# Impact of Conservatism on the Accounting Information Quality and Decision Making of the Shareholders and the Firms Listed on the Tehran Stock Exchange

## Mohammad Hamed Khan MOHAMMADI[1]
## Forough HEYRANI[2]
## Nezam GOLESTANI[3]

[1]*Department of Accounting, Damavand Branch, Islamic Azad University, Damavand, Iran*
*Safaieeh, Shoahadegomnam Road, Zip code: 89195/155, Yazd, Iran*
*Tel: (++98)351-8211391; Fax: (++98)351-8214810*
*Email: Dr.khanmohammadi@yahoo.com*
[2,3]*Department of Accounting, Yazd Branch, Islamic Azad University, Yazd, Iran*
*Safaieeh, Shoahadegomnam Road, Zip code: 89195/155, Yazd, Iran*
*Tel: (++98)351-8211391; Fax: (++98)351-8214810*
[2]*Email: Heiranyforough@gmail.com,* [3]*Email: N_golestani99@yahoo.com*

**Abstract**    *This study mainly aims at investigating the impact of conservatism on the quality of the accounting information and decisions of the shareholders and the Tehran listed firms. To achieve this goal, the impact of conservatism on the three characteristics of relevancy, reliability and timeliness of the accounting information has been explored. The main objective of the study has been defined and examined in terms of one hypothesis along with the other subsidiary objectives. The present paper is an applied study using cross-sectional correlations. The required data is obtained from the whole firms listed on the Tehran Stock Exchange for six years covering the years from 2006 to 2011. The samples are selected by a filtering technique and finally 300 firms are chosen. The data and hypotheses are analyzed by using simple linear regression. The findings reveal that there is a relationship between conservatism and information quality. It is also documented that conservatism positively influences on each characteristic of relevancy, reliability and timeliness. Therefore, the market might become more efficient after requiring the timely reporting and providing transparent and complete financial statements. It contributes the investors and participants of the stock exchanges make appropriate decisions.*

**Key words**    Conservatism, Relevancy, Reliability, Timeliness, Decision-Making

## 1. Introduction

Accounting information essentially intends to render services to the groups and individuals who prefer to use qualitative and quantitative information to obtain their goals. In doing so, accounting department holds the responsibility to provide information which is mostly of financial nature. Accordingly, considering information needs of individuals and groups is a crucial step, so that the durability and continuity of accounting system lies in establishment of interaction in the surrounding environment. Making optimum decisions about investing in the business entities requires transparent and comparable financial information. Consequently, preparing the information useful in making financial and economical decisions is one of the fundamental prerequisites of making the investors and creditors interested in conducting economic operations.

Financial statements and reports are known as the major important financial sources of most countries. That's why the fundamentals of preparing financial statements are highly important. The underlying bases of

preparing financial statements known as accounting standards should have formal characteristics and be consistent for financial statements. It would finally make the financial statements comparable. Therefore, the accounting principles and trends aim to balance the optimism of the managers, protection of the stakeholders' interests and fair presentation of the financial statements and use conservatism concept accordingly.

Conservatism is one of the essential characteristics of financial reporting by which the quality of accounting and financial reporting has been at least enhanced from the beginning of the 20th century. The prior literature extensively examined whether conservatism is a desirable specification for the financial statement. Conservatism is a concept widely used by the accountants as a constraining principle of accounting. However, it has maintained the position among the other accounting principles regardless of the frequent critics considered. There are strong evidences suggesting that there are conservative reporting in America, England and other European countries. Therefore, it seems necessary to investigate the advantages and disadvantages of conservatism based on the conservative approach and guidelines of accounting standards of Iran.

Accounting conservatism stimulates profitable companies toward more profitability and motivates them to try more to enhance their position. This would finally lead to higher quality of internal information. Conservatism has more definite influence on efficiency of the investment through the impacts on the financial decisions (Chen et al, 2009). Successfully working of the accounting system depends on the capability of accounting information in improving the decisions of the managers. However, the provision of the information can't make this happen by itself lonely. The accounting system which is not capable of providing the required managerial information with a proper quality is not considered as an efficient system for making decisions. Hence, the presentation method and the way to compute the data are very significant in terms of qualitative aspect which the financial managers and analyzers should regard. On the other hand, some measures are needed to qualify the accounting information. In fact, accounting information quality examines the extended level of real and expected performance according to the related factors and facilities; and the firm value is evaluated by this way. This definition takes the ability of financial statements into account and describes them in terms of transparency, accuracy and effectiveness in decision making (Dechow and Schrand, 2004).

Using quantitative models to compute the level of conservatism, some measures are determined to quantify the accounting information quality and the factor analysis is applied to investigate the interaction between these concepts. Consequently, this study seeks to find whether conservatism influences on the quality of accounting information and decisions made by the shareholders and Tehran listed firms. Additionally, the author seeks to examine the impact level of conservatism on any of the variables of accounting information quality.

## 2. Literature Review

### 2.1. Information Concept and the Qualitative Characteristics of Accounting Information

There are extensive prior studies which focus on different definitions of accounting theory. As Atrill and McLaney state, accounting plays a vital role in contributing individuals in making cognizant decisions. Christensen and Demski suggest that the accountants provide information from the financial history of the entities. They declare that the information is the object taken from the realities of one organization. Therefore, information is an observable talent to reduce the vagueness. As a consequence, information results in a possible evaluation. The main role of information in improving the processes includes the presentation of the required accounting information of directors to ensure that the economic resources are allocated efficiently (Christensen, 2003).

As Dechow and Schrand (2004) conclude, the qualified information might be defined as satisfying the needs of the users by the perception of the rationale and external user. Having removed the various methods and increasing the level by which the accounting measures reflect the economic situations, the authority of the managers for providing the biased accounting values is constrained and the quality of the accounting information is enhanced. Thornton (2002) believes that the quality of accounting information and financial reporting is obtained by four joint factors: managerial visions and creativity, audit quality, audit committee

experience and high quality accounting standards. The significant part includes the measures and metrics by which the quality of accounting information is evaluated.

Satek Lef (2003) applied the predictive ability and economic measurement variables to evaluate the quality of accounting information and data. Kohlbeck & Warfield (2005) utilized the measures of descriptive ability of the evaluation models based on the data of balance sheet, income statement, error and dispersion of the analysts' predictions and earnings persistency in order to test the quality of accounting information.

TRUEBLOOD is a committee introduced by American Institute of Certified Public Accountants Association (AICPA) in 1971. The statement of TRUEBLOOD defines the seven qualitative characteristics of the financial reports including relevancy, substance over form, reliability, neutrality, comparability, consistency and understandability. Trueblood asserts that: the qualitative characteristics of the financial statements must be highly consistent with the needs of the users. Relevancy can be defined in terms of the impact of financial information on the decisions made by the users about evaluation of the past events and prediction of the current and future events or correction of the expectations. The information should be prepared neutrally as much as possible. The users should be capable to perceive the provided information and judge about its reliability in order to compare them with the information related to the future opportunities and prior experiences. In all cases, the information is more useful when the economic substance is more emphasized than the technical form. Statement of financial accounting concepts number 2 provided by the financial accounting standards board (FASB) has been issued by the name of "qualitative characteristics of the accounting information". The most important quality of this statement is the useful aspect of this item in making decisions. Relevancy and reliability and their components are among the two main qualities of information.

According to Hendrikson (2005) the information should be available to the decision makers before they lose their effectiveness. Additionally, timeliness means that the financial statements should be prepared in certain times to inform the company about the variations and make them justified in predictions and decisions of the users.

### 2.2. Objective of the Financial Reporting

The general role of accounting and financial reporting is that this process provides useful information for a massive quantity of the external users who try to make decisions for allocating resources. Accounting and financial reporting should make fair information available to enhance the effectiveness of allocating the scarce resources in capital markets and other markets. The objectives of financial reporting are consistent with satisfying this role and are moving towards the general objectives of the financial reporting. Financial statements are the main part of the financial reporting process.

### 2.3. Significance of the Financial Information in Making accounting Decision

Financial reports are the most important sources of acquiring information, so that the theoretical accounting fundamentals and financial reports of most countries intend to provide information about the financial aspect of the transactions, operations and events influencing on the financial position and results of the entity. This contributes external users in making decisions and judgments. Regardless of the diverse financial decisions, the various groups of users of financial statements initially analyze the ratios for their decisions. Financial analysis is more extensive than the financial ratios, but analyzing the ratios is known as an important way to analyze the financial statement. However, many of the users are required to rely on the financial statements as the main source of financial statements. Therefore, the financial statements should be provided in accordance with their needs and requirements.

### 2.4. Conservatism

This is a dominant characteristic of financial reporting which have been highly concentrated in the recent years because of the famous corruptions by companies like Enron and WorldCom. Some other scholars like Watts (2003), Rychvrdary and Watts (2005) and LaFond and Watts (2006) particularly concentrated on the conservatism concept. While there is a wide agreement upon the conservatism in preparing financial statements, there is no comprehensive definition of this concept. However, two main characteristic of

conservatism have been extensively examined: downward bias of book value of the equity to its market value; and the tendency to quick recognition of the costs and deferrals in recognizing revenue.

Givoly & Hayn (2000) define conservatism as selecting an accounting approach under uncertainty condition which would finally lead to lower assets and revenues and has the least positive influence on the owners' equity. Wolk et al (2004) believe that conservatism is defined as recognizing less earnings and lower evaluation of the assets. Gim and Zhank (2000) think that conservatism includes identifying the whole potential losses and non-recognition of the possible earnings. Basu (1997) defines conservatism as a process in which higher degree of reliability is used to recognize and record the earnings and optimistic news (incremental value); while lower degree of reliability is applied to recognize the losses and undesirable news. Penman and Zhang (2000) perceived that accounting conservatism is composed of selecting an estimated method of accounting by which the book value of the assets is clearly shown at a lower level.

### 2.4.1. Measures of Conservatism

The most popular measures of conservatism include net assets, earnings and accruals measure, and earnings-return relationship measure. These measures are briefly discussed in the next sections.

### Net Assets Measure

The market value of assets and liabilities includes the net variations in the assets of each period, but all these changes are not recorded in the accounts and are not reflected on financial reports. According to the conservatism, increasing assets' value (earnings) which is not sufficiently confirmable will not be recorded; while their decreasing value with a similar conformability will be reduced. As a result, the net assets will be low magnified. Feltham and Ohlson (1995, 1996) model is usually used to estimate the assets at a level lower than the real assets. These models include those parameters with low magnificence of operating assets based on this assumption that the accounting depreciation is bigger than the economic depreciation. Bior and Rayan (2000) also used the ratio of book value to the market value. Taking other factors constant, using conservative accounting leads to reporting lower net assets and lower ratio of book value to market value (Watts, 2003).

### Earnings Measure and Accruals (Earnings to Accruals Ratio)

Conservatism documents that the earnings are more persistent than the losses because the insusceptible increases in the value of the assets (earnings) are not recognized when they occur; however these increases will be realized during the future periods by creating cash flows. The losses are not normally repeatable in future periods and they have less persistency than the earnings. Instability of losses and persistency of the earnings and their variations provide a measure of conservatism. This asymmetric behavior of conservatism with the profits and losses will lead to asymmetry in realizing accruals. As Givoly & Hayn (2000) document, conservatism causes the retained earnings to be declined over time. They believe that the sign and the level of retained accruals over the time are some measures of conservatism. Taking other factors constant, clear stability of the negative accruals (such as reserves) among the firms during a long period is an indicator of conservatism and the accumulation rate of negative accruals indicates the level of changes at the conservatism level during the time (Givoly & Hayn , 2000).

### Earnings-Stock Return Measure

Stocks market value tends to show the changes in the assets value at the time of occurrence; these changes might be in form of decrease of assets' value or increases in their value. As a consequence, it can be concluded that the stock return has a propensity to be timely. Conservatism leads accounting losses to be realized more timely than earnings. Accordingly, it is predicted that the accounting losses are more consistent with the stock returns than the accounting incomes. Basu (1997) explained that stock return and accounting income tend to show the losses of a same period, but the stock returns reflect the incomes earlier than accounting income (Watts, 2003). Basu (1997) defines conservatism as the faster reflection of bad news than the good news in the earnings. He used stock return to measure the news and applied the regression between earnings and stock return. Additionally, he found that the response of earnings to the bad news (negative stock return) is timelier than the response of earnings to the good news (positive stock return). He also showed that the persistency of the negative changes in the earnings is less persistent than their positive changes. Basu provided a measure to evaluate the conservatism in which there was a profit or loss perspective and is called timely asymmetry.

### 2.4.2. Accounting Conservatism

There are two completely different approaches about conservatism in accounting. Some scholars believe that conservatism is useful for the users and financial analysts. Some other ones, however, not only pay no attention to the role of information, but also believe it is useless for the suppliers and users of the financial statements. These two perspectives are briefly defined below.

### Information Role of Conservatism

The proponents of this approach believe in the information role of conservatism. They suppose that conservatism increases the volume of information reported in the securities markets. This increase might contribute the investors and other users of financial statements for making proper decisions. In fact, this theory considers three information benefits including enhancing information quality, reducing the advantages of earnings management and signaling managers for providing private information to the managers.

### Conservatism Decreases Information Quality

The proponents of this approach are opposed to conservatism. They assume that conservatism decreases information quality of financial statements and this might involve huge losses for the investors and other users of financial statements. From their point of view, conservatism as a tendency to magnify lower revenues is not merely considered as a practical reason for the undesirable conservatism. Payyk et al (2007) suppose conservatism as a factor which generates disorders in the process of earning and recognizing revenue. Therefore, it is known as a conflict of interest among investors and creditors and they prefer to use less conservative approaches (LaFond and Watts, 2008).

### 2.4.3. Measuring Conservatism: Givoly & Hayn Model

Givoly & Hayn (2000) investigated the historical trend of conservatism to find an answer to this question whether financial reporting has got more conservative? Having defined a specific definition in their mind, the discretionary accruals were used to measure conservatism. Based on their definition, conservatism approach is considered when: first, the director confronts with vagueness and uncertain situations and is required to select one choice among two or more possible choices; and second when a method is selected in which the minimum possible value is appointed for the retained earnings. Givoly & Hayn use discretionary accruals because accrual accounting is a channel for executing conservatism in one hand. Executing authority from the directors in the uncertain situation provides a scheme for conservatism, on the other hand. Discretionary accruals include the values influenced by the managerial estimations and judgments (Givoly & Hayn, 2000).

## 3. Research background

Givoly and Hayn (2000) findings suggest that conservatism is the selection among one accounting approach under uncertain situation which would finally magnify the least assets and revenues and conveys the least positive impact on the owners' equity. Wolk et al (2004) also found strong evidences suggesting that conservatism is defined as the slower identification of the earnings and lower evaluation of the assets. Gul et al (2000) tried to find the relationship between conservatism and audit fees in Hong Kong. They stated that increasing audit functions and audit fees are the respective consequences of reducing conservatism. They used the seven years observations of Hong Kong listed firms and found that conservative accounting and the average audit fees are inversely associated.

Coolbeck and Warfield (2005) used the measures of descriptive ability of valuation models based on the data of income statement and balance sheet, error and dispersion of analysts' predictions and earnings persistency in order to examine the quality of accounting information. Tornton (2002) believes that the quality of accounting information and financial reporting is a joint product of at least four main elements including creativity and managerial visions, audit quality, the experience of audit committees and high quality accounting standards. Weakness of any of these four elements might destruct the whole chain. The significant point is that the measures are the variables and metrics which evaluate the quality of accounting information.

Ditrisch, Muler and Ridel (2006) tested the time-related asymmetric measure in evaluating the conservatism and identified those characteristics of estimating time-related asymmetry which lead to bias in

statistical tests in the situations of lack of limited laboratory situations. Using a set of data which lack the time-related asymmetry in the reported income, they showed that this bias causes some evidences about the conservatism to be provided. Balachandran & Mohanram (2006) explored the relationship between conservatism and information content (relevancy of the information). They measured conservatism as a downward bias in book values and time-related asymmetry of earnings by using the extended approach of Penman and Zhang (2002) and Basu (1997). They found no evidences regarding that the upward conservatism (conditional or unconditional) which is related to the downward information content. In total, their results indicated that relating upward information content to the upward conservatism is not a rationale task.

Betti et al (2007) and Zhang (2008) concluded that conservatism plays a more vital role in debt contracts and it conveys joint interests for the creditors and borrowers. Lafond and Watts (2008) think that the investors require conservatism in their evaluations and reports. They assume the main reason of this request is the lack of information asymmetry which includes the correct execution of the conservatism.

Barth et al (2008) applied three variables of earnings management, faster recognition of loss and relevancy of the accounting figures in evaluating accounting quality. Dechono, Adela and colleagues (2008) analyzed the assurance level of internal quality of accounting information through the internal instruments of information in Romanian market. The findings revealed that making decisions by the users of accounting information depends on information quality. Betti et al (2009) studied the impact of monitoring and personal information on the role of accounting quality in making investment decisions and documented that the availability of banks in financial firms is limited to the personal information and constraining cost of capitals which would reduce the accounting quality.

Kousenidis, Ladas & Negakis (2009) examined the information content of earnings. Their results indicate that there is a non-linear relationship between conservative reporting and relevancy of the earnings. Specifically, relevancy level increases by moving from less conservative firms to the semi-conservative ones; while the level of relevancy decreases by moving toward more conservative firms. Chen, Lin and Strong (2009) classified conservatism into two groups of conditional and unconditional groups and found that unconditional conservatism associated with the accounting information of higher quality and lower cost of capital; while the conditional conservatism is associated to the accounting information of lower quality and higher cost of capital.

## 4. Measuring Variables and Extending Models

Conservatism is the independent variable of this study which Basu (1997) defines it as the higher degree of reliability for recognizing and recording the profits and desirable news (incremental value); and using lower degree of reliability for recognizing and recording the losses and undesirable news (declining value). Givoly & Hayn model has been applied to measure the conservatism. Givoly and Hayn used discretionary accruals to measure conservatism. Total accruals and discretionary accruals are computed by the following models:

$$ACC_{it} = (NI_{it} + DEP_{it}) - CFO_{it} \qquad \text{Model (1)}$$
$$OACC_{it} = \Delta(AR_{it} + I_{it} + PE_{it}) - \Delta(AP_{it} + TP_{it}) \qquad \text{Model (2)}$$
$$NOACC_{it} = ACC_{it} - OACC_{it} \qquad \text{Model (3)}$$

ACC is the total accruals, NI is the net income before extraordinary items, DEP is the depreciation and CFO is the operating cash flows. In the second model, OACC is the operating accruals (nondiscretionary), AR is the accounts receivable, I is inventory, PE is the prepaid expenses, AP id the accounts payable and TP is the taxes payable. Finally, the third model includes NOACC which indicates the non-operating accruals (discretionary).

The qualitative characteristics of accounting information are the dependent variables of this study. These characteristics describe the extent to which the accounting information might reflect the real and expected performance of the company in relation to the facilities. Hence, these characteristics evaluate the firm value (Dechow and Schrand, 2004). The present study uses relevancy, reliability and timeliness as the qualitative characteristics. Table 1 shows the models used to compute any of the characteristics and their components in detail.

*Table 1.* Measurement Models of Qualitative Characteristics of Accounting Information

| Variable | Model |
|---|---|
| *Relevancy* | $RET_{j,t} = \beta_{o,j} + \beta_{1,j} E_{j,t} + \beta_{2,j} \Delta E_{j,t} + £_{j,t}$ |
| | $RET_{j,t}$: return of firm j in year t |
| | $E_{j,t}$: earnings before abnormal items of firm j in year t |
| | $\Delta E_{j,t}$: the changes in earnings before abnormal items than the prior year |
| *Reliability* | $A_{it-1}) + \beta_2 (\Delta REV_{it} - \Delta REC_{it}) + \beta_3 PPE_{it} + £_{j,t}$ ' $TA_{it} = \beta_1 (1$ |
| | $TA_{it}$: total accruals of firm i in year t |
| | $A_{it-1}$: total assets of firm i in year t-1 |
| | $\Delta REV_{it}$: the difference between the revenues of firm i in years of t and t-1 |
| | $\Delta REC_{it}$: the difference between the receivables of firm i in years of t and t-1 |
| | $PPE_{it}$: gross value of property, plant and equipment for firm i in year t |
| *Timeliness* | $E_{j,t} = \beta_{o,j} + \beta_{1,j} NEG_{j,t} + \beta_{2,j} RET_{j,t} + \beta_{3,j} NEG_{j,t} * RET_{j,t} + £_{j,t}$ |
| | $E_{j,t}$: earnings before abnormal items of firm j in year t |
| | $RET_{j,t}$: return of firm j in year t |
| | $\Delta E_{j,t}$: the changes in earnings before abnormal items than the prior year |
| | $NEG_{j,t}$. The indicator of negative return which takes 1 if RET>0; and zero otherwise. |
| | $\beta_{2,j}$: the coefficient positive stock returns (economic profit and good news) |
| | $\beta_{3,j}$: the coefficient negative stock returns (economic profit and good news) |

## 5. Methodology of research

The present paper is an applied study classified as a descriptive-correlation and cross-sectional study. Because of using real data, the method of Ex post facto research is selected. To investigate the relationship between independent and dependent variables, regression analysis has been utilized. One major hypothesis is developed to achieve the principal objective of the study. The first hypothesis of this study is examined in terms of three subsidiary hypotheses as follows:

*H1*: Conservatism influences on the quality of accounting information and decisions of shareholders and Tehran listed firm.

*H1a*: Conservatism influences on the relevancy of accounting information and decisions of shareholders and Tehran listed firm.

*H1b*: Conservatism influences on the reliability of accounting information and decisions of shareholders and Tehran listed firm.

*H1c*: Conservatism influences on the timeliness of accounting information and decisions of shareholders and Tehran listed firm.

The population of this study is composed of the whole listed firms on the Tehran Stock Exchange during the years from 2006 to 2011. To select the sample, filtering technique has been employed. This sample consists of those companies which have a set of the following conditions:

1. The items of their financial statements reported by the related companies should be available for the years of 2006 to 2011.

2. Their end of fiscal years should be consistent with the calendar year.

3. Their stocks should be continuously traded on the Tehran Stock Exchange from 2006 to 2011 and they should have no transaction cease for more than four months.

4. The investment and financial intermediary's institutions are excluded from the sample.

Based on the above situations and executing limitations over the sample, finally 300 firms are selected for a period covering 2006 to 2011. The prior studies have been used to complete the literature review and research background. The requires data is collected from the databases of TADBIR PARDAZ software certified by the Tehran Stock Exchange along with the information gathered from WWW.CODAL.IR and WWW.RDIS.IR sites. Finally, the gathered data is prepared in EXCEL software to be analyzed.

## 6. Findings

The values of the dependent and independent variables of this study are separately computed in section four. Using regression relationships, the impact of independent variable on the dependent variables has been analyzed and the findings of each one are provided separately in different tables.

*The First Hypothesis (H1a)*

After computing the relevancy value according to the related model, the data is entered to a regression model which shows the results of analysis in table 2.

*Table 2.* Regression Analysis Results of H1a

| Linear regression | | | Investigated firms: 300 | |
|---|---|---|---|---|
| The method of entering the variable: Enter | | Confidence level: 95% | Error level: 5% | |
| Adjusted R square | R square | Durbin-Watson | Total significance of ANOVA | |
| | | | Sig | F statistics |
| 0.00534 | 0.000529 | 1.621 | 0.0024 | 23.186 |
| Dependent Variable | | beta | Significance of each variable | |
| | | | Sig | t statistics |
| Relevancy | | 0.824 | 0.0061 | 26.148 |

Based on the above table, Durbin-Watson statistic is 1.621 and it is an indicator of non-correlation between the errors. The value of R squared shows that 0.000529 of the changes in the relevancy of accounting information can be explained by the independent variable of conservatism. In doing so, it can be said that the independent variable influences on the dependent variable. Additionally, sig. value in ANOVA test is equal to 0.0024 which is less than 5% and it is an indicator of the significance of the whole model. Based on the sig. value of the independent variable which is equal to 0.0061, the significance level of conservatism is verified. Therefore, the first hypothesis is confirmed and the conservatism has a positive significant impact on the relevancy of the accounting information and consequently affects the decisions of the shareholders and listed firms.

*The Second Hypothesis (H1b)*

The second sub-hypothesis seeks to study the impact of conservatism on the reliability of the accounting information and the decisions made by the shareholders and listed firms on the Tehran Stock Exchange. After computing the value of reliability of the related model, the data is entered into the regression model which its results are provided in table 3.

Durbin-Watson statistic is equal to 1.769 and confirms the non-correlation between the errors. R squared value describes that 0.001089 of the variations in reliability of the accounting information of the Tehran listed firms can be explained by the independent variable. In doing so, it can be concluded that the independent variable affects dependent variable.

*Table 3.* Regression Analysis Results of H1b

| Linear regression | | | Investigated firms: 300 | |
|---|---|---|---|---|
| The method of entering the variable: Enter | | Confidence level: 95% | Error level: 5% | |
| Adjusted R square | R square | Durbin-Watson | Total significance of ANOVA | |
| | | | Sig | statistics F |
| 0.001096 | 0.001089 | 1.769 | 0.0011 | 37.221 |
| Dependent Variable | | Beta | Significance of each variable | |
| | | | Sig | statistics t |

| Reliability | 0.736 | 0.0143 | 22.512 |
|---|---|---|---|

The whole model is significant because sig. value in ANOVA test is 0.0011 and this value is less than 5 percent. The significance of conservatism is also confirmed because the dig. Value of the independent variable is 0.0143 and this is less than 5 percent. As a consequence, the second subsidiary hypothesis is confirmed. The conservatism has a positive significant impact on the reliability of the accounting information quality and therefore influences on the decisions of the shareholders and the listed firms.

*The Third Hypothesis (H1c)*

The third hypothesis seeks to investigate the impact of conservatism on the timeliness of accounting information and decisions made by the shareholders and listed firms of Tehran Stock Exchange. After entering the data to the regression model, the analysis results are shown in table 4.

*Table 4.* Regression Analysis Results of H1c

| Linear regression | | | Investigated firms: 300 | |
|---|---|---|---|---|
| The method of entering the variable: Enter | | Confidence level: 95% | Error level: 5% | |
| Adjusted R square | R square | Durbin- Watson | Total significance of ANOVA | |
| | | | Sig | Statistics F |
| 0.000789 | 0.000784 | 1.693 | 0.0032 | 28.112 |
| Dependent variable | | Beta | Significance of each variable | |
| | | | Sig | Statistics t |
| Timeliness | | 0.768 | 0.0057 | 28.331 |

Based on table above, 0.000784 of variations in timeliness of the accounting information is explained by the independent variable. Therefore, it can be said that the independent variable influences on the dependent variable. The whole model is significant because its sig. value in ANOVA column is less than 5 percent. The significance of conservatism is also confirmed because sig. value of the independent variable is 0.0057 and less than 5 percent. Consequently, the third sub-hypothesis is confirmed and conservatism is in a positive significant relationship with the timeliness of the accounting information quality and consequently affects the decisions made by the shareholders and listed firms.

## 7. Conclusion

The main hypothesis of this study includes three subsidiary hypotheses. There are three dependent variables which are affected by the independent variable. According to the statistical results, there is a positive association between conservatism and qualitative characteristic of relevancy of financial statements. Based on the statistical computations, the findings reveal that there is a positive relationship between conservatism and the reliability of financial information. That is, the conservatism increases the reliability of the information provided in financial statements. The findings confirm the third subsidiary hypothesis. In other words, there is a positive relationship between conservative and timeliness of the information. Conservative representation of the financial information leads to providing timely financial information. In general, Conservatism influences on the accounting information quality and the decisions of the shareholders and Tehran listed firms. Some critiques and advocates are developed for the conservative representation of the financial information of the firms because of their own reasons. The author also developed some models and information and found that the conservatism positively influences on reliability, relevancy and timeliness of the accounting information of Tehran listed firms.

There are similar studies conducted about the conservatism and quality of accounting information which have some results consistent with the prior studies. For instance, Balachandran & Mohanram (2006) examined the relationship between conservatism and information content. They measured conservatism by

the downward bias of book values and time-related asymmetry of the earnings by using the extended approach of Penman and Zhang (2002) and Basu (1997). However, they found no evidence suggesting that upward conservatism (conditional or unconditional) is related to the downward information content. There are some other different studies, such as the one conducted by AICPA, which reveal that the conservatism reduces the quality of accounting information because it might lead to systematic biases and real deviations in real economic events.

### Discussion

*Conservatism in contrast with relevancy and decisions of shareholders and listed firms*

The information reflected on the financial statements might be effective in the decision making of the users when it has specific characteristics. The qualitative characteristics of the information in this study have specifications which make the components of financial information applicable. According to the statistical results, there is a positive association between conservatism and qualitative characteristic of relevancy of financial statements. That is, conservatism enhances the quality of the provided information and this might play an efficient role for the investors and other users of the financial statements. Based on the investigations, more conservative financial information influences on the relevancy of the information. Most companies tend to behave conservatively in presentation of the financial information and this leads to an effect on the characteristics of the quality of financial information.

Although this study confirms the positive relationship between conservatism and relevancy of financial information, the literature review and the personal opinion of the author show that the observed relationship between conservatism and relevancy has been inversely associated. Stated another way, conservatism reduces the qualitative characteristic of relevancy and the evidences also do not support a strong relationship between the two variables. The author also believes that relevancy is a major specification of the accounting information. Presenting relevant information contributes the decision makers to make conscious and rational decisions and can be considered as a factor for preventing the vagueness and uncertainty in studying the financial information.

*Conservatism in contrast with reliability and decisions of shareholders and listed firms*

The second dependent variable is the reliability of the accounting information. This variable refers to the trust the users put on the basic financial statements. To make the information useful, it should be reliable. The information which is free of material tendencies and errors and faithfully represents the object it tries to describe is called reliable information. Based on the statistical computations, the findings reveal that there is a positive relationship between conservatism and the reliability of financial information. That is, the conservatism increases the reliability of the information provided in financial statements. In other words, the more conservative financial information issued by the firms enhances the qualitative characteristic of reliability of the information.

This hypothesis is the same as the first hypothesis and the findings demonstrate that there is a positive relationship between conservatism and reliability of the information. Based on the prior studies and the existing theories, the conservative presentation of the financial information by the firms reduces the reliability of the financial statements and this is supported by the personal opinion of the author. Transparency in presenting financial information lead managers makes better decisions. The information might be relevant but have an unreliable nature so that potentially misleads the recognition in the financial statements. The accounting measures are reliable when they are faithfully representing the value they are expected to show.

*Conservatism in contrast with timeliness and decisions of shareholders and listed firms*

Untimely information does not convey the expected influence on the decisions. That is, the information should be available to the investors before it loses the effectiveness on decisions. The findings confirm the third subsidiary hypothesis. In other words, there is a positive relationship between conservative and timeliness of the information. Conservative representation of the financial information leads to providing timely financial information. Collecting, summarizing and issuing accounting information should have enough speed to ensure that they are available to the users at the specified time. Regardless of the proved positive relationship between the two variables of conservative and timeliness, the author strongly believes that these two elements are negatively associated. Stated another way, conservative representation of the financial

information loses the chance to provide timely and quick information. However, timeliness of the information does not guarantee the effectiveness of the information; but the untimely information can never enhance the efficiency of the information.

According to the statistical results, there is a positive association between conservatism and qualitative characteristic of relevancy of financial statements. Based on the statistical computations, the findings reveal that there is a positive relationship between conservatism and the reliability of financial information. That is, the conservatism increases the reliability of the information provided in financial statements. The findings confirm the third subsidiary hypothesis. In other words, there is a positive relationship between conservative and timeliness of the information. Conservative representation of the financial information leads to providing timely financial information.

### *Applicable Suggestions Based on the Findings*

According to the results and the theoretical bases of the study and the confirmed relationship between conservatism and qualitative characteristics of the financial information, it is offered to provide financial information with the characteristics of usefulness, reliability, relevancy and timeliness. The stock exchanges hold the responsibility to monitor the information disclosure of the listed firms and these exchanges protect the interests of the potential and current investors and creditors. Therefore, the necessity to timely and proper reporting of the firms might be useful because it helps the market to reach more efficiency. There are also several suggestions offered for the firms, stock exchanges and the listed firms as follows:

- Requiring companies to prepare and present the financial statements in a transparent and complete manner.

- Requiring companies to prepare accounting information so that it could be perceived by the all individuals with a fair level of knowledge about accounting and economics.

- Directing training periods to achieve accounting information and analyze it for the new and potential investors on the stock exchanges.

- Providing useful and complete reports from the positions of the Tehran listed firms.

- Activating the dealers of the stock exchanges and financial analysts to provide approaches and analyzes of the information related to the decision of the investors.

### References

1. Balachandran, S. V., & Mohanram, P. S. (2006), Conservatism and the Value Relevance of Accounting Information: Unpublished Working Paper, Columbia University.

2. Barth, M.E., Beaver, W.H., Landsman, W., (2008). The relevance of value relevance research. Journal of Accounting and Economics 31, 77–104.

3. Basu, S., 1997. The conservatism principle and the asymmetric timeliness of earnings. Journal of Accounting and Economics 24, 3-37.

4. Beatty, A., Weber, J., Yu, J., (2007). Conservatism and Debt. Journal of Accounting and Economics, forthcoming.

5. Beatty, Anne, Joseph Weber and J. Scott, (2009), "The Role of Accounting Quality in Reducing Investment Inefficiency in the Presence of Private Information and Direct Monitoring", Working paper, The Ohio State University.

6. Chan, A. L.-C. & Lin, S. W.J. & Strong, N. ,(2009), Accounting conservatism.

7. Chen, Q., T. Hemmer, and Y. Zhang. (2009). On the relation between conservatism in accounting standards and incentives for earnings management. Journal of Accounting Research 45 (3) (Jun): 541. the cost of equity capital: on line, http://www.ssrn.com

8. Christensen, J.A., & J.S. Demski, (2003), Accounting theory.

9. Dechow P.M., Ge, W., and Schrand, C., (2004). Understanding earnings quality: A review of the proxies, their determinants and their consequences. Journal of Accounting and Economics 50, 344-401.

10. Dietrich, J. R., K. Muller III, and E. Riedl. (2006). Asymmetric timeliness tests of accounting conservatism. *Review of Accounting Studies* 12 (1) (Mar): 95.

11. Feltham, G., and J. Ohlson (1995). Valuation and dean surplus accounting for operating and financial activities. Contemporary Accounting Research 11 (2) (Spring): 689.

12. Givoly, D., and C. Hayn.( 2000). The changing time-series properties of earnings, cash flows and accruals: Has financial reporting become more conservative? Journal of Accounting & Economics 29 (3) (Jun): 287.

13. Kohlbeck, Mark, Warfield, Terry,(2005), "The Effects of Accounting Standard Setting on Accounting Quality", Florida Atlantic University; SSRN Website.

14. Kousenidis, D. V., Ladas, A. C., Negakis, C. I., (2009), Value relevance of conservative and non-conservative accounting information. Journal of Accounting, 44, 219-238.

15. LaFond, R., and R. Watts.( 2008). The information role of conservatism. The Accounting Review 83 (2) (Mar): 447.

16. Penman, S. H. and X. Zhang. (2000). "Accounting Conservatism, the Quality of Earnings, and Stock Returns." The Accounting Review 77:237-264.

17. Roychowdhury, S. and Watts, R. (2005). Asymmetric Timeliness of Earnings, Marketto Book and Conservatism in Financial Reporting, Journal of Accounting and Economics, 44(1), 2-32.

18. Thornton, Daniel, B. (2002). Financial Reporting Quality: Implications of Accounting Research. Submited to the senate standing committee on banking, trade and commerce, May 29.

19. Watts, Ross, L (2003). "Conservatism in Accounting Part I: Explantions and Implications", Accounting Horizons, Vol. 17(3), pp. 207-221.

20. Wolk, Harry. I, J. L. Dodd, and M. G. Tearney, (2004), "Accounting Theory: A Conceptual and Institutional Approach", 5th edition, South-Western.

21. Zhang, J., (2008). The contracting benefits of accounting conservatism to lenders and borrowers. Journal of Accounting and Economics, 45, 27–54.