THE INFLUENCE OF EXTERNAL SURROUNDINGS ON EARNINGS MANIPULATIONS: A JAPANESE STUDY

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ABSTRACT
The keiretsu business model of Japan is unique and has been described as “criss-crossed capitalism” (Economist, 2008). At the center are the main industrial banks, which play a primary role in the system of corporate governance. However, global capital and international accounting standards may have begun to erode this influence. This paper investigates the influence of banks, capital markets, and accounting firms have on earnings manipulations in Japan using a 2010 sample of firms listed on the Tokyo Stock Exchange. The findings suggest the declining influence of the main banks and an increasing influence of capital markets and accounting firms.

Key words: corporate governance, keiretsu, earnings manipulations, international financial reporting standards, Big 4 auditors

INTRODUCTION

The function of corporate governance has been partly controlled by banks in Japan. It is the unique governance system in the world. Over the last few decades, previous research (Douthett and Jung, 2001: Fan and Wong, 2002; Weinstein and Yafeh, 1998) has attempted to explain the main bank relationship with firm in terms of specificity. Douthett and Jung (2001:137) contend that the main bank played an important role in monitoring. The Keiretsu main bank, as a creditor and shareholder, had strong incentives to become informed about firms and their investment opportunities and to use the information to ensure that efficient choices were made. Fan and Wong (2002:16) reported that different from the East Asian firms that were typically family controlled, the dominant ultimate owners of Japanese firms were institutions, typically the main banks of industrial groups. Japanese firms’ ownership structures were also quite different from those of the East Asian firms in both the degree of control and cash-vote divergence. On the other hand, Weinstein and Yafeh (1998) had a

1 See, for example, Douthett and Jung (2001) for a discussion of firms in Keiretsu.
doubt the role of main bank in free markets. They noted the negative sense of main bank system. The main bank made use of monopoly power to lend funds with relatively higher interest rates in undeveloped financial markets.

Above these previous studies argued that main bank relationship was unique economic bonds. In special, Japanese firms have not had a strong relationship with stock markets but banks since post war (Aoki et al., 1994). For instance, firms make a deal with a few banks to get the working funds, indirect financing. Among these banks, the special relation bank is called a main bank. Main bank is principal bank to support the working funds, to monitor behaviors, and to rescue managements for borrowers in the crisis of running firms. However, business setback and International Accounting Standards (IAS)\(^2\) brought the change of existing systems around the firms in 1990’s. It was the reason that firms were compelled to comply with the International Financial Reporting Standards (IFRS). Most firms were obliged to require changing the evaluation of holding stocks by fair market value at the end of year. They recognized loss of the mutual holding stocks in relation to recessions. They released these stocks to avoid the loss in income statement. Moreover, some matters were brought to the banks’ bad debts, restructuring the group firms’. These change took the main bank’s power weaken with firms (Numata and Takeda, 2010).

These arguments have been continued in academic papers. However, empirical previous studies are not enforced including in banks, firms, stock markets and accounting firms, as far as we know. To analyze the relationships to earning manipulations under above conditions, the authors grasp the power factors’ of banks, stock markets and accounting firms for firms’ earning manipulations.

The most important addition to be made to what Pong and Kita (2006) found that the accounting firms audited the banks, which had the strong relationships with firms as main banks. These firms were also audited by the main banks’ identical accounting firms. They identified that main banks had a power to prefer their auditors for cooperative firms in Japan. While Pong and Kita (2006) investigated the mechanism of framework among main banks, accounting firms and firms, they did just present ratio analysis. We have two motivations based on their research. First, their study targeted to the sample in 2000. The surrounding of firms has dramatically changed since then. For example, mergers have been occurred with firms, moreover, banks in financial trouble. And the dissolution of an auditing firm; ChuoAoyama, it affiliated with the global network of PricewaterhouseCoopers, had also occurred (Numata and Takeda, 2010). There is a need to study to follow the subsequent 10 years. Numata and Takeda (2010) mentioned that the traditional role of main bank decreased,

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\(^2\) IAS is an old name of IFRS.
and the role of auditors increased in the 2000’s. Especially, the main banks monitoring powers have been weakened to the large listed firms. These firms began to raise funds from the stock markets, rather than indirect financing. The authors need to carry out these investigations of the firms’ external surroundings.

Our research, one step forward, takes up this challenge. This paper takes a different approach from Pong and Kita (2006) toward an exploratory study. We investigate whether the relationship between main banks, stock markets and accounting firms affected managements’ accounting practices by the regression analysis. Namely, this study verifies whether firms’ external surroundings impact on earning manipulations. A key distinguishing feature of this analysis is to examine the accounting and audit qualities in addition to discretionary accruals to accuse of external influences in Japan. Our objective is to analyze whether large firms focus on the stock markets, rather than banks. It leads to realize the management of shareholders’ value and select an accounting firm having a good audit reputation by firms to get the working funds in financial markets.

**Institutional background: Changing finance raising by firms**

In this chapter, we discuss the changing financing method under the recent economies. First of all, we focus on the indirect financing, main bank relationship with firm. The unique Japanese economic system has changed since the 1990’s. Numata and Takdea (2010:181) mentioned that it had begun the restructuring of banks and firms after the collapse of economic bubble. The dependence of firms on bank financing and monitoring was further reduced by a decrease in the traditional cross-shareholding between banks and firms and a substantial wave of mergers and acquisitions beginning in the late 1990’s. Stable shareholding and cross-shareholding decreased 18 percent and 11 percent from 1991 to 2003 respectively (Patrick, 2004).

The relationships between firms and banks have been changed dramatically since 1990’s. Large firms have not heavily depended on the financing from main banks under these conditions. They have come to raise finance from stock markets in appealing management of stockholder’s value. By raising funds from the stock markets, it has come to use care to the auditors’ assertions of the auditor’s report. Based on the data of bank of Japan, banks reduced to the lending funds for borrowers since 1989. Reversely, the volume of the repayment bank loans has been excess the borrowing since 1996. Sakai and Shikano (2011) pointed that the increasing of equity financing reduced the dependence on bank loans by the policy effects of

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3 See the Scher (1997) mentioned the purpose of cross-held shareholdings and responsibilities of main bank.

4 See the White paper of the Small and Medium Enterprise Agency, ninety four percent of Small and medium-sized firms depend on main banks to get the funds.
financial liberalization, deregulation market securities and high stock prices. It is an apparent that firms tend to stress the direct financing. Namely, firms have not pivoted the main banks with the decreasing indirect financing.

Large firms had been eager to acquire individual shareholders with investor relations; the issue an annual report. Additionally, it had emerged new stock markets, Market of the high-growth and emerging stocks (Mothers), for start-up firms in 1999. It would be insufficient attention about the requirements on listing in order to promote the economic revitalization and the investment from international investors\(^5\). Initial public offering (IPO) has been performed 1,100 firms since 2000. In contrast to existing stock markets, the emerging stock markets have predominance conditions about the going public on the markets. Small and medium-sized enterprises (SMEs) made raising finance easier. They have possibilities of being listed on the emerging stock markets with deficiencies, if their performances would be remarkable.

However, Yonezawa (2006:142) paid two special attentions to the emerging stock markets. One was for a market interested party. Owing to just aim to increase the number of listed firms on emerging markets, it turned out to the market risks by being not to strict the examination listing standards. Second was for a top management of firms. There was a concern about the increasing managers with unawareness of social responsibilities of public firms; performing corporate governance and regulatory compliances. Such managers would neglect the operations and disclosures firms’ information after the listed. It would continue to decline the reliance of the emerging markets. In fact, fraud incidence has occurred by listed firms on emerging markets. For instance, a firm revised the downward performances after listing immediately in 2001. In addition, Livedoor Co., Ltd., listed firms on Mothers, was famous for having done a creative accounting in 2006. Based on the influence of them, it decreased 106 firms in 2007 to nine firms in 2009 on IPO.

In summary, the change of financing has been brought to the weak relationship between bank and firms. Firms correlate strongly with direct financing; stock markets. However, the listed firms have a tendency of earnings manipulations to raise funds in emerging markets.

**Hypothesis 1:** Emerging stock markets have a close relation to the firms’ earnings manipulations, rather than banks.

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\(^5\) Other emerging markets are as follows: Jasdaq, Centrex, Q-Board, Ambitious.
THEORETICAL BACKGROUND AND HYPOTHESIS

City bank vs. small and middle-sized bank

Main banks system is one of the governance systems in Japan. It has been taken in unique mechanism of business operations in other countries (Fan and Wong, 2002). Main banks system was considered as a source of power factors, the reason was that it had a major impact on both firms and accounting firms (Pong and Kita, 2006). We categorize the banks by size. There are two types of bank in Japan. One is the city bank which consists of six mega banks\(^6\). These banks has served as coordinator of their groups activities and raising funds as a facilitator of their group companies, Keiretsu and corporate group mainly. On the other hand, the small and medium- sized bank is near the firms. It calls a regional bank in Japan.

We review the previous research about these banks. The main bank research was performed between big banks and large firms (Aoki et al., 1994; Hoshi et al., 1994; Teranishi, 1993). The research focused on the solving agency problems of managerial behaviors and solving problems of information asymmetry between lenders and borrowers.

However, as far as we know, there are little empirical small and medium-sized main banks and firms relationship studies. Prior research did not touch a theory of these relationships. We formulate a hypothesis to use the multitude relationship lending research in US. There is a reason to use relationship lending\(^7\) research to formulate our hypothesis. Muramoto (2005) indicated that relationship lending was a kind of main bank system. In general, main bank analyzes both hard and soft information having been gotten from borrowers. On the other hand, banks accord especially importance to the soft information of firms. The soft information is ascribable to the length of time. The banks are relevant to firms by a mean of 10 years in US. Contrastively, SMEs have a correlation with main banks on average 30 years in Japan (Kano, 2006). In the light of viewpoint, the banks have the profusion soft information with regard to borrowers in Japan.

Stein (2002) discussed the priority of relationship lending. This relationship lending was useful for small and middle-sized bank. While large banks were better with respect to the transaction-based lending, they were at a disadvantage in case of the relationship lending. It

\(^6\) City bank consists of six banks: Tokyo Mitsubishi UFJ, Mitsui sumitomo, Mizuho, Mizuho corporate, Risona, Saitama Risona.

\(^7\) Berger and Udell (2001) explained two lending methods for borrower. One was a transaction lending; hard information. It consisted of financial statement lending, asset based lending, and credit scoring. The other was a relationship lending; soft information.
took a time and costs to judge the soft information in large banks. Small and middle-sized banks depended much on their personal relationship with the existing borrowers to mitigate the information asymmetries and agency costs (Boot, 2000; Berger and Udell, 2002). The same line of research was performed by Fama (1985) and Diamond (1984). Fama (1985) argued that banks access to soft information about the borrowing firms, which was useful the screening the loans and making risk assessments before the loan was approved, and also for monitoring the loan afterwards. Diamond (1984) wrote that the insider position allowed the bank to overcome information asymmetry. In brief, a bank’s assessment of the borrowing firm was of value because it had an inside position and thereby had detailed special (inside) information about its decision process and concurrent projects.

Berger et al. (2005) examined smaller banks had stronger relationship with their borrowers. Uchida et al. (2008) supported the same results about Japanese samples by the methodology of Berger et al. (2005). Uchida et al. (2008) reported that recent academic research suggested that small banks have an advantage over large banks in providing credit to SMEs. The small bank had more management relationship than large bank.

Therefore, small and middle-sized bank has a profound influence on the borrowers’ governances. They make use of the soft information collecting from the borrowers to reduce information asymmetry and to strength the monitoring. In addition, they monitor their potential borrowers’ managements by the advantages of favorable locations. It is that the relationship between banks and firms tends to be suppressed the fraud by the firms.

**Hypothesis 2**: Small and middle-sized banks deter firms’ earning manipulation to a great extent.

**Audit service and earning manipulation**

**Big accounting firms vs. non-big accounting firms**

In this section, the authors classify the size by accounting firms’ audit quality based on previous academic literatures. Big accounting firms have a motivation to detect and report material misstatements to be fear of decreasing their valuable reputations. Various groups of researchers have tackled with the reputation of auditors and earning manipulations. For example, Becker et al. (1998) have written widely about the comparison Big Six auditors with non-Big Six auditors. They examined that non-Big Six auditors’ clients reported

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8 In contrast, Brevoort and Hannan (2003) mentioned that the change in technology that could give rise to increasing distances appear to have been adopted only by a small groups of banks.

9 Big accounting firms in Japan and their international accounting firms partners: ShinNihon LLC (Ernst & Young LLC), Tohmatsu LLC (Deloitte Touche Tohmatsu LLC), and Azusa LLC (KPMG Azusa LLC)
discretionary accruals that increased income relatively more than the discretionary accruals reported by Big six auditors’ clients. They found that the clients of non-Big Six auditors reported higher discretionary accruals than that of Big Six auditors. The related previous research had the identical results (Francis et al., 1999; Nelson et al., 2002; Lobo and Zhou, 2006; Ashbaugh-Skaife et al., 2008). Lobo and Zhou (2006) demonstrated that audit qualities regulated the earning manipulations by management after Sarbanes-Oxley Act: SOX.

There is some research that big accounting firms have a tendency of avoiding the audit contracts with firms in risky of litigations. DeAngelo (1981) indicated the evidence that Big 5 auditors avoided the litigation risk, compared with non-big 5 auditors. Francis (1999) and Becker et al., (1998) obtained that Big 5 auditors seemed to resist managers’ accounting manipulations. Their evidences were consistent with the result of DeAngelo (1981). Reynolds and Francis (2001) also mentioned that larger clients also posed greater litigation risks, and Big 5 auditors reported more conservatively for larger clients, having been suggesting that reputation protection dominates auditor behavior. Shu (2002) described that large auditors tended to resign the audit contracts with firms having increased the litigation risks and emerging mismatches.

In summary, big accounting firms have a tendency to avoid audit contracts of risky firms to keep their reputations and to remain existing clients. Therefore, big accounting firms prevent firms from managing earnings.

_Hypothesis 3: Big accounting firm is much decreasing firms’ earning manipulations than non-big accounting firm._

**Audit report and earning manipulation**

We perform the literature review about the relationship between auditor’s reports and earning manipulations. Some studies (Francis and Krishman, 1999; Bartov et al., 2000; Bradshaw et al., 2001) have been worked with the connection between accounting accruals and the presence of modified audit opinions. Their findings were that earnings manipulations increase the likelihood of receiving a modified audit opinions (Bulter et al., 2004).

Especially, managers have a motivation to manipulate increase earnings to have gotten the going concern opinions on audit reports. Rosner (2003) discussed the relation between modified opinions and abnormal accruals rested with firms having had going concern opinions. Their sample firms had negative accruals that were likely due to sever financial distress. In other words, these firms had already performed the earnings manipulations before
the year. The earnings were turned over in the sample year. Therefore, their results were not consistent with previous studies that firms receiving modified opinions by managing earnings. Francis and Krishnan (2010) investigated auditors of high-accrual firms were more likely to issue modified opinions for asset realization uncertainties for the going concern problems. Further, Japanese academic research (Suda et al., 2007; Takada, 2007) has done the extensive work with increasing earning manipulations in the face of bankruptcy.

In addition, as far as we know, few studies examined the subsequent event information on auditor’s report after balance sheet data. The authors consider the subsequent events as an important disclosure information for stakeholders. Auditor should disclose the kinds of events on auditor's report. They should notice the events for investors to mitigate information asymmetry between firms and stakeholders and more to resist earnings manipulations.

Therefore, the additional information of auditors’ report alarms the earning manipulations.

_Hypothesis 4: The additional information on auditor’s report has an influence on the accruals._

_Audit fee, non-audit fee and earning manipulation_

Previous academic research examines the audit and non-audit fees effects on earning manipulations. These works indicated in the literature, which could be classified into two major categories. One is that fees have reference to earning manipulations. Gore et al. (2001) found that non-big 5 auditor allowed more earning manipulation than Big 5 auditors by using of U.K sample. They also provided evidence of positive associations between the provision of non-audit services and earnings manipulation. Frankel et al. (2002) investigated the association between the provision of non-audit services and earnings quality. Their evidence showed that firms purchasing more non-audit services from their auditor were more likely to report larger absolute discretionary accruals. The purchasing non-audit services were associated with lower quality earnings. They indicated that non-audit fee was negative effect on earnings quality. Srindhi and Gul (2007) wrote that non-audit fee had an impact on the auditor’s independence.

The other is that fees, audit fee and non-audit fee, are not linked with earning manipulations. Several prior studies (e.g., Frankel et al., 2002; DeFond et al., 2002; Ashbaugh et al., 2003; Chung and Kallapur, 2003; Reynolds et al., 2004) had addressed the regulatory concerns and examined whether non-audit service fee adversely impacted the quality of reported accounting numbers as measured by the level of abnormal accrual adjustments, or, influenced
auditor’s opinion formulation process. All those studies (except Frankel et al., 2002) had produced limited evidence that the provision of non-audit services was associated with the reported earnings quality (Mitra and Hossain, 2007: 348). Asbaugh et al. (2003) challenged the research findings of Frankel et al. (2002). They inquired the non-audit fees did not have an effect on the independence of auditors. They contradicted the findings of Frankel et al. (2002). Non-audit fees were not related with earnings manipulations. Chung and Kallapur (2003) used modified Jones models. They surveyed that audit fee metrics were not associated with the absolute value of discretionary accruals. Ruddock et al. (2006) explored the concerning between the provision of non-audit services by incumbent auditors and the extent to which earnings reflected bad news on a timely basis. Their findings revealed that higher levels of non-audit services were not associated with reduced conservatism.

In summary, the results of previous research did not achieve the unified results. However, we suppose that audit fees and non-audit fees have a positive effect on the accruals.

Hypothesis 5: Audit and non-audit fees are positively related with accruals.

SAMPLE AND METHODOLOGY

The sample is selected at the 2010 using the following criteria:

1. The firms are listed on the all Japanese stock exchange in 2010.
2. The year end is March.
3. Banks, securities firms, insurance, and utilities firms are excluded.
4. Compliance with foreign accounting standards is deleted.

Financial data, main bank, and securities report necessary for the study is available from the eol database. The accounting data is used consolidated financial statements. Final sample is 1931.

In testing these hypotheses, this study focuses on total accruals and discretionary accruals to observe the earning manipulations of firms. The discretionary accruals are estimated as total accruals minus nondiscretionary accruals. Nondiscretionary accruals are calculated using the modified CFO Jones model (Kasznik 1999)\textsuperscript{10}. This analysis uses the cross-sectional accrual model to control the effect of changing industry-wide economic conditions on total accruals and allows the coefficient to vary across years. By estimating the cross-sectional accruals

\textsuperscript{10} Suda and Shuto (2004) indicated this model had the highest interpretabilities in the earning manipulation models.
model, each firm-year sample is assigned to an estimation portfolio that consists of similar firms matched on the basis of the industry classification code and the fiscal year.

The following is the model to estimate nondiscretionary accruals:

\[
\frac{(IB_{it} - CFO_{it})}{AT_{it-1}} = \alpha_1 \frac{1}{AT_{it-1}} + \alpha_2 \left\{ \frac{(SALE_{it} - SALE_{it-1}) - (AR_{it} - AR_{it-1})}{AT_{it-1}} \right\} + \alpha_3 \frac{PPE_{it}}{AT_{it-1}} + \epsilon_{it}
\]

(1)

where:
- \(IB\) = net income before extraordinary item defines as net income, minus gain from extraordinary item, plus loss from extraordinary item;
- \(CFO\) = net cash flow from operational activities;
- \(AT\) = total assets;
- \(SALE\) = sales;
- \(AR\) = account receivables;
- \(PPE\) = gross property, plant, equipments and
- \(\epsilon\) = error term.

<table>
<thead>
<tr>
<th>Table 1</th>
<th>No. of obs.</th>
</tr>
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<tbody>
<tr>
<td>Catiorize the the banks and accounting firms</td>
<td></td>
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<tr>
<td>City bank and big accounting firm</td>
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<tr>
<td>City bank and non-big accounting firm</td>
<td>469</td>
</tr>
<tr>
<td>Small- and middle- sized bank and big accounting firm</td>
<td>244</td>
</tr>
<tr>
<td>Small- and middle- sized bank and non-big accounting firm</td>
<td>86</td>
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<tr>
<td></td>
<td>1931</td>
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</table>
In this section, we verify whether any factors affect the total accruals and discretionary accruals. We first estimate total accruals and discretionary accruals using multiple regression analysis for all sample firms (N=1,931).

Table 2 shows the results of multiple regressions about total accruals in Panel A and discretionary accruals in Panel B. It examines that the external variables influence accounting manipulations. In short, it presents the results that the main bank, the stock market, and accounting firms have an effect on earning manipulations of the firms by using of total accruals and discretionary accruals as dependent variables.

Accruals among bank, stock market, accounting firm and firm

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Table 2 shows the results of multiple regressions about total accruals in Panel A and discretionary accruals in Panel B. It examines that the external variables influence accounting manipulations. In short, it presents the results that the main bank, the stock market, and accounting firms have an effect on earning manipulations of the firms by using of total accruals and discretionary accruals as dependent variables.

\[
Accrual_{it} = \beta_1 CPA_{it} + \beta_2 AF_{it} + \beta_3 NAF_{it} + \beta_4 MB_{it} + \beta_5 STOCK_{it} + \beta_6 UNQUALIFIED_{it} + \beta_7 GOING_{it} + \beta_8 SUBSEQUENT_{it} + \epsilon_{it} \tag{2}
\]

where:

- Accrual = total accrual;
- CPA = 1 if auditor is a non-big accounting firm, 0 otherwise;
- AF = logarithm of audit fees;
- NAF = logarithm of non-audit fees;
- MB = 1 if main bank is small-and medium-sized bank, 0 otherwise;
- STOCK = 1 if stock market is for emerging markets, 0 otherwise;
UNQUALIFIED = 1 if additional information is on unqualified opinion, 0 otherwise;
GOING = 1 if going concern information is on opinion, 0 otherwise;
SUBSEQUENT = 1 if subsequent event information is on opinion, 0 otherwise; and
e = error term.

<table>
<thead>
<tr>
<th>Variables</th>
<th>Coefficient</th>
<th>t -Statistic</th>
<th>Prob.</th>
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<tr>
<td>Panel A: Absolute value total accruals</td>
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<td></td>
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<tr>
<td>C</td>
<td>0.071</td>
<td>19.970</td>
<td>0.000 **</td>
</tr>
<tr>
<td>CPA</td>
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<td>-3.270</td>
<td>0.001 **</td>
</tr>
<tr>
<td>MB</td>
<td>0.000</td>
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<td>UNQUALIFIED</td>
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<td>0.011 *</td>
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<td>0.016 *</td>
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<tr>
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<tr>
<td>AF</td>
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<td>0.890</td>
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<tr>
<td>NAF</td>
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<tr>
<td>Adjusted R-square</td>
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<tr>
<td>N</td>
<td>1,931</td>
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<tr>
<td>Panel B: Absolute value discretionary accruals</td>
<td></td>
<td></td>
<td></td>
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<tr>
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<td>0.045 **</td>
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<td>0.001 **</td>
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<td>SUBSEQUENT</td>
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<td>0.007 **</td>
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<tr>
<td>GOING</td>
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<tr>
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<tr>
<td>Adjusted R-square</td>
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<tr>
<td>N</td>
<td>1,931</td>
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Note: p-values are one-tailed; **, *, # denote p < 0.01, < 0.05, < 0.10, respectively.

First of all, it presents the income increasing manipulations by coefficients of positive (Coefficient = 0.071, p = 0.000). Next, we show the results of main banks’ and stock markets’ influence on earning manipulations by firms. Our study demonstrates that bank is not the strongest predictor of total accruals (t = -0.130, p = .894). On the other hand, stock markets are negative linked with total accruals (t = -2.180, p = .030). These results suggest the significance of stock markets’ effects on total accruals. This is consistent with the arguments about the bank and emergency markets. This hypothesis 1 is supported by these evidences.
Next, it is tested the hypothesis 2. We confirm with the relations between the variable of CPA and total accruals. The variable of CPA is relevant to total accruals ($t = -3.270, p = .001$) negatively. This exhibits that non-big accounting firms decrease the total accruals. It means that big accounting firms are not decrease the total accruals. It does not show the same line in the results of previous academic research (Francis et al., 1999; Nelson et al., 2002; Lobo and Zhou, 2006; Ashbaugh-Skaife et al., 2008). This hypothesis 2 is not supported under the result.

Then, we describe the results of each accounting firm’s tasks. The findings from these evidences indicated that the accounting firms’ tasks, presenting audit reports, have showing auditors’ responsibilities. Unqualified variable; unqualified audit opinion with explanatory information has the following the evidence ($t = -2.550, p = .011$). Subsequent variable is positive associated with total accruals ($t = 2.420, p = .016$). It means that audit reports show the working together with firms’ performances.

Finally, both audit and non-audit fees variables are not related with total accruals ($t = .890, p = .372; t = .080, p = .935$, respectively). These findings show that fees have nothing to do with earning manipulations.

Thus, accounting firms, stock markets, and clean opinion with additional information are negative relationship with total accruals. Big accounting firms do not always regulate the earning manipulations.

$$\text{Dis Accrual}_{it} = \theta_1 \text{CPA}_{it} + \theta_2 \text{AF}_{it} + \theta_3 \text{NAF}_{it} + \theta_4 \text{MB}_{it} + \theta_5 \text{STOCK}_{it} + \theta_6 \text{UNQUALIFIED}_{it} + \theta_7 \text{GOING}_{it} + \theta_8 \text{SUBSEQUENT}_{it} + \epsilon_{it}$$  \hspace{1cm} (3)

where:

- Dis Accrual = discretionary accrual;
- CPA = 1 if auditor is a non-big CPA firm, 0 otherwise;
- AF = logarithm of audit fees;
- NAF = logarithm of non-audit fees;
- MB = 1 if main bank is small-and medium-sized bank, 0 otherwise;
- STOCK = 1 if stock market is for emerging markets, 0 otherwise;
- UNQUALIFIED = 1 if additional information is on unqualified opinion, 0 otherwise;
- GOING = 1 if going concern information is on opinion, 0 otherwise;
- SUBSEQUENT = 1 if subsequent event information is on opinion, 0 otherwise; and
- $\epsilon$ = error term.
Panel B illustrates the results from estimating Model 3, which variables are affect discretionary accruals. We indicate the results of the correlation between the external environments of firms and discretionary accruals. At first, we obtain the results of main banks’ and stock markets’ impacts on firms. It also represents the income increasing manipulations by discretionary accruals of positive coefficient (Coefficient = 0.026, p = 0.000). The test of bank is also not significant interaction effects on discretionary accruals (t = .250, p = .800). On the other hand, stock markets’ results were positively correlated (t = 2.910, p = .004). The listed firms on emerging markets are connected with dependent variable. These results suggest that stock markets’ importance convey to earning manipulations. Many rapidly growing SMEs are listing on emerging stock markets to raise funds. According to chapter two and these evidences, listing application requirements are much looser than the existing stock markets. For example, information technology (IT) firms can not afford to recognize gains stably under rapidly changing the IT circumstances. It suggests that these listed firms manipulate earnings. It supports the hypothesis 1 from above evidences.

Next, it reveals the relations between the variable of CPA and discretionary accruals. The variable of CPA is not associated with discretionary accruals (t = -1.260, p = .207). This result means that discretionary accrual has nothing to do with size of accounting firms. Therefore, the test of hypothesis 2 is rejected.

Then, it describes that audit report variables are connected with discretionary accruals. Specifically, clean opinion with additional information is negative relationship with discretionary accruals (t = -3.440, p = .001). Further, it has closely connections between subsequent event, going concern information and discretionary accruals (t =2.690, p = .007; t = 2.760, p = .006, respectively). These results suggest that accountants’ task regulate the firms’ earning manipulations. Especially, it is an interesting evidence that going concern information has strongly relationship with discretionary accruals.

Additionally, No significant correlation is covered between both audit fees and non-audit fees and discretionary accruals (t =-0.020 p = .987; t = 0.300, p = .763, respectively).

We report summary of this section by using of the both evidences. Stock markets, here, emerging stock markets, are much relationship with earning manipulations. Hypothesis 1 is supported. More importantly, bank is not related with earning manipulations. Next, Test of hypothesis 2 is rejected. Total accrual and discretionary accruals are not influenced by big accounting firms. Big accounting firms do not reveal better audit quality than non-big accounting firms in our sample. Then, hypothesis 3 is rejected. Unqualified opinion with additional information and subsequent information on audit report are associated with total
and discretionary accruals. Even though additional information exists in clean audit report, it decreases the earning manipulations. However, going concern information on audit reports are not related with total accruals. Therefore, hypothesis 4 is partly supported. Finally, both audit fees and non-audit fees are not connected to total and discretionary accruals. Therefore, hypothesis 5 is rejected.

CONCLUSION AND DISCUSSION

This current study attempted to analyze the connections among banks, stock markets, accounting firms and firms. Our most interesting findings show that banks do not always impact on firms’ earning manipulations. It means that main banks do not play an important role on resist earning manipulations. As the basis of the conclusion, we have an empirical result. The result of multiple regression analysis indicates no relationship bank and earning manipulations.

In addition, results also suggest that firms tend to motivate the discretionary accruals on issuing stocks in emerging markets. The reason is that firms stress stockholders’ supervision to raise funds. It might lead to inducements for firms to do earning manipulations. Unqualified auditors’ opinion’s report with information prevents firms from doing motivation of earning manipulations. This suggests that listed firms recognize the importance of auditing to raise working capital from financial markets by weakening the influence of banks.

We show the limitations of this study. One is our data limitation. We use the single year sample. We did not perform collecting samples in and before the 1990’s. If panel data analysis were performed, the results would be challenging for earning manipulations research. Second, the research results might not suit for other countries. It can be reasoned that main bank system would be unique Japanese governance style. However, our findings have useful suggestions for international investors in investing the listed firms on the financial markets in Japan.

In future research, we compare the 1990’s data with the results of this study. We can confirm whether main banks and firms’ relationships were strong then. The authors present the more accurate evidences on the investors and researchers for corporate governances in Japan.

This research implication is that listed firms on emerging markets have an effect on total accruals and discretionary accruals. Stock markets are closely relationship with accruals than banks in the current research. Stock markets do not depend on main banks power.
Regulations of the earning manipulations are focused attention on the auditors’ reports. Auditors’ performances do impacts on earning manipulations by firms.

In our conclusion, our study contributes to distinct the declining main banks power and stress financial markets and auditor’s report in Japan.

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