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   STATEMENT OF THE PROBLEM

   OBJECTIVES

   HYPOTHESES

   RESEARCH METHODOLOGY

   RESULTS & DISCUSSION

   FINDINGS

   RECOMMENDATIONS/SUGGESTIONS

   CONCLUSIONS

   SCOPE FOR FURTHER RESEARCH

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CONTRIBUTIONS TO BOOKS
- Sharma T., Kwatra, G. (2008) Effectiveness of Social Advertising: A Study of Selected Campaigns, Corporate Social Responsibility, Edited by David Crowther & Nicholas Capaldi, Ashgate Research Companion to Corporate Social Responsibility, Chapter 15, pp 287-303.

JOURNAL AND OTHER ARTICLES
- Schemenner, R.W., Huber, J.C. and Cook, R.L. (1987), "Geographic Differences and the Location of New Manufacturing Facilities," Journal of Urban Economics, Vol. 21, No. 1, pp. 83-104.

CONFERENCE PAPERS
- Garg, Sambhav (2011): "Business Ethics" Paper presented at the Annual International Conference for the All India Management Association, New Delhi, India, 19–22 June.

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INVESTIGATING THE RELATIONSHIP BETWEEN OVERVALUATION OF STOCKS AND STOCKHOLDERS' EQUITY AND PROFIT-SMOOTHING IN TSE CEMENT AND AUTOMOBILE INDUSTRIES

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ABSTRACT
The main purpose of Accounting and preparation of financial statementsis to make useful information available so that business decisions can be made. Information plays a key rolein different aspects of decision-making.Decisions that aren't primarily based on useful information fall short in meeting the demands of decision makers. The information should contain good-quality features in order toprovide correct basis for decision making. One of the important factors that affect the reliability of the information in financial markets is the profit-smoothing. Profit-smoothing occurs when managers use judgment in financial reports and prepare business transactions in a way that misleads differentstakeholders or that influences the results of contracts based on accounting numbers (Haley and Wallen, 1999, page368).This study tries to assess the relationship between the overvaluation of stocks with profit-smoothing and value of the firm. Overvaluation of stocks and value of the firm are set to be our two independent variables and profit-smoothingasthe dependent variable.The sample usedin this study was chosen from the companies listed inTSEcement and automobile industries. By testing our research hypotheses, we find that there is a positive correlation between overvaluation of stocks andprofit-smoothing. This meansit is likely that there is a chance that companies whose stocks are overvalued are likely to commitprofit-smoothing to justify the company's performance and stock prices. However, no correlation and significantrelationship could be found between the value of the firm and stockholders' equity with profit-smoothing.

KEYWORDS
overvaluation of stocks, profit-smoothing, agency theory, representing financial information reliability.

INTRODUCTION
Information plays a key role in different aspects of decision making. Decisions that aren't primarily based on useful information fall short in meeting the demands of decision makers. The information should contain good-quality features in order to provide correct basis for decisionmaking. Vekry (1958) defines qualitative characteristics ofinformation as "characteristicsofinformationthat makesit useful".According to the conceptual framework, reliability is one of the most important qualitative characteristics ofinformation. In the absence of the qualitative characteristics, any decision-making based on the information will be combined with high risk. Being reliable means to be free of any bias and to show reality as it is,not as the presenter wants it to be. Profit-smoothing is one of the factors that effectsthe reliability ofinformation in financial markets. Profit-smoothing occurs when managers use judgment in financial reports and prepare business transactions in a way that misleads different stakeholders or influences the results of contract based on accounting numbers (Haley and Wallen, 1999, page368). Many texts about profit-smoothing have been trying to justify this phenomenon by using agency theory. Based on the Positive Economics principles everyone is looking for his personal gain.So, management, using its position, tries to show the financial information in a way that meets its interests. When market value of stocks is more than intrinsic value, management has two solutions.First, warning the market about overvaluation to adjust the company's stock price, and second,showing the corporate performance in a way that can justify the company's stock price in the market. This research attempts to assess the relationship between overvaluationof stocks and stockholders' equity using profit-smoothing.

RESEARCH PROBLEM
In the literature on finance, there is a lot of research about influence of management behavior and company's actions on the firms' value in financial markets. Accordingto the agency theory in the early twentieth century, role of managers as representatives of the owners has a significant impact on the company's control method. Separation of ownership from management lead to a well-known organizational problem called the agency problem. Jenson and Macling (1976) introduced principles of agency theory and defined the company's managers as brokers and the shareholders as owners. In their analysis,managers confront shareholders. One of the main assumptions in the agency theory is that the owners and brokers have a conflict of interests.Overvaluationofstocks can be considered a new form of agency costs. Now,regarding what has been talked about so far, we are looking for scientific answers to these questions:
1) Whetherovervaluation of stocks makes management prone toprofit-smoothing
2) Whether there is any significant relationship between profit-smoothingand firm value and wealth of shareholders

IMPORTANCEOF THE RESEARCH
Nowadays, financial markets are one of the most important ways to invest small and large savings. Financial markets determine the market value of stocks according to the company'sexpected profit and the information in support of these expectations. This valuation is based on net present value of future cash flows and if any new information in this regard is released, the market will try to adjust expectations about the share in question thus the market share price will be adjusted. The periodic management reports are main sources of market intelligence. This information impacts on market value and confirms or adjusts market expectations. Managers are informed about the value surplus of stocks in the market, which is based on unreal expectations, and can control this value surplus and correct the stock market price by providing reports on the adjustment of market expectations. Although this action isin line with benefit of the market and prevents growth of a possible price bubble, it would endanger managers' positions and rewards. Therefore, managers will seek to swell the profit and confirm market expectations to prevent a reduction in their management time and rewards. One of the most important ways to swell the profit is profit management (profit-smoothing).Managers, in order to achieve their benefits, use profit-smoothingto control transmitted information.Review of information provided to the market and assessment ofthe role of profit-smoothing in overvaluation of stocks in financial markets are necessary.Overvaluation of stocks can

be a potential factor for destruction of shareholders' wealth in long term and a cause of waste of investors' confidence in stock prices in market and ultimately a reduction in investments in the stock markets.

BACKGROUND RESEARCH

Overall, the research conducted about profit-smoothing can be divided in two main research categories, theoretical and empirical research.
Glavr and Sandra (2004) have challenged the disclosure principles. Their argument was based on game theory. According to this theory, if one game party (management) possesses information that the other side (external users) are unaware of, he will try to keep it covered. Therefore, according to this argument, profit-smoothing is the management's efforts to keep the market unaware of the true information which he is aware of.
Effective stimuli acting on profit-smoothing and profit management. (BahariMogadam 2006) In this study, the researcher intends to assess the seven affecting stimuli acting on smoothing and profit management and also to evaluate each of their roles. These motives include financial structure (financial leverage), the ownership structure, major stock market, reward plans, independent auditors, the company's growth rate, and the company's size. Ultimately, the researcher finds that there is a positive and significant relationship between financial structure (financial leverage), ownership structure, reward plans, independent auditors and company's size and smoothing and profit management but there isn't a significant relationship between the major provision of stocks and the company's growth with smoothing and profit management.Profit-smoothing by manipulating the classification of income statement items (Bakhtaki, 2007).
In this study, smoothing through applying changes in the classification of income statement items has been studied. The researcher assumes that since use of accruals and transferring company's costs to future years and also identifying future periods' earnings causes future periods' benefit to be affected strongly, therefore managers are interested to get smoothing applying changes in the classification of income statement items. But the research findings show that most of the companies in Iran's capital market are interested to use accruals for profit-smoothing. In general, research in Iran's capital market has been done in five specific areas.
1-Researches that sought to examine the relationship between profit-smoothing and price and stock returns.
2-Researches that examined the factors affecting profit-smoothing.
3-Researches that sought to examine profit-smoothing incentives.
4-Researches that examined profit quality and the accruals role in this field.
5-Researches that has evaluated profit-smoothing from a cultural perspective and standard.
Marcio and Vrma (2008)Re-providing financial information is one of the key factors leading to uncertainty about the correctness of information presented. According to this idea, this study tries to assess the relationship between overvaluation of stocks and re-presentation of profits. Researchers assume that there is a relationship between profit manipulation due to overvaluation and the re-presentation of profits that shows a reduction in profits. Evidence obtained show that there is a relationship between overvaluation and re-presentation of profits showing a reduction.

RESEARCH PURPOSES

In general, the objectives of this research can be classified into two theoretical and practical categories.
Theoretical objectives of this research are:
1. Literature review about the research topic.
2. Making studies in the field of profit-smoothing More complete.
3. Providing a new basis for other studies.

Practical purposes of this research for use by players in capital market are:
1. Managers' paying more attention to profit-smoothing effect on the shareholders' wealth.
2. Market attention to the overvaluation of stocks and its effects.
3. Market attention to the profit-smoothing and its effect on stock pricing.
4. Warning the market about results of overvaluation of stocksdone byprofit-smoothing.
5. Providing a method for evaluating overvaluationof stocksdone byprofit-smoothing.
6. Urging for thetimely evaluation of profit-smoothing.

RESEARCH QUESTIONS AND HYPOTHESES

In this study, to answer the main research questions, identify and explain the relationship between overvaluation of stocks and profit-smoothing and shareholders' wealth,twohypotheses are put forward as following:
1- There is a significant relationship between the overvaluation of stocksandprofit-smoothing.
2- There is a significant relationship between firm value and profit-smoothing.

RESEARCH VARIABLES

A variable is a conceptthat is attributed more than two or more values or numbers. In other words, a variable refers to a feature that can be observed or measured and replaced by two or more values or numbers. The number or value assigned to the variable represents a change from one person to another or from one state to another.Variables are the conditions or featuresthat the researcher wishes to control, manipulate or see. Variables are divided into two categories based on their roles in a study.
1- Independent variables
2- Dependent variables

In this study,overvaluation of stocks and firm value are the independent variables and profit-smoothing is the dependent variable.

DEFINITION OF VARIABLES

A-PROFIT-SMOOTHING

Represents an attempt by companies' management to reduce abnormal changes of the profit in generally accepted accounting principles framework.In other words,managers of some business units use tools such as accounting methods for smoothing profits in different accounting periods and so manipulate and distort the real profit. Profit-smoothing refers to certain types of profit management in which a manager temporarily reduces profit fluctuations to make it appear more stable.In other words,implementation of management's opinion in the recorded costs and revenues to change their succession or transfer them to the next years using theflexibility of common methods and accounting principles insuch away that the company's profit trendswon't show major changes over several consecutive years is called profit-smoothing.

B-OVERVALUATION OFSTOCKS

Overvaluation of stocks occurs when a company'smarket priceishigher than its original value (Yuns, 2005).This means that these companies are unable to save themselves against severe declining prices in future unless their performance can justify stock prices by chance. Intrinsic value is one of the most prevalent assessment measures for market value.

C-FIRM VALUE

Firm valuerepresents the product of a company's stockprice and thenumber of its issued shares. A company's average value is calculated as follows:

$$\overline{MVE}_i = \frac{\sum_{t=1}^{n} Pit * Nit}{n}$$

Pit shows the company's stock price at the end of year T and Nit is the number of company's issued shares at the end of the same year.

STATISTICAL POPULATION AND ITS NUMBER

Companies, which are listed in Teheran Securities Exchange and fall under cement and automobiles categoriesform the statistical population.

ESTIMATION OF SAMPLE SIZE AND SAMPLING METHODS

Considering the study'sgeographical scope,all companies listed in TSE cement and automobiles groups form the statistical population. Statistical sample is chosen using the elimination method and with regard to the following conditions, considering the time and geographical scopes of this study:

1- The company's financial year ends on the last day of March each year.
2- The company has been listed in TSE by the beginningof 2005.
3- The company's financial statements for all years between 2005 and 2011, inclusive, are available.
4- The company'sstock tradingin TSEhas beenon-going and hasn't been halted for more than one monthduring the specified period.
5- The company's stock pricesareknown at the end of the year.

RESEARCH METHOD

Our research method is based on inductive and deductive reasoning approaches. This study,like all research-based deductive approaches, begins with detailed goal description and somehypothesesand key definitions are put forward after setting goals. But because the investigation is based on observation, inference and generalization of observations,itfollows an inductive approach.

The method used is examination of correlation to explore the correlation between the stability ofprofit-smoothing and overvaluation of stocks. The correlation coefficient calculatedin this study is the x2 correlation coefficient. Because the data used is of the real and historical type, it can be considered a post hoc analysis.

DATA COLLECTION METHODS

The internet sites such as www.irburse.com and www.parsportfolio.comare used to extract companies' information listed in the TSE.Also financial statement information was extracted using the financial databases of companiesaccepted in TSE (2005 to 2011) and also Tadbirpardaz and Rahavardnovinsoftware. In case the databases lack information, the archive of financial statements in the TSE library is used.

DATA ANALYSIS METHOD

The relationship between variablesin this study will be studied systematically.The studied variables are non-experimental and are not controlled by the researcher and to explore and explain the relationship between the variables, statistical sampledata are analyzed. With regard to the research goal, the study is classified as an applied study, andthe obtained results can be used by groups, individuals, securitiesand exchange organizations or other legislative bodies, commercial banks, credit rating agencies, actual and potential investors, all teachers and students of accounting,corporate and organizational executives and chief financialofficers.Regarding the research method,the research uses correlation examination and is a post-hoc research.

Correlation method has two aims:

1- Discovering the correlation between variables
2- Predicting or explaining a variable through one or more other variables (Delavary, Ali, 1995)

PROFIT-SMOOTHING DEFINITIONS

In recent years and decades, different definitionsofprofit-smoothinghave been presented, some of which are:

Hey Verc in 1953 definesprofit-smoothing as:

Profit-smoothing is a rational and logical operation that managers use, byspecific accounting tools,tosmoothen their profits.Verci defines profit-smoothing as an action that can provide incorrect information so that the investors will not get useful information about their return on investment and risk.Balkoyi definesprofit-smoothingas a deliberate attempt by management to show a normal profit to achieve a desired and expected level.

THE DUAL ROLE OF ACCOUNTING

The traditional accounting approach about accounting information value indicates that information has dual roles includingdispersing awareness and stewardshiprole. The role of awareness comes from investors' information demand, so they can predict future cash flows and assess their risk through this information. Accounting stewardship role comes from separation of ownership and management in public companies that puts management in shareholders' steward position.

THE PLAYERS INPROFIT-SMOOTHING

The provided classification of the players in profit-smoothingis based on the main characters in financial accounting area that they can be classified in three groups: **managers**, **users and regulators**. Managers' report profits, and users can use it to decide and regulators show the validity and value of the reported profitinformation to other users.

PROFIT-SMOOTHING AND INFORMATION ASYMMETRY

Basically,profit-smoothing is possible when, first, there is information asymmetry, and second, there isn't any technique to eliminate this information asymmetry. Overall, this is a known phenomenon that in commercial transactions some parties may havemore information than others.When such a situation exists, it is said that the economy is characterized by information asymmetry.

PROFIT-SMOOTHING INCENTIVES

Maintaining the company'scredibility is one of the primary purposes of profit-smoothing.This credit makes the company look efficient and dynamic. The main motivation behind profit-smoothing the belief that companies that have good profit trends and whose profits will not suffer major changes are more valuable than similar companies.

1- Bonus-related incentives behind profit-smoothing.
2- Contractual incentives behind profit-smoothing.
1- Politically motivated profit-smoothing.
2- Tax-related incentives.
3- Changes in top management.
4- Initial public offering (IPO).

5- Information transfer to investors.

AGENCY COSTS AND OVERVALUATION OF STOCKS

Yuns (2005) believes that overvaluation is a form of agency costswhich will provide management with benefitsin short term butdestroy companyvalue in long run. Simply put,overvaluation can be considered as the market errorin assessing the particular share and expectation from it.ValuationError isn't an important and influential factor in financial markets by itself because soon the market will quickly adjust its expectations and decrease the price to the actual price level when the company puts forward new information. But if the information flow is disrupted or manipulated, then the market will not be able to adjust its expectations about the firm's future cash flows based on incorrect information and in long term, theincorrect price and overvaluation of stocks will destroy the company.

WHAT IS OVERVALUATION?

Overvaluationoccurs when a company's stock prices in the market is significantly more than its true value(Yencen 2005). This definition means that these companies are unable to save themselves from price drastic reductions in future unless theirperformance can justify the stock prices by chance.

AGENCY THEORY

According to this theory, an agency relationship occurs when one or more people (as company owners and shareholders) hire one or more other persons (as agents and managers) to represent the former people in doing things. However, agents cannot always do things in the best.

SOLUTION TO FIGHT OVERVALUATION

The solution forovervaluation problem is to stop it (Jyanzyn 2008). This is a trait in any human being not to be willing toobtain long-term benefits by enduring pain and suffering in the short–term and managers,because of the same trait and also their uncertainly about the future of their position in the long term, aren't willing to do an effective action to stop overvaluation. Warren Buffett is one of the few managers whowarned the shareholders and the market when the company he was the director at (Berkshy corporate) wasovervalued by market.

THE OVERALL RESULTS FROM THE TEST OF RESEARCH HYPOTHESES

The relationship between the dependent and independent variables was investigated using hypothesis testing. According to the findings from the first hypothesis, there is a positive correlation between overvaluation of stocksandprofit-smoothing variable. This means it is likely that there is a chance that companies whose stocks are overvalued are likely to commit profit-smoothing to justify the company's performance and stock prices. But based on the second finding,no correlation and significant relationship could be found between the value of the firm and stockholders' equity with profit-smoothing. As a result, firms of different values in Tehran Security Exchange attempt to profit-smoothing.

RESEARCH FINDINGS

1- Shortage of attention to the corporate governance structure and lack of appropriate legal mechanisms to require companies to establish a proper internal control structure.
2- Lack of a legal mechanism for complainingabout and prosecuting the directors.
3- Lackof sufficient attention from users to the re-presentations of financial statements gives the management the opportunity to easily commit profit smoothing.
4- When a company facesovervaluation of stocks and managers smooth profits to justify the stock market value, thisleads to long-term decrease in the company value.

RECOMMENDATIONSFROM RESEARCH FINDINGS

1- Legislation to improve corporate governance structure.
2- Requiring company managers to disclose important weaknesses.
3- Review of reports on internal controlsby independent auditors, making a report on this.
4- As long as accounting and auditing standards and the main structure of financial statements are not developed to be comprehensive and accurate, financial reporting process will face ambiguity.
5- Developing a separate regulation charter concerning disclosure practices in re-presentation of the financial statements.
6- Careful monitoring of the corporate and independent auditors by the capital market authorities.

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