relationship between auditor industry and actual profit management."

In this equation, the fifth hypothesis states that there is a meaningful relationship between auditor industry and actual profit management, which is rejected, based on the findings of the study, as changes in auditor industry does not affect actual profit management. This subject proves that a rise in the ability and expertise in a specific industry achieved by great volume and surveying major companies in the industry cannot affect fundamental components of actual profit management (such as R & D costs, the final price of sold goods, public organizational costs and etc.). In investors' viewpoint, industry expert auditor must prevent actual profit management, which is rejected by the findings of this study proving the opposite. As a result, the auditors are able to reduce profit management through more audits. Therefore, the fifth hypothesis of the study is rejected and there is no meaningful relationship between audit tenure and actual profit management. The findings of the study is similar to those of Gumanti et al. (2015), Tiokuzo & Tisegba (2015), Novaiseh (2016), Ardakani, Etemadi & Azar (2009) and in contrast with Kuhen & Zarvin (2010), Chi et al. (2011) and Etemadi et al. (2010).

Sixth Hypothesis Test Results

The sixth hypothesis of the study states that: "There is a meaningful relationship between auditor's size and companies' actual profit management."

In this equation, the sixth hypothesis states that there is a meaningful relationship between auditor's size and companies' actual profit management, which is rejected according to the results of the study as the changes in auditor's size affect actual profit management. The subject shows that auditors with characteristics such as number of auditors and more audit partners and/or wider audit institutes or branches are among the group of great auditors unable to discover actual profit management in the companies. In this case, auditor's size cannot reduce actual profit management. In this case, greater auditors affect discovering actual profit management with their reputation, ability and professional audit activities compared with the smaller auditors; the results of this study proves opposite of researchers' hypothesis. Therefore, the sixth hypothesis of the study is accepted and there is a meaningful relationship between audit tenure and profit management of accruals. The results of this study matches those of Gumanti et al. (2015), Tiokuzo & Tisegba (2015), Novaiseh (2016), Ardakani, Etemadi & Azar (2009) and in contrast with Kuhen & Zarvin (2010), Chi et al. (2011) and Etemadi et al. (2010).

IV. Recommendations

1. Based on the findings of the study investors, shareholders and managers are advised to select auditors with more industry expertise (surveying independent auditors' ex-employers and selection of independent auditor with activity in the industry) since industry specialized auditor prevents opportunistic activities around profit management of accruals reducing accruals profit management.
2. Based on the findings of the study it is recommended that in order to select independent auditor general assembly of shareholders trust ex-auditor in case of not having a logical reason to omit previous auditor and selection of alternative auditor as well as selecting an auditor with previous experience in the company since a rise in audit tenure leads to a reduction in profit management of accruals and increasing quality of financial statements. Therefore, selection of an auditor who passed audit tenure may lead to a reduction in opportunistic activities of management.
3. Furthermore, based on the findings of the study it is recommended companies' shareholders look for a more major auditor since such auditors are more effective in reduction of profit management of accruals while great auditors are not effective in reduction of company's actual profit management.
4. Since effectiveness of audit tenure, industry expertise and independent auditors' size on reduction of companies' actual profit management; hence, the CEO uses board members and company owners it is recommended other effective criteria to select auditor to reduce actual profit management. Additionally, based on ineffectiveness of independent auditors' industry specialization on companies' actual profit management it is recommended that auditors increase their industry expertise to increase their ability to detect actual distortions (through actual benefits) to improve auditor industry specialization as well as actual profit management.
5. It is recommended to Iraqi Stock Exchange Organization specific criteria is ordained for the auditors to reduce actual profit management in companies and increasing efficiency as well as auditors' efficacy to detect and discovery of actual management so that auditors are able to fully comprehend profit management since then.

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