

### Case Report

## **The effect of promissory items on business lines and its analysis in predicting profit in admitted companies in Tehran Stock Exchange**

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### **ABSTRACT:**

This research analyzes the effect of promissory items on business lines and predicting profit in admitted companies in Tehran Stock Exchange. 120 companies in 1389-94 were considered. It is an applied correlative research. It was used from multiple and simple regression method to consider the model and results of hypotheses testing, and In order to document the statistical analysis of results and to present final solutions, the researcher used SPSS software to analyze questions and hypotheses. The research results will show that all three variants, promissory items, business plan and business prediction, predict future function significantly. Because of evaluating last year financial functions, there is not much difference between predictions by managers and real items and there is a significant connection between research variants based on approved hypotheses.

**Keywords:** profit prediction, promissory items, business lines

### **1.INTRODUCTION**

Accounting profits are different from functional cash flows as the result of adjustments in promissory items. Therefore, if accounting is conservative, it is expected from promissory items to detect non-symmetry of profits or losses. Ball and Shivakumar assert that the lack of chronological symmetry in detecting profits and losses determines the lack of symmetry in the connection between promissory items and cash flows. Expenses are detected faster than incomes, just like not-flow promissory items, while the detection of incomes is postponed until they are changed to cash flows. This lack of symmetry both exist for working capital (for example, the principle of minimum price or market for goods which should be identified by promissory items decreasing the profit and should not identify promissory items increasing profit) and for promissory items with a long period-rotation (for example, the test of decreasing in merit of fixed possessions, goodwill of a business and the lack of up re-

evaluating). By accepting the promissory base for calculating the accounting profit, it can be claimed that accounting profit composes from cash and promissory parts. Moreover, does discrimination of promissory items to components improve the ability of explanation in company? According to the usefulness concept of decision by standard group of financial accounting of U.S.A individuals who use financial reports to make decisions on investing and conclude contracts, are interested in profit quality and generally in the quality of financial reporting.

By accepting this hypothesis that profit prediction is useful for making decision and relates to decision models, and also by accepting useful pattern in making decision and decision models (those who have selected this pattern know the accounting information as the main subject of accounting, is it possible to predict future profit of commercial unit based on accounting information?) (Foroughi, 1388, page

15), Aslon proved that those companies with profits more than cash functional flows will experience decreasing in functional profit in future years. Promissory items express the difference between accounting profit and cash currency resulting of functions. This difference is the result of accounting constraints to identify the expense at exact time. According to this, hypotheses I, II, and III can be expressed as follow:

1. There is a significant connection between promissory items and business lines in admitted companies in Tehran Stock Exchange
2. There is a significant connection between promissory items and profit prediction in admitted companies in Tehran Stock Exchange
3. There is a significant connection between business lines and profit prediction in admitted companies in Tehran Stock Exchange

Since cash flows play an important role in all decisions of groups such as the analysts of stocks, creditors and managers, the prediction of cash flow is an important matter which is needed in many economical decisions. They are interested in evaluating the cash flows of company, so they can reach to a clear index of cash flows of company in future. In other words, the purpose of fundamental analyzing is to predict future cash flows of company. Because cash flows are the base of paying stock profit, interest and repaying of debts and result in the ability of a company to stock profit from its ability in paying cash flows (Sarebanham 1387, page 46). In the direction of present study, some research has been accomplished by researchers.

Karimi (1389) considered the connection between profit quality with profit stability of admitted companies in Tehran Stock Exchange, the results of this research showed that there is a significant connection between profit quality and profit stability both in retrospective and provident approach. They have used financial proportion in retrospective approach and applied chronological regressions in provident approach to calculate profit quality based on investing. Ghaemi et al. (1387) showed in a research that there is a significant difference between stocking output in companies which have the

most and the least promissory items. Modares (1387) evaluated the effect of ability in predicting promissory components and cash flows on the quality of predicted profit. The results of this study showed that future profits can be predicted with the minimum error by using previous profits. The research is in harmony with the present one. In a research Nowroush et al. (1385) have studied the quality of promissory items by emphasizing on the role of error in evaluating the promissory items. The results show that high promissory items decrease their quality. Therefore, promissory items refer to less quality and less stability of profit.

Kenz and Lorckdonald (2011) considered the effect of promissory items on business and analysis on profit prediction and concluded that there is a positive connection between promissory items and profit prediction. BernardThomas (1996) studied the effect of promissory items on marketing income and its effect on business in firms. Aslon (1996): previous findings show that investors and financial analysts have failed in comprehensive understanding of applications of promissory items to have profit in next year. As the prediction of profit and creating promissory items and its affect on business lines affect managers` personal beliefs, probably the obvious errors in evaluating business background will be disclosed in predicting management profit and promissory items. Macnikolas (1989) studied the lack of symmetry of information in predicting the management and stocking output and showed that investors` information about future profits of company is reflected in stocking rate, and there is a positive connection between stocking output before predicting the profit and the time of predicting with management and profit prediction.

## **2.METHODOLOGY AND HYPOTHESES TEST**

The methodology of research was experimental-like and correlative. The information related to research literature and theoretical principals were extracted from library sources, scientific bases, local and foreign articles. Also research

data was collected from RahavardNovin information Bank, and financial bills of companies and after having initial processing in Excel software, it was analyzed by SPSS software. In this research, all admitted companies in Tehran Stock Exchange in 1389-1394 were considered. Sampling was purposeful and 120 companies were selected according to above mentioned conditions. It was used from multiple and simple regression to test

hypotheses. Based on the data nature, it was used from this methodology. According to the presented models which were dependent on their previous period, we applied a chronological method at first. It was used from F-statistics to consider the whole model, and it was used from T-statistics to study the significance of coefficient model of independent variants. The decision was made on accepting or rejecting hypotheses with 95% certainty.

### 3. Findings

In this research, three research hypotheses have been tested by applying three models of regression. Research variants conclude promissory items as independent variant, profit prediction as dependent variant, company size, cash flows resulting from financial activities, financial lever, the percentage of annual changes in financial incomes in 6 last years, the criteria deviation of percentage of annual changes in functional incomes before tax and profit and industry type are as controlling ones.

$$ROAt+1 = \beta_0 + \beta_1 Lindt + \beta_2 TAcc + \epsilon_t \quad (1)$$

$$ROAt+1 = \beta_0 + \beta_1 peps_t + \beta_2 WCt + \beta_3 NCOt + \beta_4 FINt + \epsilon_t \quad (2) \quad CATROA_{t+1} =$$

$$\beta_0 + \beta_1 pepst + \beta_2 pepts * Lindt + \beta_3 pepts * Lind^2 + \beta_4 WCt * Lind$$

$$t + \beta_5 WC * Lind^2 + \beta_6 NCOt * Lind + \beta_7 NCOt * Lind^2 + \beta_8 FINt * Lind + \beta_9 FINt * Lind^2 + \beta_{10} Lind + \beta_{11} Lind^2 + \beta_{12} IN.DIR + \beta_{13} B.SIZE + \beta_{14} F.SIZE + \beta_{15} CFO + \beta_{16} LEV + \beta_{17} GROWTH + \beta_{18} VOLTY + \beta_{19} IND + \epsilon_t$$

(3)

### 4. Figures and tables

In order to identify statistical population and studied variants more, the descriptive statistics of research variants are presented in summary in table 1.

**Table 1.** The descriptive statistics of research variants

Variants	variants	average	mean	Criteria deviation	curve	elongation
The prediction of current year profit	Peps	0.1498	0.13	0.10615	1.064	1.722
The prediction of next year profit	Peps+1	0.1397	0.12	0.10630	0.946	1.891
The whole of promissory items	TACC	8324.28	10677.50	428314.612	6.785	75.017
Flow promissory items	WC	67884.66	19972.663	-1709891	1.628	0.121
Non-flow promissory items	NCO	13086.55	17452.558	-3851797	1.243	0.121
Financial promissory items	FIN	2277.08	19595.812	-27	1.567	0.121
The reciprocal effect of profit prediction and promissory items	Rpepst*tacc	0.0793	0.00312	-0.07	0.004	0.121
The reciprocal effect of profit prediction and the square of business lines	Rpepts*Lind <sup>2</sup>	0.0467	0.00238	0.01	0.002	0.121
Business lines	Lind	0.5294	0.00868	0.52	0.031	0.121
The square of business line	Lind <sup>2</sup>	0.3111	0.01004	0.27	0.041	0.121
Company size	F.SIZE	5.6568	0.02767	5.28	0.312	0.121
Cash flows resulting of functional activities	CFO	0.793	38844.38	12964	156.6	0.121
Financial lever	LEV	0.0467	0.00833	0	0.028	0.121

The percentage of annual changes of last year functional incomes	GROWTH	0.5294	3.25904	6.30	495.4333	0.121
The standard deviation of annual changes in functional incomes in 6 last years ago	VOLTY	0.3111	0.13567	4.80	510.7	0.121
Industry	IND	0.6054	0.00488	1	0.010	0.121

In descriptive statistics, the data was analyzed by using central indices such as average and mean and distribution indices of criteria deviation 3, curve 4, and elongation 5. Average shows the mean of data. Mean shows that 50% of data are less than mean number of set and 50% are more than mean number of set. When mean and average are close, the data are symmetrical. Criteria deviation shows distribution and finally curve is the index of symmetry in data.

**4-1. Normality test**

As normality is one of pre-conditions of using quantitative data for regression analysis, Kolmogorov Smirnov test was accomplished. This test is a simple non-parametric method to determine the similarity between experimental information and selected statistical distribution. The test results have been presented in table 2 and shows that data distribution is normal. The normality of model remainders is one of the most regressive hypotheses.

**Table 2.** Kolmogorov Smirnov test

	Number	Average	Standard deviation	Absolute value	Positive	Negative	Kolmogorov-Smirnov test	Significance
CATROAt+1	408	0.3483	0.1438	0.06	0.044	-0.06	1.203	0.111

Kolmogoro Smirnov test compares a distributed compressed function with a theoretical compressed function. The theoretical compressed function can be normal, eventful or paoson. The significance of >0.05 determines that if observed distribution is related to theoretical distribution or not. Significance is more than 0.05 in CATROAt+1 variants, so the distribution is normal.

**4-2. Hypotheses test**

In this research at first the connection between promissory items on business lines, the kinds of components of promissory items including flow promissory items, not-flow promissory items, and financial promissory items are considered too. Then the effect of promissory items and its analysis on predicting profit is evaluated.

Hypothesis I. There is a significant connection between promissory items and business lines in admitted companies in Tehran Stock Exchange

$$ROAt+1 = \beta_0 + \beta_1 Lindt + \beta_2 TAacct + \epsilon_t \tag{4}$$

The test result of hypothesis 1 has been presented in table 3.

**Table 3.** Test result of hypothesis I

CATROt+1 = β0 + β1Lind			
variant	coefficient	T statistics	significance
y-intercept	0.204	23.504	0.000
Business lines	0.971	20.265	0.000
Promissory items	-1.150	-0.968	0.333
F statistics		208.090	
Significance		0.000	
Correlation coefficient		0.712	
Durbin Watson statistics		1.970	

The significance for the test of this hypothesis is 0.000. Therefore, hypothesis 0 is rejected with 95% certainty, i.e. there is a significant connection. The determination coefficient or R<sup>2</sup> is 0.712. F statistics is 208.090, T statistics is 20.265, and Durbin Watson statistics is 1.970 showing that there is no self-

correlation. Therefore there is a significant and direct connection between original and dependent variant.

Hypothesis II. There is a significant connection between promissory items and profit prediction in admitted companies in Tehran Stock Exchange.

$$ROA_{t+1} = \beta_0 + \beta_1 pepst + \beta_2 WCt + \beta_3 NCOt + \beta_4 FINt + \epsilon_t$$

$$\begin{cases} H_0 : \beta_1 = \beta_2 = \beta_3 = 0 \\ H_1 : \beta_i \neq 0 \quad i = 1, 2, 3 \end{cases} \quad (5)$$

Test result of hypothesis II has been presented in table 4.

**Table 4.** Test result of hypothesis II

$CATROA_{t+1} = \beta_0 + \beta_1 PEPS_t$			
variant	significance	T statistics	Coefficient
y-intercept	0.205	23.41	0.000
Profit prediction	0.967	19.98	0.000
flow promissory items	-1.743	-1.304	0.193
Not-flow promissory items	-2.285	-0.121	0.904
Financial promissory items	3.925	0.222	0.824
F statistics		104.251	
Significance		0.000	
Correlation coefficient		0.713	
Durbin Watson statistics		1.970	

The significance for test of this hypothesis is 0.000 and as this rate is less than 0.05, so hypothesis 0 is rejected with 95% certainty, i.e. there is a significant connection. The determination coefficient or  $R^2$  is 0.713. F statistics is 104.251, T statistics is 19.98, and Durbin Watson statistics is 1.970 showing that there is no self-correlation. Therefore there is a significant and direct connection between original and dependent variant.

Not-flow promissory items < flow promissory items < financial promissory items

Hypothesis III-III: There is a significant connection between business lines and profit prediction in admitted companies in Tehran Stock Exchange.

$$CATROA_{t+1} = \beta_0 + \beta_1 pepst + \beta_2 pepts * Lindt + \beta_3 pepts * Lindt^2 + \beta_4 WCt * Lindt + \beta_5 WC * Lindt^2 + \beta_6 NCOt * Lindt + \beta_7 NCOt * Lindt^2 + \beta_8 FINt * Lindt + \beta_9 FINt * Lindt^2 + \beta_{10} Lind + \beta_{11} * Lind + \beta_{12} IN.DIR + \beta_{13} B.SIZE + \beta_{14} F.S IZEt + \beta_{15} CFO + \beta_{16} LEVt + \beta_{17} GROWTht + \beta_{18} VOLTYt + \beta_{19} IND + \epsilon_t \quad (6)$$

$$\begin{cases} H_0 : \beta_1 = \beta_2 = \beta_3 = 0 \\ H_1 : \beta_i \neq 0 \quad i = 1, 2, 3 \end{cases}$$

Test result of hypothesis III has been presented in table 5.

**Table 5.** Test result of hypothesis III

$CATROA_{t+1} = \beta_0 + \beta_1 Peps + \beta_{17} GROWTh + \beta_{18} VOLTYt$			
Variant	significance	T statistics	coefficient
Y-intercept	0.010	2.596	0.315
Profit prediction	0.007	2.708	0.898
The reciprocal effect of profit prediction and business lines	0.777	0.284	0.336
The reciprocal effect of profit prediction and the square of business lines	0.797	-0.257	-0.265
Flow promissory items	0.759	-0.307	-6.868
The reciprocal effect of flow promissory items and business lines	0.901	0.124	1.060
Not-flow promissory items	0.615	-0.504	-9.664

The effect of promissory items on business lines and its analysis in predicting profit

The reciprocal effect of not-flow promissory items and business lines	0.842	0.199	1.522
The reciprocal effect of not-flow promissory items and the square of business lines	0.944	0.071	5.252
Financial promissory items	0.751	0.318	6.530
The reciprocal effect of financial promissory items and business lines	0.610	-0.510	-4.171
The reciprocal effect of financial promissory items and the square of business lines	0.512	0.656	5.153
Business lines	0.602	0.521	0.119
The square of business lines	0.555	-0.591	0.116
Company size	0.410	0.825	-0.010
Cash flows resulting from functions	0.486	0.698	8.352
Financial lever	0.420	0.807	0.029
The percentage of annual changes in functional incomes during 3 years ago	0.000	3.714	0.001
Industry	0.133	-1.505	-0.088
The criteria deviation of percentage of annual changes in functional incomes during 6 years ago	0.001	-3.402	-0.014
F statistics	20.601		
Significance	0.000		
Correlation coefficient	0.735		
Watson camera statistics	2.029		

The significance of predicting profit is 0.007. The percentage of annual changes and criteria deviation of functional incomes during 3 years ago were 0.000 and 0.001; respectively. As it is less than 0.05, so Hypothesis 0 is rejected with 95% certainty, i.e. there is a significant connection. The determination coefficient or  $R^2$  is 0.735. F statistics is 20.601, T statistics is 2.708, and DurbinWatson statistics is 2.029 showing that there is no self-correlation. Therefore there is a significant and direct connection between original and dependent variant, and according to other components having significance more than 0.05, Hypothesis 0 is accepted with 95% certainty, i.e. it is not significant.

**5.CONCLUSION**

Accounting profit and related components are among information which are considered by individuals in making decision. According to items, this rate is calculated and identified. Based on promissory approach if expenses are established, profit rate can be reported. In this study, the connection between promissory items, business lines and profit prediction were considered. All of them, promissory items, business lines and profit prediction, predict

future function significantly. Owing to estimations of last year financial bills, usually there is no difference between predictions by managers and real items. According to Pandeh (2009) without considering and creating promissory items at cash items no business is possible. Prospering in a business is as the result of many factors, a most important and pivotal of these factors is to design and accomplish an optimal business model in the beginning of establishing the company. The results of this research are in harmony with his theories. Also the results of hypotheses II show that as the promissory items of working capital in companies increases, the predictions by these companies is more optimistic. Trust in functional environment is one of the reasons. Also the profit of commercial unit is one of items of financial bills having high importance to all consumers. In statement I on emphasis concepts of financial reports it is asserted that financial reports emphasize on information which are about company performance and is presented through profit calculation and its components. In the process of calculating profit, it is used from promissory accounting system in which promissory items modulate cash flow in a period to measure the performance of

commercial unit in a better way. Also according to theoretician, the pattern of structural business is for products, services and company information flow, and includes some explanation on economical factors and their roles. Also business pattern describes the profits of different factors and defines possible flow of income and profit prediction. This framework shows that a company accomplishes what kind of activity, how, and in what time to meet customers` needs and to get profit.

As hypothesis 1 was confirmed, there is more attention toward the role of promissory items as an opportunity for managers in using a special kind of management and it is suggested to standard formulators to establish some standards toward these promissory items in order to avoid creating opportunistic profit from these items for managers. It is suggested to investors to pay attention toward the percentage of pure profit of companies at the time of announcing profit (establishing the annual associations), since according to the findings of this study, the percentage of pure profit is one of the most effective factors in creating unusual outputs, and has a reverse connection with different reactions of stocking market of companies.

Based on results about the effect of business plan and company size in hypothesis III, it is suggested to investors to pay attention toward analyzing the business plan, the combination of investors, company size, output, and the prediction of future profit. Also future projects should create a better model of discriminating promissory items optionally or non-optionally, and for each industry a special model should be created to conclude the best results in projects in which promissory items are among basic variants and error in discriminating these items should be minimized.

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