The investigation of relation between accounting conservatism and management ownership in listed companies in Tehran stock exchange

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ABSTRACT

The main theme of the research is the illumination of the relationship between the percent management proprietorship and the conservatism level practiced in the financial reporting of corporations accepted in the Tehran Stock Exchange. The study sample consists of 104 of the corporations accepted in the Tehran Stock Exchange market and the research periods spans from 1383-1387. The results obtained from the hypotheses tests of the research, in general signify an inverse and meaningful relationship between management proprietorship and conservatism. The results imply that the managers' sharing in the proprietorship of the company reduces the demand for the conservative accounting.

Key words: managerial proprietorship, accounting conservatism, Tehran Stock Exchange market.

Introduction

Managers and proprietors tend to be over-optimistic to the business entity. This over-optimism causes the assets and incomes to be asserted more the reality. Conservatism is the necessary panacea for this exaggeration in being optimistic. Carol Dwine argues that the suppression of the optimism and the induction of pessimism is difficult. The consequences of over optimism is more dire than the over pessimism's. Suffering a real loss due to overestimation because of being too optimistic is more serious comparing to the loss of benefit-making opportunity which is resulted from over-pessimistic pricing; since investors, probably, sue the auditor for the magnification of the net value of the assets and not for the lowering net value of the assets. Since by managers' sharing in the proprietorship of the company, the problem of the profit contrast is solved to a large extent; it seems that the need for mechanism to control profit-seeking incentives in the managers reduces. This research seeks to survey of the managerial proprietorship effects as a part of the corporation governing structure on accounting conservatism.

The problem expression:

Conservatism as a limiting principle in accounting, has long being used by accountants and despite the great deal of criticism, has persisted in the middle of other accounting principles. The reason for this can be related to the role of this principle in the preserving proprietors' profits. If the company is the business institute for the proprietor, the need for conservatism reduces because the managers' profits and proprietor are on the same line and the aforementioned paradox in the agency theory is removed. This paradox is a result of non-correspondence in the objectives. In the agency theory it is supposed that each of the parties tries to maximize their own profits. The supposition of the existence of the paradox in the profits between employer or proprietor and the agent or representative makes each of them to try to optimize and maximize his/her profits. The observation of the conservatism in the corporation accounting, resolves, to a great extent the, problem of agency and lowers the objections between the proprietor and the manager. It can be understood that the more distant the manager and the proprietor be there would be a need for greater degree to control the opportunities and the managers incentives. The opposite can as well be true i.e. with the reduction in the gap between managers and the proprietors of the entity, the demand for conservatism in the financial reporting and its necessity would be lower. One of the manners by which this gap can be narrower is the existence of the managerial proprietorship in the proprietorship structure of the company. It seems that in this way with the omission of some of the agency problems the need for the conservatism accounting pales and this limiting principle loses somewhat of its significance. This research is to study the
The relationship between managers’ proprietorship and the need for conservatism in the financial reports and it is expected that the more the percent of managers shares in the proprietorship of the company the lower the rate of conservatism in the company.

**Background:**

Watts in [14] offered a comprehensive and widespread research about the conservatism existence related reasons which has been taken use of in many of the researches as a reference. The findings of the researches on the relationship between conservatism and corporation leadership and managerial proprietorship implies that from one hand there is a positive relationship between conservatism in the financial report and corporation leadership and from the other hand the more the shares of managers in the corporation because of the placement of the managers and proprietors on the same line the need for conservatism lowers. Therefore, there is always a negative relationship between conservatism in financial reports and the percentage of managers’ shares in the corporation. Lafund in 2007 performed a research about the relationship between conservatism and corporation leadership and managerial proprietorship that the results show that, on the one hand, there is a positive relationship between conservatism in the financial reports and corporation leadership and, on the other, the more the shares of managers in the corporation due to the parallelism in the managers and the stakeholders the need for conservatism reduces. Therefore, there is always a negative relationship between conservatism in the financial reports and the percentage of managerial proprietorship.

Zimsky and Haugerman realized that there is a negative meaningful relationship between the company size and conservatism. They express that with the increase in the inclusiveness in the industry the tendency for conservatism grows. Lafund and Watts [9] observed that conservatism causes some sort of information asymmetry. Ahmed and Diulman argue that conservatism reduces as a result of the increase in the percentage of responsible members of managerial board. The other result obtained from their research is that conservatism increases with an increase in the numbers of non-responsible managerial boards. Lafund and Rooychery [10] arrived at this result that if one defines the conservatism as an asymmetry in the timeliness of profits and losses, managerial proprietorship would have an inverse relationship with conservatism. Lara, Usma, and Penalwa found out that stronger governance over the company will increase the conservatism. Ahmed and colleagues observed that with an increase in the debt costs, conservatism reduces. Bakes in the confirmation of Ahmed and Diulman asserts that the presence of a greater number of unassigned members in the management boards would increase conservatism.

Biti realizes that there would be a greater shift in the debts in the absence of conservative accounting. Nicolaw came to this conclusion that greater limitation in debts causes more conservative operations. Chen [5] states that more conservatism reduces profits management. Rajan realized that higher growth would cause the rate of assets outcome and conservatism dominates. Rezazadeh an Azad in 1387 performed a research with the title of ‘the relationship between the information asymmetry and conservatism in the financial reporting. The results of experimental tests with the use of the information related to a sample of corporation accepted in the Tehran Stock Exchange market in the period 1381-1385 signify the positive and meaningful relationship between asymmetry in the information between investors and the level of conservatism exercised in the financial reports. The mentioned results indicate that following the increase in the information asymmetry between investors, demand for conservatism and conservatism undertakings in the financial reporting increase. And in this case, the conservatism usefulness as a quality characteristic in the financial reports has been affirmed. Miliuer and Spitz analyze the relationship between managerial proprietorship (which includes stakes hold by the management board family boards) and the performance of middle and small German private corporations with the tests of motivational hypothesis. They used a sample of 356 corporation of the service sector that are related to business for the period between 1997 and 2000. The findings of these researches show that the corporation performance with the above 40% percentage of managerial proprietorship is recovering.

**Research Hypothesis:**

According to the literature cited in the current research, the following suppositions and are edited and tested:

1. There is a negative and meaningful relationship between the percentage of managerial proprietorship and accounting conservatism.

2. With the increase in the percentage of the managerial proprietorship, the amount of conservatism in the financial reports reduces.

**The study sample and statistical society:**

In the current study for examining the research hypotheses the classified and audited financial data of the active manufacturing companies accept in the Tehran Stock Exchange market. Also, the sampling method is systematic omission. According to the hypotheses and the basic necessary variables, the following terms have been defined for the extraction and the choice of samples.

1. Not included in the investing companies and banks
2. The end of financial year be the last day of Esfand.
3. The company doesn't have a financial year shift in the target period
4. The corporation transaction sign has not been transferred to the informal stock market
5. The corporation transaction sign is active and has been transacted once every year.
6. The financial information for the company is available in the study period.

As a result of considering the terms and conditions in the systematic omission sampling, 104 corporations were chosen. The study period is five consecutive years so the final volume of the sample is 520 year-corporations (5*120).

The study method:

According to the model of the study which tracks the occurrence of a behavioral pattern and makes use of real information, the study design is comparative analysis or post-event study. In such studies, the researcher seeks to survey the cause and effect (dependent variable and independent variable) after the occurrence. In this study there is a statistical relationship between variables and the target is the examination of this relationship. Also, these variables cannot be manipulated. In this research the level of the conservatism of the sample study corporations has been measured by taking advantage of Baso-model. Also, the relationship between the mentioned variable and the percentage of managerial proprietorship of these companies during 1383-1387 has been surveyed by the method of linear regression and the least squares.

The study variables and the method of measurement:

Variables are among the main elements of a research. Variable is the thing that changes from amount point of view and normally can get different numbers, so everything existent can be a variable which the researcher observe, control or manipulate them. The most useful way to classify variables is to categorize them into dependent and independent. This way of classification because of being general and due to its simplicity and the importance in the conceptualization and the design of the research as well as the preparation of the results report is very useful and valuable.

Managerial proprietorship:

The ratio of the managers' shares to the total number of issued shares (the percent Managerial proprietorship) is used as the independent variable in the current study.

Conservatism: the dependent variable of the study is the amount of exercised conservatism in the financial reports. Conservatism is used in this way that the accountants should report the minimum sum for the assets and revenues and the maximum amount for the expenditures and costs. In this way it is possible that the net value of the assets be reported lower than the current price. Conservatism is measured as a ratio of the faster profit reaction to the bad news to the profit reaction to the good news. The more the reaction of the profit to the bad news, the more conservatism exists there. In the present study in order to measure the conservatism the Basu model (1995) has been used. In this model the positive outcome is the representative of the good news and the negative outcome is the representative of the bad news. According to Basu the reaction of the profit to the bad news is more on tile than the reaction of the profit to the good news. The mentioned pattern is as follows:

$$NI = \beta_0 + \beta_1 \text{NEG} + \beta_2 \text{RET} + \beta_3 \text{RET*NEG} + \epsilon$$

In which,

$NI =$ the net profit before the unexpected items divided by the market value of the equity in the first financial period

$\text{NEG} =$ a virtual variable for the companies with negative outcome equal to one and for the other companies equal to zero.

$\text{RET} =$the annual stock share of the company. In this model if $\beta_3$ is non zero and positive is indicative of conservatism, which for every company is defined individually and is calculated annually. ($\beta_2 + \beta_3 > \beta_2$) so $\beta_3$ is positive and in fact it is the profit time asymmetry coefficient which is the conservatism scale.

The first hypothesis test pattern:

The essence of the first hypothesis test is the examination of the expressed relationship in the hypothesis. The objective is not the survey of the variables, but the relationship between them is to be tested. Data gathering and classification and statistical tests are performed to experimentally test the existing relationships. In this research conservatism is considered as the dependent variable and the effect of managerial proprietorship has been studied. Basu coefficient is measured as the conservatism scale for every company and then with the use of the relationship study model, the dependent and independent variables are distinguished. To test the first hypothesis the regression model has been used in which the conservatism is the dependent variable and the percentage of the proprietorship is the independent variable.

$$NI = \beta_0 + \beta_1 \text{NEG} + \beta_2 \text{RET} + \beta_3 \text{OWN} + \beta_4 \text{RET*NEG} + \beta_5 \text{RET*OWN} + \beta_6 \text{RET*NEG*OWN} + \epsilon$$

$H_0: \beta_i = 0$
H1: $\beta_i \neq 0$

NI = the net profit before the unexpected items divided by the market value of the equity in the first financial period.

NEG: a virtual variable for the companies with negative outcome equal to one and for the other companies equal to zero.

RET: the annual output of the company stock share

OWN: the percent of the shares belonging to the company managers.

In the above model $\beta_6$ is indicative of the relationship between conservatism and the management proprietorship.

The test pattern of the second hypothesis:

To test the second hypothesis a regression model has been used in which the conservatism level is used as the dependent variable and the management proprietorship is used as the independent variable. The conservatism level of the sample companies is obtained according to the Basu model. This variable is equal to the profit reaction based on the bad news in the studied period therefore variable coefficient RETNEG is equal to the conservatism level of the sample companies. The test procedure of the second hypothesis is as follows:

Conservatism $i,t = \beta_0 + \beta_1OWN_{it} + \epsilon_{i,t}$

H0: $\beta_1 \geq 0$

H1: $\beta_1 < 0$

Conservatism $i,t$: is the conservatism level of the company $i$ in the year $t$.

OWN: is the percent of the managers' proprietorship from company $i$ in the year $t$.

The results of the first hypothesis:

In the first hypothesis, it has been predicted that there is a meaningful relationship between the percentage of manager's proprietorship and the conservatism level in the financial reporting of the companies. The theoretical premise of the hypothesis is based on this subject that with the existence of managers in the proprietorship structure and the parallelism in the managers and proprietors, the need to use controlling structures to curb the managers profit-seeking incentives, such as conservatism, reduces to a great extent. In the current study, to test the level of the conservatism there has been an application of the Basu Model (1995). In this model the positive output is indicative of good news and the negative output is indicative of bad news. The test model of the hypothesis, is a synthetic poly regression model. This synthetic model is made of the Basu model and the independent variable of the managers' proprietorship percentage. The first hypothesis is tested and edited as follows:

First Hypothesis:

H0: there is no positive relationship between the percentage of managers' proprietorship and accounting conservatism.

H1: there is a meaningful relationship between the percentage of managers' proprietorship and accounting conservatism.

To test this hypothesis a regression model has been used in which conservatism level is the dependent variable and the managers' proprietorship is the independent variable.

NI = $\beta_0 + \beta_1NEG + \beta_2RET + \beta_3OWN + \beta_4RET *NEG + \beta_5RET*OWN + \beta_6RET*NEG*OWN + \epsilon$

Table 1: The results obtained from the first hypothesis.

<table>
<thead>
<tr>
<th>The results of the statistical analysis for the independent variables coefficient</th>
<th>Significance level (p-value)</th>
<th>t-statistics</th>
<th>Coefficient amount</th>
<th>coefficients</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>0.031</td>
<td>2.162</td>
<td>416</td>
<td>RET</td>
</tr>
<tr>
<td></td>
<td>0.03</td>
<td>-2.178</td>
<td>-149472</td>
<td>NEG</td>
</tr>
<tr>
<td></td>
<td>0.013</td>
<td>-0.021</td>
<td>-66.86</td>
<td>OWN</td>
</tr>
<tr>
<td></td>
<td>0.014</td>
<td>8.27</td>
<td>6567</td>
<td>RETNEG</td>
</tr>
<tr>
<td></td>
<td>0.000</td>
<td>5.49</td>
<td>55.133</td>
<td>RETOWN</td>
</tr>
<tr>
<td></td>
<td>0.04</td>
<td>1.474</td>
<td>145.173</td>
<td>RETOWNNEG</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>The results of the statistical analysis for the model</th>
<th>Watson predicted statistics</th>
<th>F statistics</th>
<th>p-value</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1.88</td>
<td>0.228</td>
<td>26.071</td>
</tr>
<tr>
<td></td>
<td>0.000</td>
<td>0.000</td>
<td>0.000</td>
</tr>
</tbody>
</table>

Table 2 shows the results obtained from the fitting regression model. Statistical analysis results for the test model of the first hypothesis shows that this model could explain 22.8% of the dependent variable changes through the changes in the independent variables. F statistic is 26.071 and its contingency is 0.0000. The results imply that the hypothesis test model is favorable and linear. According to the Watson prediction statistics the output closer to 2, it can be concluded that there is no...
The above finding verifies the theoretical basis of the Basu model for private companies with managerial proprietorship structure. Based on the statistical analysis results for the hypothesis test pattern and estimated coefficients for the independent variables, in the reliability level of 99%, it can be claimed that there is a positive and meaningful relationship between conservatism and managerial proprietorship level. In other words, hypothesis H0 in this level is rejected.

The results of the second hypothesis:

In the second hypothesis, it is predicted that with the increase in managerial proprietorship in the companies, the amount of the exercised conservatism in the financial reporting has been reduced. In fact, this hypothesis has predicted an inverse relationship between managerial proprietorship and conservatism. To test this hypothesis a regression model has been used in which the conservatism level is being used as a dependent variable and the percentage of managerial proprietorship as an independent variable. The level of the sample companies' conservatism obtained from Basu Model. This variable is equal to the profit reaction to the bad news in the research period and therefore the variable coefficient RETNEG is the level of the conservatism in the sample companies. The second hypothesis and the test style is as follows:

Second Hypothesis:

H0: with an increase in the percentage of the managerial proprietorship the rate of the conservatism in the financial reporting is not reduced.
H1: with an increase in the managerial proprietorship, the amount of the conservatism reduces in the financial reporting.
Conservatism i,t = $\beta 0 + \beta 1OWNit + eit$

The statistical analysis results for the hypothesis test pattern and estimated coefficients for the independent variables, in the reliability level of 99%, it can be claimed that there is a positive and meaningful relationship between conservatism and managerial proprietorship level. In other words, hypothesis H0 in this level is rejected.

The results of the second hypothesis and the above fitting pattern are included in the second statistic.

Table 2: The results obtained from the second hypothesis.

<table>
<thead>
<tr>
<th>The statistical analysis results for the coefficients</th>
<th>Significance level(p-value)</th>
<th>t-statistics</th>
<th>Coefficient size</th>
<th>coefficients</th>
</tr>
</thead>
<tbody>
<tr>
<td>[Table entries]</td>
<td>0.035</td>
<td>-7.43</td>
<td>-164.77</td>
<td>OWNit</td>
</tr>
<tr>
<td>The model statistical analysis</td>
<td>Watson prediction statistics</td>
<td>R2</td>
<td>F-statistics</td>
<td>p-value</td>
</tr>
<tr>
<td></td>
<td>1.757</td>
<td>0.409</td>
<td>365.559</td>
<td>0.000</td>
</tr>
</tbody>
</table>

The statistical analysis results for the second hypothesis shows that the model has explained the 40.9% of the conservatism varieties (dependent variable) through the percentage of the managerial proprietorship (independent variable). F-statistic is in a high level (365.559) and the probability amount is 0.000. these results signify that the second hypothesis test model is favorable and
linear. The estimated Watson predictor is close to 2; therefore there is a correlation between in the model errors.

Based on the table 3 the independent variable coefficient is the percentage of the managerial proprietorship (β1) with the amount of -164.77 and with the probability of 0.035. It is negative and meaningful. This finding shows that with an increase in the managerial proprietorship in the sample companies the level of the conservatism in the study period is reduced. Based on the above results, the second hypothesis is accepted in the significance level of the 95% and the hypothesis H0 which predicted the lack of the relationship or the positive relationship of the hypothesis, is rejected.

**Conclusion:**

Based on the findings obtained from the fitting Basu Model (the measurement pattern for the conservatism level), the sample companies in the study period applied conservatism in their financial reporting. This result has been claimed according to the theoretical basis of Basu Model about the faster profit reaction to bad news and based on the obtained coefficient in the test of the model. On the other hand, after inserting the managerial proprietorship variable in the Basu Model, the regression test outputs signify the estimated conservatism level reduction. Therefore, besides the existence of a meaningful relationship between conservatism and the percentage of the managerial proprietorship is verified, the obtained results with a theoretical basis and the researcher expectations complies with the basic research variables. In other words, with an increase in the percentage of the managerial proprietorship, the need for exercising the conservative procedures in the financial reports is lowered. Also, these findings correspond to the hypotheses of the agency theory and show that with the increase in the percentage of the managers’ shares, there would be a reduction in the interest contradictions between the managers and the proprietors. Since it has been proved that demand for conservatism in the companies with high managerial proprietorship is lower in comparison to the other companies. In the second hypothesis the relationship between the conservatism levels and managerial proprietorship has been evaluated based on a regression model. In this pattern, conservatism is a function of the managerial proprietorship. The results obtained from the regression test showed and verified this expectation that there is an inverse and meaningful relationship between the existing variables in the regression pattern. In other word, with an increase in the percentage of the managerial proprietorship, the conservatism in the sample studied companies has reduced. These results, are in the supplementation and verification of the results obtained from the first hypothesis test and is correspondent to it. These findings show that companies management and administrating variables is meaningfully influential on the reporting environment. The application of the conservative measures in the financial reporting and the exercising level of such procedures in the profit units, may stem from various factors. These factors can be classified to two categories: internal factors such as management attitude, size and activity type and external factors such as capital market effects and disclosure rules.

**Research Suggestions:**

Based on the results obtained from the hypotheses tests, we offer some suggestions for the applied areas and some for the future research. In the applied area it has been suggested that the related organizations such as Audit Organization and the Organization for the Stock Exchange Market for the sake of homogeneity and lawfulness edit and state the regulations guideline for the execution of the conservative procedures in the financial reporting. In the research area it has been suggested to the future researchers to evaluate the influence of the other proprietorship combinations such as institutional and concentrated proprietorship on the conservatism. Also, it seems that the level of the conservatism is sensitive to time periods, so future researches in this area has been suggested.

**References**

7. LaFond, R., S. Roychowdhury, 2008. Managerial ownership and accounting