Political Connections, Family Ownership and Earnings Quality: Some Evidence from Iran

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Submit: 23/08/2021 Accept: 29/12/2021

ABSTRACT

This research examining the relationship between political connections in board, family ownership and earnings quality with an emphasis on political economy perspective and agency theory at the firms listed in Tehran stock exchange (TSE) from the years 2012 to 2018. To achieve this Purpose, this study uses a sample (805 firm-years observations) including the firms listed to examine research hypothesis. Also, the multivariate panel data regression is used for testing the relationship between variables. To enhance the robustness of the empirical results, this study uses other proxies of earnings quality and it has seen the effect of inflation. The present study finds are consistent with the resulting of the studies on the theory of political economy and agency theory previous literature. The results of the study indicate that firms with politically connected in board, have a lower earnings quality than politically non-connected. Also, the results show that family-owned firms have a higher quality of earnings than non-family companies. Furthermore, the negative effect of political connections on earnings quality moderating by family ownership. This means that mitigates the costs of political connection and improves the quality of firm's earnings when existing family ownership.

Keywords:

Political Connections, Earnings Quality, Corporate Governance, Family Ownership

1. Introduction

In many studies have revealed that only the compliance with accounting standards cannot guarantee the quality of financial statements and the items contained; because other factors are affecting the quality of financial statements and financial reporting. In addition to accounting standards, financial statements prepared by a political related firm are affected by various factors. One of the important factors is the political influence of managers and owners of the firms in their political circles and their connections with political power centers (Sejati, 2009; Faccio, 2006; Chaney et al., 2011). Connections and political influence not only affect the financial position of businesses but also influence managers' motivations for financial reporting and preparing financial statements, which is expected to ultimately make a significant difference in the quality of financial statements of companies with political connections compared to companies without that connections (Chaney et al., 2011; Faccio, 2010; Leuz and Oberholzer-Gee, 2006).

Prior studies confirm that firms with political connections suffer from problems such as poor financial reporting quality, financial corruption, impairment of the performance, and lack of investor protection (Faccio 2010; Faccio, 2006; Chaney et al., 2011; Fan et al., 2007). Political connections, explicitly or implicitly, promotes political connections (Hashmi et al., 2018). Explicit connections develop through personal relationships between politicians and business (Faccio, 2010; Faccio, 2006; Fisman, 2001). On the other hand, implicit political connections are formed through the friendly relations between the executives of a company and the politicians (Faccio et al., 2006). Despite the nature of such connections, the involvement of politicians in trade raises problems. When politicians intend to maximize their business activities, they abandon their official responsibilities (Chaney et al., 2011; Riahi-Belkaoui, 2004). In addition, previous research indicates that politically connected firms often sacrifice the interests of minorities and face serious problems with agency theory (Hashemi et al., 2018). Khan et al. (2016) demonstrate in emerging economies; political connections could lead to the costs of agency that are usually accompanied by a weak legal environment. High financial reporting quality is as a factor that reduces agency costs (Lari Dashtbayaz et al., 2018). Hence, high financial reporting quality is important in firms; whereas, firms with political ties generally have poor financial reporting quality (Chaney et al., 2011; Imeni et al., 2019; Riahi-Belkaoui, 2004). There are several reasons to prove why the quality of financial reporting is poorer in companies with politically connected than in companies non-connected. First, companies with such connections deliberately attempt to conceal financial information (leuz et al., 2003). Second, connected firms have political backed, and do not care much about the quality of financial information that should be made public. In addition, companies with politically connected benefit from other sources, such as greater access to finance and less taxation, and their focus is not on quality financial reporting information (Chaney et al., 2011; Leuz and Oberholzer-Gee, 2006). Also, Harymawan et al. (2019) indicate political connected firms provide different financial reporting quality in the level of political stability and governmental effectiveness. Hashemi et al. (2018) believe that the existence of family ownership in the board structure could increase earnings quality. This concept is consistent with agency theory. Meaning that Family ownership due to protecting its interests avoids influence politicians in decisions.

The first objective of this study is to examine how political connections in board, family ownership and earnings quality. The second objective is to examine whether family ownership plays an important role with respect to the link between political connections and earnings quality. Third, the results could represent an overall view of the empirical test of agency theory in the Iranian context.

Also, this paper makes important contributions to the political connections literature in developing economies called Iran. This paper develops literature examining the link of political connections on earnings quality. Second, this study empirically investigated the claims of agency theory by examining the link between political connections and earnings quality. Because, the results indicate that family ownership reduces the intensity of agency problems in politically connected firms.

The remainder of this study is organized as follows. Section 2 presents a brief background of research and a hypothesis. Section 3 presents the research design and methods. Section 4 presents the findings and concludes the paper.

2. Literature Review and Research Background

2.1. Literature Review

The presence and influence of government officials in corporate governance is a matter that can be seen as empirical given the obvious evidence. However, political connections can be established through various ways between firms and the government, including through ownership structure, board presence, production of specific products, and network ties (Rezaei and Weysihesar, 2014). Regardless of the way companies and government ties, what matters most is the consequences of this type of connection for companies. One of the most important features of fledgling capital markets, especially in developing countries, is the presence of major investors and the ownership of much of the corporate's ownership by them. Our country is no exception, with the presence of major investors, including large government agencies, and financial institutions in the capital market (Rashidian et al. 2014). Recently, there have been discussions about the relationship between politics and business, as well as the increasing degree of political connections around the world. Due to the international evidence on the relationship between politicians and corporations, a large number of studies have examined the phenomenon of corporate political communication. These studies show that political communication is widespread around the world, especially in countries with weak legal systems. Of course, recent studies show that political communication is not limited to such environments, for example, Goldman et al. (2009) and Cooper et al. (2010) have shown that political ties are also widespread in the United States. Studies in companies with politically connected show that political connections can affect both the positive and the negative aspects of the company. On the one hand, some studies have pointed to the great benefits of political connections, including 1) easier access to financial resources, such as bank loans and appropriately-funded budgets; 2) increased confidence in the legal system; 3) improvement of Performance 4) High probability of being bailed out 5) increasing company value e.g. by increasing stock value, lower capital cost 6) Transaction concession such as priority in government contracts (Leuz and Oberholzer-Gee, 2006). On the other hand, some studies have shown that political ties can have a negative impact on a company, such as (1) lower quality accounting information, (2) the selection of managers and members of the board of directors with lower competencies, lower Long-term participation due to reduced management incentives or inefficiencies, (3) Higher debt costs (Shalifar and Vishny, 1994).

The positive links between political connection, economic rents and corporates value is visible worldwide. Such cases reinforce the argument that if political communication is important in determining the value of companies, the survival of companies, their power, and other characteristics of firms, and then they should be systematically reflects on the stock market (Civilize et al., 2015).

2.1.1. Theory of Political Economy

From the second half of the twentieth century, the theory of political economy entered the economic texts of the world with the expansion and penetration of liberalism. This theory has not only attracted the attention of economists and politicians, but sociologists have also contributed to expanding and explaining it (Mahdifard and Royayee, 2015). According to this theory, economics and politics have a mutual influence. This means that political activity and decision-making have a direct and indirect impact on economic activity and vice versa. The basic assumption of this theory in the area of politics as well as in the area of economics is that decision-makers and individuals seek to maximize their objective functions with respect to constraints.

Government agents, based on the principles and teachings of their liberalism, are part of society and seek to maximize their personal interests. According to this theory, politicians and bureaucrats, like anyone else, have incentives to transfer wealth through the political process. They are not merely brokers among competing stakeholder groups. Rather, they are stakeholders. In addition, their access to more and easier resources has placed them in a distinct position in relation to other players in the economic field. The external manifestation of such a situation is the direct presence of the state or institutional investors and natural persons who are close to the authorities, in the corporate ownership structure (Mahdifard, and Royayee, 2015).

Political economy is an important area in the scientific study of social phenomena. This method attributes the formation of social phenomena to political and economic factors. According to political economy theory, in most market-oriented economic societies, business units are the focus of economic, social, and political interactions between different groups. Therefore, understanding the relationships between economic, social and political groups is essential to understanding the changing characteristics of business units. According to this theory, accounting information is provided only for the support of influential groups in the social, political and economic spheres. Accounting information enables power-holders to use this information for their benefit (Abeysekera, 2003).

The political economy insists that power ties as forces and processes must be brought for the fundamental analysis in the market. Ignoring power relations in social, political or any other type of analysis will not be justified at all (Mosco, 2009). In countries where the legal system does not have sufficient power to protect the security of private equity investors and there is widespread corruption, political connection and proximity to government is a valuable asset for companies to overcome the failures of such markets and to avoid discrimination. It is an ideology (Boubakri et al., 2012). Owners of corporations can be classified according to their political position and economic ability. Investigating the effects of different ownership investments on venture capital firms is an issue that can be examined in the context of political economy theory.

2.2.2. Concept of Earnings Quality

Earnings quality theory was first put forward by financial analysts and stockbrokers; because they felt that the reported profit did not reflect the profitability of the corporation in such a way that it came to mind. They found that analyzing corporate financial statements is difficult due to numerous weaknesses in measuring accounting information. The key question is why financial analysts do not use reported earnings or earnings per share (unadjusted) and exercise caution. The answer is that at the value of the company should not only be based on the quantity of Earning but also on its quality. Earnings quality refers to the potential for Earnings growth and the likelihood of future Earnings being realized (Rezaei Lashkjany and Samadi Largani, 2017). In other words, the value of a share does not depend solely on the Earnings of each share of current year of company, but rather on our expectations of the future of the company and the profitability of the coming years and the confidence factor on future Earnings (Jahankhani and Zarif Fard, 1995).

Accountants and financial analysts have a different perception of profit. Financial analysts generally consider reported profit (accounting profit) to be different from actual profit. One reason for this difference, analysts say, is that profit can be manipulated by managers. Financial analysts try to gauge corporate profit prospects. The profit outlook refers to the desirable and undesirable characteristics of net profit. For example, a company that has fixed elements and figures in the event of a profit or loss than a company without those items has a higher profit quality. This allows analysts to predict the firm's future earnings more reliably (Ismaili, 2007). The quality of reporting, i.e., the usefulness and usability of information in decision making, has different perspectives. Raybal (2004) considers one of its most important features is the timely identification of losses and the timeliness of quality elements (Raybal, 2004). From Basu prospective, this means identifying economic losses (Basu, 1997). Profit accounting is a criterion for evaluating financial reporting: because the change in the balance sheet occurs following the profit and loss statement (without reclassification) and the timely identification of gains and losses results in a timely renewal of all variables and financial ratios. Although earning represents the ultimate performance of companies, when each company has an accounting system with its own accounts leading to different profits Therefore, it should be possible for investors to tell the true story of these figures (Shabahang, 2002). There is no definitive definition of earnings quality and its determinants, as Siegel's 1997 definition is not simple (Siegel, 1982), and Beneish (1999) has many definitions for that too. According Schipper and Vincent (2003), the quality of earnings is somewhat close to that of Hicks in 1939: that is, profits close to those of Hicks are of high quality. It should be noted that, in Hicks' view, profit refers to the amount of consumption in the company: such that the economic value of the first period of the company is equal to the end of its period. This measure reflects a change in the net assets of the economy and, ultimately in the view of the stock Exchange Commission, the managed earnings are of poor quality (Hicks, 1939).

2.2. Research Background

Boubakri et al. (2012) examined the impact of political connection on firm performances and financing decisions. They found that corporations have easier access to credit after establishing political connection than other companies. To improve their profitability, political connection is strongly correlated with changes in leverage and operational performance.

In a study, Rezaei and Weysihesar (2014) examined the effect of political relationships with the government on the relationship between focus on ownership with financial reporting quality and the cost of common stock and examined 149 firms from 2002 to 2013. The results of the study showed that in companies with a centralized ownership structure, the earnings quality is also high, while in companies with extensive political relationships with the government that have a centralized ownership structure, the earnings quality is low.

Chen et al. (2014) examine whether public authorities colluded with private investors to the privatization of state-owned corporations for earnings management. They found that government executives were adopting a diminishing earnings management policy to "reduce share prices" for privatization. The research results also show that "downward earnings management" occurs in relation to the amount of financial turnover of the company in the years after the privatization.

Al-dhamari and Ku Ismail (2015) examined cash holdings, political connection, and their interactions on earnings quality in the Malaysian context. Their findings show that policymakers are encouraged or mandatory to disclose information about their connection with the government, political parties or politicians so that investors and stakeholders can access quality information (corporate earnings quality).

Ben-Nasr et al. (2015) indicate that state ownership is associated with poor earnings quality, while foreign ownership is associated with high earnings quality. In other words, foreign ownership with high quality of earnings is in countries with stability governmental.

He (2016) investigates financial support and earnings management in Chinese firms. The result of his research is consistent with the perspective that firms that receive stronger financial support have less demand for earnings management; because it's an expensive tool for the company to achieve the expected earnings.

Ebrahimi et al. (2017) in a study titled quality of financial reporting and tax avoidance in the light of state ownership and political connection, with a survey of 106 firms during 2010 to 2015 and a total of 636 years of observations found that government ownership and political connection had a negative and it has a significant effect on the quality of financial reporting, and when the percentage of government ownership or political connection in companies increases, the quality of corporate reporting decreases. The results also show that government ownership has no significant effect on corporate tax avoidance, but political connection has a positive and significant effect ton tax evasion.

Ding et al. (2018) examined the affiliation of state, real earnings management, and corporate performance. Their results show that companies with political affiliation tend to have high accounting performance. The findings also suggest that companies with political affiliation to other non-affiliated companies can manipulate the real activities of earnings. Furthermore, regional economic development can moderate the relationship between political affiliation and real earnings management and corporate performance.

Rahnamay Roodposhti and Mohseni (2018) in a Research on Political connections, dividend and stock return in Companies Listed in Tehran Stock Exchange with a Study of 114 Companies During 2009 to 2016. They found that there is a positive relationship between political communication and cash dividends. And there is a meaning. In other words, with the increase in political communication, dividend cash profits increase. The findings also indicate a positive and significant relationship between political communication and stock returns. In other words, with increasing political communication, corporate stock returns increase. These results imply that political affiliation can be considered as an important factor in cash dividends and returns. Li and Xia (2018) indicate, at private-owned firms, the quality of earnings is higher than at state-owned enterprises.

Ghonji Feshki et al. (2020) investigated political connection and earnings management methods in the Tehran stock exchange. They find that there is a link between political connection and real earnings management; also, the change of the general level of prices and economic indicators affects the link.

Abdul Wahab et al. (2020) investigates the relationship between director networks and earnings quality in Malaysia Using data on 4,416 individual directors who served on the boards of 745 firms listed on Bursa, Malaysia during 2011. They find a negative and significant relationship between the overall connectedness of a director's network and the firm's earnings quality. In addition, they find a negative and significant relationship between the political connectedness of the director's network and earnings quality.

Ghaleb et al. (2020) examined the effect of family ownership concentration on real earnings management in manufacturing firms listed on Bursa Malaysia. the results show that family ownership concentration is negatively and significantly associated with real earnings management.

Faraji et al. (2020) examined the effect of political connections and political cycles on stock returns of listed companies in Iran. Using 1146 firm-year observations derived from firms listed on the Tehran Stock Exchange (TSE) for the period 2005–2017, they find that political connections are positively associated with firms' annual actual returns and annual abnormal returns. Presidential elections strengthen the positive relationship between political connections and cumulative abnormal returns. Transfer of power to the Moderation (Principlist) party in 2013 (2005) strengthened (weakened) the positive relation between cumulative abnormal returns and political connections.

3. Hypotheses Development

The existence of politicians on the board of directors of a company and the political influences of it make drastic problems of agency in companies (Al-dhamari and Ku Ismail, 2015; Chenay et al., 2011; Faccio, 2010). Political pressure induces managers to deviate from their fundamental goals of maximizing dividends (Braam et al., 2015). Political impact also has a negative impact on a company's accounting and internal control system (Faccio 2010). The existence of political influences in a company forces manager to deliberately manipulate information in the annual report and gain access to financial statements (Watts and Zimmerman, 1990). In addition, agency conflicts in companies with political connections can cause poor quality financial information reporting (Al-dhamari and Ku Ismail, 2015; Ramanna and Roychowdhury, 2010; Chung et al., 2005) and even reduce key information disclosure (Rodríguez et al., 2007). On the other hand, as Riahi-Belkaoui (2004) has stated, companies with a political influence are less likely to report earnings quality and this is because of legal and external interference. The political impact of the concentration of state ownership in a company can also decrease the authenticity of earnings reports, as there is more probability for more manipulation in financial statements (Ben-Nasr et al., 2015; Fan and Wong, 2002). Many empirical studies have shown that there is a negatively relationship between companies with political connections and the quality of financial reporting (Al-dhamari and Ku Ismail, 2015; Braam et al., 2015; Fan et al., 2014; Huang et al., 2014; Li et al., 2016; Narayanaswamy, 2013; Chaney et al., 2011; Bushman and Piotroski, 2006). Accordingly, the first hypothesis of the present study is as follows:

H1: There is a negative relationship between political connections and earnings quality.

Adıgüzel (2013) demonstrate due to mitigate separation of ownership and management, family firms certainly have less drastic agency problems. Also, based on the agency theory is to expect that family ownership leads to high financial reporting quality (Wang, 2006; Hashemi et al., 2018). Man et al. (2018) suggest earnings management is positively associated with agency conflict. Hence, family ownership could increase earnings quality. Thus, we propose the following hypothesis:

H2: There is a positive link between family ownership and earnings quality.

H3. Ceteris paribus, family ownership mitigates the negative effect of political connections and earnings quality.

4. Empirical Methodology

4.1. Data and sample description

The study uses sample data from 115 active non-financial firms listed on the Tehran Stock Exchange during the period of 2012-2018. This resulted in a sample size of more than 805 firm-year observations. The firms belong to major non-financial industry classifications at the Tehran Stock Exchange, i.e. oil, gas and petroleum, automobiles and parts, cement, chemicals and fertilizers, textiles, power generation and distribution, paper, glass and ceramics, food, sugar and beverages, engineering, communication and technology and pharmaceuticals. The sample excludes financial institutions from the list of active firms because their data did not meet the specific requirements for empirical analysis. This entire data set was hand-collected from the annual reports of the chosen companies.

4.2. Regression Models and Variable Definitions

The Eq. (1) has been used to test the research hypotheses:

$$\boldsymbol{EQ_{JM} = \beta_0 + \beta_1 FAM_{i,t} + \beta_2 PCON_{i,t} + \beta_3 PCON_{i,t} \times FAM_{i,t} + \beta_4 ROA_{i,t} + \beta_5 SIZE_{i,t} + \beta_6 LEV_{i,t} + \beta_7 CFO_{i,t} + \varepsilon_{i,t}}$$

4.2.1. Dependent Variable

Earnings Quality

Our dependent variable is earning quality. This variable is calculated based on the residual values of the Jones (1991) model.

$$\frac{TA_{it}}{A_{i,t-1}} = a_0 + a_1\left[\frac{1}{A_{i,t-1}}\right] + a_2\left[\frac{\Delta REV_{i,t}}{A_{i,t-1}}\right] + a_3\left[\frac{PPE_{i,t}}{A_{i,t-1}}\right] + \varepsilon_{i,t}$$

TA_{it} is from the difference between operating earnings and cash flow from operation. ΔREV_{it} is changes in revenue in company i during year t. PPE_{it} is property, plant and equipment of i company in year t. A_{it-1} is lagged total assets. ε is residual values of model's.

In order to calculate the residual values, the data of the firms were collected during the period research; calculations were made on the basis of the industry-year analysis. We use the standard deviation of the regression residuals with reference to the researches of Deng *et al.* (2017), Zhong *et al.* (2017), and Farinha *et al.* (2018). Therefore, the standard deviation (σ) of five firm-year residuals is used to measure a firm's earnings quality; and higher values indicate lower earnings quality (Farinha et al., 2018).

4.2.2. Independent Variable

Political Connections

Political Connections (PCONN) is a variable that used to measure the effect of political economy on earnings quality. Signs of firm's political connections include the existence of board members affiliated with the government, parliament, political institutions, or the existence of a major government and quasi-state shareholder in the corporate ownership structure. This variable is dummy, equal 1 if the firms have political connections (such as board members affiliated with the government, parliament and etc.) and otherwise, it will be 0 (Hashemi et al., 2018).

4.2.3. Moderating Variable

Family ownership is a dummy variable; 1 if there is family ownership and 0 otherwise (Chen et al., 2014).

4.2.4. Control Variables

Following Wang (2006), Chen et al. (2011), Ben-Nasr et al. (2015), and Abbasi and Qomi (2017) the control variables in this paper are leverage, cash flow from the operation, profitability, and size. Firms size (SIZE) derived natural logarithm of total sales. Firm Profitability (ROA) is divided net income by total assets at the beginning of the period. Financial leverage (LEV) divides the total debt into total assets. Cash flow from operations ratio is cash flow of operating activities scaled by lagged total assets.

5. Empirical results

5.1. Descriptive statistics

Table 1 provides the descriptive statistics of research.

Table 1 Descriptive statistics

Variable	Symbol	Mean	Median	max	min	Std. Dev.
Earnings quality	EQ	.0916	.0873	.2486	.0127	.0422
Cash flow from operation	CFO	.1202	.1041	.642	-.46	.1347
Leverage	LEV	.611	.602	1.721	.090	3.123
Profitability	ROA	.1305	.1916	.620	-.404	.193
Firm size	SIZE	13.915	13.837	18.878	8.899	1.506
Descriptive statistics of other variables		**Political Connections (PCON)**			**Family Ownership (FAM)**	
		connected	**non-connected**		**family**	**non-family**
		275	530		98	707
		34%	66%		12%	88%

The results of the descriptive statistics show that the net income is equals 13% of the amounts of assets. About 61 percent of the assets come from debt. Also, cash flow from operation is 12% of the assets. It should be noted that 12% of companies are family-owned and 34% have politically connected.

5.2. Correlations analysis

In Table 2, we provide Pearson correlations between the variables used in our regression analyses.

Table 2 shows the Pearson correlation matrix between variables used in the previous model. EQ is negatively correlated with SIZE and LEV. Correlation is significant at the 0.01 and 0.05 level.

Table 2 Pearson correlation matrix

variables	EQ	FAM	PCON	FAM×PCON	ROA	SIZE	LEV	CFO
EQ	1							
FAM	-.069	1						
PCON	-.051	-.068	1					
FAM×PCON	-.043	.461**	.238**	1				
ROA	-.042	0.12	-.006	.021	1			
SIZE	-.093**	-.166**	.075*	-.057	.412**	1		
LEV	.088*	-.11**	.010	-.051	-.621**	.071*	1	
CFO	-.047	.010	.003	-.003	.486**	.157**	-.260**	1

**p < 0.01 * .p < 0.05.

5.3. Results

Table 3 presents the results of testing our hypotheses. We employ Eq. (1) to examine the link between political connections, family ownership and earnings quality. Also, we employ the following paneled model using firm fixed-effects regression:

This table presents the regression results of Eq. (1). Table 3 reports the results hypotheses. The existence of political connection in board reduces earnings quality. The finding is according to with hypothesis 1. Also, the result of this study is consistent with political economy theory and finding Al-Dhamari and Ku Ismail (2015), and Hashemi et al. (2018). Political influences within a firm could seriously affect the quality and quantity of accounting information contained in financial reports (Riahi-Belkaoui, 2004; Leuz and Oberholzer-Gee, 2006; Chaney et al., 2011). Furthermore, the finds show that there is a positive significant relationship between family ownership and earnings quality. Hypothesis 2 also is confirmed. The finds of the paper are consistent with the agency theory; Like that predicted family ownership would lead to superior financial reporting quality (Wang, 2006).

The results of Table 3 indicate that the interactive effect of these two variables has a positive relationship with earnings quality. In other words, family ownership moderates the negative effect of political connections on earnings quality; that this finds are also consistent with agency theory (Hashemi et al, 2018).

Table 3 OLS regression estimates using firm fixed-effects

Variables	Pred. Sign	Coeff.	t-Stat.
FAM	-	-.0195	.050
PCON	+	.0130	.039
FAM×PCON	-	-.0566	.000
PROF	-	.0180	.045
SIZE	-	.0001	.936
LEV	+	.0168	.016
CFO	-	.0092	.342
INTERCEPT		.0749	.020
R^2	.67	Adj. R^2	.61
F-stat.	11.546	D-W stat.	1.747
Prob.(F-stat.)	.000	Observations	805

6. Additional test

6.1. Earnings quality metrics

In this study, two other criteria for calculating earnings quality used to re-examine the link between political connections, family ownership, and other earnings quality criteria. For the calculation of earnings quality, there are available different models. In the present study, we use the model of Dechow et al. (1995) Eq. (3), and Kothari et al. (2005) Eq. (4) which will be discussed in detail below.

Dechow et al. (1995) model assumes that all changes in revenues after changes in receivable accounts (ΔREC) are due to earnings management and should be considered as discretionary accruals items.

$$\frac{TA_{it}}{A_{i,t-1}} = a_0 + a_1\left[\frac{1}{A_{i,t-1}}\right] + a_2\left[\frac{\Delta REV_{i,t}}{A_{i,t-1}} - \frac{\Delta REC_{i,t}}{A_{i,t-1}}\right] + a_3\left[\frac{PPE_{i,t}}{A_{i,t-1}}\right] + \varepsilon_{i,t}$$

Kothari et al. (2005) also modified the above model by controlling performance (good or poor). EAR is defined as net earnings divided by lagged total assets

$$\frac{TA_{it}}{A_{i,t-1}} = a_0 + a_1\left[\frac{1}{A_{i,t-1}}\right] + a_2\left[\frac{\Delta REV_{i,t}}{A_{i,t-1}} - \frac{\Delta REC_{i,t}}{A_{i,t-1}}\right] + a_3\left[\frac{PPE_{i,t}}{A_{i,t-1}}\right] + a_4\left(\frac{EAR_{i,t}}{A_{i,t-1}}\right) + \varepsilon_{i,t}$$

Table 4 OLS regression re-estimates using Eq. (1) and fixed-effects regression

Dependent variable: Earnings quality	Dechow et al. (1995)		Kothari et al. (2005)	
	Coeff.	t-Stat.	Coeff.	t-Stat.
FAM	-.0087	1.441	-.0038	-.374
PCON	.0098	-.817	.0072	1.094
FAM×PCON	-.0487	-3.744	-.0509	-4.021
PROF	.0179	1.854	.0146	1.558
SIZE	.0004	.203	.0002	.125
LEV	.0159	2.116	.0104	1.433
CFO	.0109	1.044	.0142	1.396
INTERCEPT	.0762	2.206	.0761	2.263
R^2	.65		.61	
Adj. R^2	.58		.55	
D-W stat.	1.754		1.862	
F-stat.	10.516		9.193	
Prob.	.000		.000	

The results of Table 4 indicate that the interactive political connection and family ownership has a positive relationship with earnings quality. In other words, family ownership moderates the negative effect of political connections on earnings quality; that these finds are also consistent with agency theory.

7. Summary and Conclusion

Our study provides evidence about relation between political connection and earning quality, and the impact of family ownership on the relation between political connection and earning quality. As presented in the Theoretical Foundations section of this study, political relations and political cycles of power have a significant effect on the performance of companies. Due to the prevailing conditions of politicians in power, the poor performance of the companies they support has had a significant impact on the disclosure and reporting process. As our results show, political relations have a positive effect on the earning quality. Accordingly, to a large extent, the results of the study support the efficiency of the presence of politicians in the governing structure of companies. We provide evidence that firms with higher political connection have Higher earning quality. As far as political connections are concerned, the environment of operations is not transparent. As a result, the quality of the information in companies with political connections is lower than in other companies. Connection and political influence also influence managers' motivations in relation to financial reporting and financial statements preparation, and ultimately because significant differences in the quality of financial statements of companies with politically connected compared to companies non-connected. Also, the result of this study is consistent with political economy theory and finding Al-dhamari and Ku Ismail (2015), and Hashemi et al. (2018).

On the other hand, the quality of profits is significantly affected by family ownership, so that our results show a negative relationship, which is contrary to the fundamental theory. We provide evidence that firms with higher family ownership have higher earning quality. Based on the second hypothesis of the study, it can be concluded that family ownership has a significant and positive effect on the quality of accounting information and when the level of family ownership in companies increases, the quality of accounting information increases accordingly. The ownership structure is one of the most important factors influencing the corporate governance system. When shareholder control is concentrated within the company, it is expected that controlling shareholders will have greater ability and less oversight cost to achieve their goal (maximizing company wealth). The relationship between the quality of disclosure of accounting information and family firms can be expressed as family firms have fewer representation issues and less information asymmetry than other firms. It is expected that the quality of disclosure of accounting information in such companies is expected to be higher than that of other companies. On the other hand, agency theory predicts that a focus on family ownership can enhance the quality of financial reporting. Because family companies are dominated by members of the same family, the personal interests of the family and the interests of the company are alike. This incentive reconciliation will prevent family management from manipulating financial reports; the result of this study is consistent with agency theory and finding Wang (2006).

In our additional tests, we find that family ownership moderates the negative effect of political connections on earnings quality. This shows that family ownership can lead to the elimination of the costs of political connection, and thus improve the quality of a company's earnings. The findings are in line with agency theory; the theory holds that the focus of family ownership is in line with the interests of shareholders, stakeholders, and managers, and also leads to the elimination of agency costs.

Due to the structural components of ownership, shareholders and investors in the capital market can benefit from political coverage to some extent in dense market conditions. However, in our research, political cycles have not been examined and the issue of power transfer has not been developed, and therefore it is better to consider the interpretation of the results and its generalization.

In this study, there is a limit to identifying the levels of political relations and researchers do not have access to a criterion for measuring hidden political relations.

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Appendix 1. Variable definition

Variables	Symbol	Measurement
Earnings quality	EQ	The standard deviation (σ) of five firm-year residuals is used to measure a firm's earnings quality, and higher values indicate lower earnings quality. This variable derived from the residuals of the Jones (1991) model represented in Eq. (2). Also, other criteria of earning quality calculated by Dechow et al. (1995), and Kothari et al. (2005) that represented in Eq. (3), and Eq. (4).
Firm size	SIZE	firm's size is natural logarithm of total sales.
Profitability	ROA	divided net income by total assets at the beginning of the period.
Leverage	LEV	divides the total debt into total assets.
Cash flow from operation	CFO	ratio is cash flow of operating activities scaled by lagged total assets.
Political connection	PCON	This variable is dummy, equal 1 if the firms have political connections (such as board members affiliated with the government, parliament and etc.) and otherwise, it will be 0.
Family ownership	FAM	Family ownership is a dummy variable; coded as 1 for family ownership firms and 0 otherwise.