The Association between Accounting Conservatism and Cash Dividends: Evidence from Emerging Markets

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Accounting Department, Benha University, Egypt, currently, Bahrain University, Kingdom of Bahrain, Egypt
Email: gamousa1999@yahoo.com

Abstract

This research examines the association between accounting conservatism and cash dividends of listed firms in the Kingdom of Bahrain. It has addressed two questions. First, does accounting conservatism actually work? Second, can accounting conservatism influence cash dividends of firms in the Kingdom of Bahrain? The findings of this study support the hypothesis that accounting conservatism plays an important role in reducing cash dividends and managing agency conflicts. It documents a significant negative association between accounting conservatism and cash dividends of Bahraini Firms.

Keywords: Accounting Conservatism, Financial Reporting, Cash Dividends, Emerging Markets

Introduction

Conservatism is an important convention of financial reporting. It implies the exercise of caution in the recognition and measurement of income and assets (Givoly and Hayn, 2000). It requires more verification to recognize gains than to recognize losses (Gao, 2013). Shroff *et al* (2004) define accounting conservatism as recognizing revenues and gains only when they are reasonably certain, while recognizing expenses and losses as soon as they are reasonably possible. Basu (1997) defines conservatism as the accountant's practice of recognizing bad news more quickly than good news, which translates the accounting principle of "anticipate all losses but anticipate no gains". Conservatism has a tendency which is opposed to the ideal of matching costs with income (Basu, 1997). Accounting conservatism means a delayed recognition of potential earnings (Wang, 2009). Conservative accounting facilitates monitoring of managers and of debt and other contracts, and is an important feature of corporate governance (Ball *et al.*, 2000).

There is only one official definition for conservatism that was presented in the glossary of Statement of Concepts No. 2 of the FASB (1980) in which conservatism is defined as prudent reaction to uncertainty. Basu (1997) interprets conservatism as capturing accountants' tendency to require a higher degree of verification for recognizing good news than bad news in financial statements that means earnings reflects bad news more quickly than good news. Therefore unrealized losses are typically recognized earlier than unrealized

gains. This asymmetry in recognition leads to systematic differences between bad news and good news periods in the timeliness and persistence of earnings.

Literature on accounting conservatism documents that the degree of reporting conservatism has increased over time (Watts, 2002). For example, Givol and Hayn (2000) find that reported profitability over the last four decades has generally declined on a sample of 896 firms in the period from 1968 to 1998. This study provides evidence that a massive accumulation of negative non-operating accruals over this period. Also, the earnings distribution has become more dispersed and negatively skewed relative to that of cash flows which suggests a more timely recognition of bad news than good news. In the same line, Ball and Shivakumar (2005) examine timely loss recognition, an important attribute of financial reporting quality, in a large sample of UK private and public firms during 1990-2000. The results of the study show that the timeliness of loss recognition is lower in private companies than public companies.

An interesting stream of research has links between conservative accounting and cash Dividends. Since cash dividends are based on retained earnings that are calculated on conservative accounting principles therefore relationship between them exist. Associations among conservative accounting, cash Dividends and agency theory are supposed. Agency theory suggests that cash dividends can play an important role in managing conflicts between shareholders and other stakeholders such as creditors. Paying cash dividends to stockholders reduces the funds available to pay creditors' claims (Jensen and Meckling, 1976; Watts, 2003 a & b). Overpayment of cash dividend to management/shareholders will impact on the interests of creditors and may reduce the efficiency of debt contracts. Accounting conservatism is suggested as one mechanism that can mitigate agency conflicts because it is used to compute net income and retained earnings, which can reduce dividend payout (Ahmed et al., 2002; Zhang, 2000; Beatty et al., 2008)

The study has three main contributions. First, it provides a starting point for research involving accounting conservatism and cash dividends in a Bahraini environment. This study is one of the first empirical studies in the Kingdom of Bahrain that investigate the relationship between accounting conservatism as an attribute of financial reporting and cash dividends. Second, relatively little is known about such relationship in one of the emerging markets such as Bahrain therefore the current study extends the literature on this topic. The empirical investigation of this study could provide set of benefits to many parties as investors and regulators. Third, it may help in studying other capital markets in this area, especially Gulf countries.

The rest of this study is organized as follows. Section 2 reviews relevant literature and develops the hypotheses concerning the association between accounting conservatism and cash dividends. Section 3 presents the research method, sample selection and variables definitions. Empirical analysis and results are discussed in section 4. Section 5 concludes the paper and suggests avenues for future research.

Literature Review and Hypotheses Development

Several studies have examined how accounting conservatism impacts on financial reporting, how the cost of debt varies with the amount of conservatism in financial reports and how accounting conservatism can restrict paying cash dividends to stockholders. Literature links conservatism and agency theory because overpayment of dividends can transfer wealth from bondholders to shareholders by reducing the assets available for meeting bondholders' fixed claims, and hence, increase the default risk for bondholders

(Jensen and Meckling, 1976; Ahmed et al., 2002). Conservatism produces estimates of net assets and retained earnings that are biased downward for a reason, i.e., to prevent actions by managers and others that reduce the size of the pie available to all claimants on the firm (Watts, 2002). In the same line, Grossman and Hart (1980) point out that the dividend payouts mitigate agency conflicts by reducing the amount of free cash flow available to managers, who do not necessarily act in the best interest of shareholders. Jensen (1986) argues that dividend payouts can help control agency problems by getting rid of the excess cash that could be spent on unprofitable projects.

Another stream of related research assesses the relation between accounting conservatism and debt covenants. For example, Beatty *et al* (2008) provide some evidence that conservative financial reporting and conservative adjustments in debt covenants are used simultaneously by firms and lenders to resolve agency conflicts. Zhang (2008) documents that lenders benefit from conservative accounting via the accelerated violations of debt covenants while borrowers benefit from conservative accounting via lower initial interest rates using a sample of 327 firms. For debt contracts, lenders prefer mechanisms that reduce their risks. Accounting conservatism is considered one of these mechanisms that recognize bad news on a more timely basis than good news (Zhang, 2008; Watts, 2003 a). Accelerated covenant violations benefit lenders ex post by providing them an opportunity to reduce their downside risk by taking protective actions (Zhang, 2008).

On the other hand, a number of studies have documented a relationship between accounting conservatism and earnings and returns of firms. For example, in USA, Basu (1997) test the asymmetric timeliness hypothesis implied by accounting conservatism using contemporaneous positive/negative annual stock returns as the measure of publicly available good/bad news in a sample of 43,321 firm-year observations from 1963 to 1990. He finds that the contemporaneous sensitivity of earnings to negative returns is significantly higher than that of earnings to positive returns. The results of his study show that the slope coefficient and R^2 in the regression of earnings on returns are greater for bad news firms than for good news firms. In the same vein, Hayn (1995) reports that the slope coefficient and R^2 are higher for firms reporting profits (3.35 and 23.8%, respectively), than for firms reporting losses (0.63 and 3.6%, respectively) by using a sample of 85,919 firm years over the 29-year period 1962-1990. Shroff *et al* (2004) use a sample of 61,867 firm-quarter observations from 1987 to 2000 and report that bad news has a higher correlation with concurrent earnings while, good news has a higher correlation with subsequent earnings. Pae (2008) examines the effect of accounting conservatism on the relation between earnings and returns. The findings of the study show that the slope coefficient is higher for bad news firms reporting losses than for good news firms reporting profits, but R^2 is lower for bad news firms reporting losses than for good news firms reporting profits. The coefficient on earnings is not significantly different from zero and the adjusted R^2 is close to zero (0.002) for loss firms. The regression of earnings on returns shows that the mean coefficient estimate on returns is higher for profit firms (0.056) than for loss firms (0.019).

The existing empirical literature finds statistically controversial effects of accounting conservatism on cash dividends. Such effects stem from cash dividends based on retained earnings that was computed by conservative accounting principles. For example, Daniel et al (2008) report that changes in dividends predict future changes in earnings. In China, with the data of Chinese listed firms from 2001 to 2006, Chen *et al* (2012) find that publicly listed firms with more conservative accounting are less likely to pay dividends, and they pay less cash dividends. Also, accounting conservatism does not have a statistically significant impact on

the dividends of firms with low debt indicates that the relationship between accounting conservatism and dividend payments is induced by the stockholder-creditor agency relationship instead of non-creditor reasons. Ahmed *et al* (2002) investigate the determinants of accounting conservatism and include dividend policy as an independent variable in models that predict accounting conservatism using a sample of 7004 USA firms from 1993 to 1998. The findings of the study show that accounting conservatism helps reduce conflict between bondholders and shareholders about dividends, and reduces the cost of debt to companies. Firms with aggressive accounting reports were more likely to pay cash dividends. In the same line, Ahmed and Duellman (2007) provide evidence that accounting conservatism assists directors in reducing agency costs of firms. While, Frankel et al (2008) use US firm-year observations during 1997-2005 to examine the relation of accounting conservatism and payouts to shareholders. The study shows that asymmetric timeliness of operating cash flows is significantly and positively related to asymmetric sensitivity of shareholder payouts. The level of shareholder distributions is negatively related to accounting conservatism which means greater conservatism leads to lower shareholder distributions. Skinner (2008) examines the correlation between payouts and earnings and finds a significantly positive relation between payouts and earnings for firms that make regular payouts between 1995 and 2005. Kowalewski *et al* (2007) examine the relation between corporate governance and cash dividend policy in Poland by using 110 non-financial companies listed on Warsaw Stock Exchange between 1998 and 2004.The findings of the study report that companies with weak shareholder rights pay dividends less than firms with high corporate governance. In the light of the above arguments, the following hypotheses are formulated.

H1: accounting conservatism plays a role in annual earnings of Bahraini firms.

H2: there is a negative association between accounting conservatism and cash dividends.

Research Method and Sample Selection

This section provides details on the methodology, sample selection, and definitions of all variables which were adopted in the current study.

The Sample Selection

To test the hypotheses above, a sample of Bahraini listed companies on the Bahraini Bourse (BHB) during 2007 and 2012 was collected. The final sample of the study consists of 40 firms which were selected from 49 companies. Since the following criteria were applied to include any firm in the sample: (1) the companies had to be Bahraini firms that were listed on BHB during 2007 and 2012; (2) the company had to have paid a cash dividend in at least one year during 2007-2012 period; (3) availability of complete information on all variables. To build the database for this study, several sources have been relied on; one source was BHB and its website (www.bahrainbourse.net) which is the main provider of information about the Bahraini stock market. Other sources were companies' annual reports; the web page of each of the listed companies; and other specialized web sites which include data bases of listed companies in the BHB (e.g., www.mistnews.com; and www.mubasher.net). Various web pages were used to obtain data related to some variables (e.g., financial leverage, return on equity - ROE).

Variables Definitions

Accounting conservatism proxies (dependent variables)

Because conservative accounting is applied before cash dividend policy is determined by management, this means that cash dividend policy is based on the earnings or net income that is calculated under a conservative accounting policy. In this paper accounting conservatism was used as an independent variable following (Chen *et al.*, 2012). There is no generally accepted definition of accounting conservatism. Wang (2009) argues that an interesting feature of the conservatism literature is the variety of existing measures of conservatism, and the apparent lack of consistency among these measures. Therefore, a number of accounting conservatism measures was suggested in the literature. For example, Basu's (1997) asymmetric timeliness of earnings measure; the Market-to-Book (or Book-to-Market) ratio; Penman and Zhang's (2002) hidden reserves measure; Givoly and Hayn's (2000) negative accruals measure.

The current study uses two measures of the above. First, Basu's (1997) measure which is the most popular measure of conservatism in the literature (see, Ryan, 2006). It has been used in numerous studies to assess the extent of accounting conservatism (Givoly *et al.*, 2007; Beaver and Ryan, 2005). Basu's measure relates to the speed of response of accounting earnings to bad news relative to good news. In this measure of conservatism, earnings reflect bad news more quickly than good news because accountants require more verifiable information before they recognize good news. This conservatism measure relies on the extent to which the earnings-return association is stronger during periods of bad news (i.e., negative return periods) as compared with periods of good news (i.e., positive return periods).

Also, the current study has used Market-to-Book ratio (M/B) as the second most widely applied measure of conservatism. Market-to-book ratio is a commonly used measure of conservatism in the accounting literature (Beaver and Ryan, 2005; Ahmed *et al.,* 2002; Pae *et al.,* 2005). On the other hand, a number of studies (Feltham and Ohlson, 1995; Beaver and Ryan, 2005; Givoly and Hayn; 2000) have used M/B as another conservatism measure, calculated as the ratio of market value of equity over book value of equity. This ratio has been used to gauge changes in reporting conservatism over time. The M/B is regarded as a measurement of overall conservatism rather than unconditional conservatism, since when the market value is much higher than the book value, it is not only due to some accounting treatments like assets impairment, which is thought to be recognized bad news more timely (conditional conservatism), but also due to some accounting treatments such as research and development expenses or an accelerated depreciation method rather than the average way, which is considered to be unconditional conservatism (see, Chen *et al.*, 2012). Pae (2008) uses M/B (defined as the ratio of the market value of equity to the book value of equity). The mean and median of M/B are 2.90 and 1.43, respectively, suggesting that accounting is on average conservative over the sample period if the market-to-book ratio is used as a measure of balance sheet conservatism (Pae *et al.*, 2005). The median annual stock returns and earnings per share deflated by the beginning stock price is 5.6% and 6.4%, respectively. According to Beaver and Ryan (2005), conditional conservatism is measured by Basu's measure, and unconditional conservatism is measured by M/B.

Following a number of studies (Givoly et al., 2007; Beaver and Ryan, 2005; Basu, 1997), The Basu asymmetric timeliness measure was applied in the current study as follows:

$$EPS_{it} / P_{it\_1} = \alpha_0 + B_0 R_{it} + \varepsilon_{it} \qquad (1)$$

$$EPS_{it} / P_{it\_1} = \alpha_0 + \alpha_1 DR_{it} + B_0 R_{it} + B_1 R_{it} * DR_{it} + \varepsilon_{it} \qquad (2)$$

Equation1 for the full sample; equation 2 divides firm year observations into good news and bad news samples based on whether the return was greater than or less than zero). Where EPS_{it} is the earnings per share of firm i in fiscal year t, P_{it_1} is the price per share of firm i at the beginning of fiscal year t, R it is the 12-month return of firm i ending 3 months after the end of fiscal year t, and DR_{it} is a dummy variable that is equal to 1 if the stock market return for firm i in year t is negative, and equal to 0 if the stock market return for firm i in year t is positive). In this regression, the sensitivity of earnings to good news is captured by B 0 and the sensitivity of earnings to bad news is captured by ($B_0 + B_1$).

Cash dividends proxies (independent variables)

In contrast with Frankel *et al* (2008), the current study considers only the cash dividends rather than the total distributions to shareholders (dividends plus stock repurchases minus stock issuances), since stock re-purchases show different management' incentives and have different consequences on firms (following Chen *et al*., 2012). The current paper uses four measures to reflect cash dividend policy. The first measure is the cash dividend payout ratio (PAOUT), which equals annual cash dividend divided by the net income excluding minority interest and extraordinary income. This measure shows how much a company pays out in dividends each year relative to its net profit. The second measure, the cash dividend yield ratio (YIELD), which equals the cash dividend per share divided by the closing price per share, shows how much a company pays out in dividends each year relative to its share price. The third measure is the cash dividend per share (DVSHR), which equals total cash dividend divided by the number of shares of common stock outstanding. The fourth measure is DUMV, a dummy variable, which is 1 if the firm paid cash dividends in the current year, 0 otherwise.

Control Variables

A number of studies (such as Al-Najjar and Hussainey; 2009; Li and Zhao; 2008) have examined factors that impact on cash dividends policy in firms, in other words, they investigated a set of firm characteristics, such as (liquidity, size, growth opportunities, profitability, leverage). For example, Kowalewski *et al* (2007) show that firm size and return on assets are positively associated with the variable cash dividends to cash flow at 1% significance level while, financial leverage is negatively associated with the same variable. Al-Najjar and Hussainey (2009) found a positive relationship between dividend payout and firms' profitability. Following prior research (i.e. Al-Najjar and Hussainey; 2009; Li and Zhao; 2008; Kowalewski *et al.,* 2007), the current study controls the relationship between profitability and cash dividends by including return on equity (ROE) as an independent variable. ROE is calculated as net income divided by shareholders' equity at the end of the year. Also, it uses total liabilities/total assets ratio to control the effect of financial leverage (FLEVER) and total assets (Size) to control the firm size effect, using the natural logarithm of total assets at the end of the year as a proxy for firm size.

Table 1

Definitions of the all variables in the current study

Variables	Definitions
Dependent Variables Basu measure (Consm1) Market-to-Book ratio (M/B)	Is identified in section 3.2.1. The ratio of the market value of equity to the book value of equity.
Independent Variables Cash dividend payout ratio (PAOUT)	Cash dividend/the net income excluding minority interest and extraordinary income.
Cash dividend yield ratio (YIELD)	Cash dividend per share/the closing price per share.
Cash dividend per share (DVSHR)	Total cash dividend/the number of shares of common stock outstanding.
Dummy variable (DUMV)	1 if the firm paid cash dividends in the current year, 0 otherwise.
Control Variables Firm Size (FISZ)	The natural logarithm of total assets at the end of the year.
Financial Leverage (FLEVER)	Total liabilities/total assets.
Return on Equity (ROE)	Net income/shareholders' equity.

Data Analysis

The Ordinary least square (OLS) regression analysis was performed for the two measures of accounting conservatism (Consm1 and M/B ratios) as dependent variables and four independent variables of cash dividends (PAOUT; YIELD; DVSHR; DUMV). In addition, three control variables (FSIZE, FLEVER and ROE) were included in the models.

Two regression models of accounting conservatism were estimated in the current study as follows:

Model 1:

Y (Consm1) = β_0 + β_1 PAOUT + β_2 YIELD + β_3 DVSHR + β_4 DUMV + β_5 FSIZE + β_6 FLEVER + β_7 ROE + ε (3)

Where Y = Consm1; β_0 is a constant; $\beta_{i,\ i=1,\ \dots,\ 6}$, is parameters; and ε is error term.

Model 2:

Y (M/B) = β_0 + β_1 PAOUT + β_2 YIELD + β_3 DVSHR + β_4 DUMV + β_5 FSIZE + β_6 FLEVER + β_7 ROE + ε (4)

Where Y = M/B ratio; β_0 is a constant; $\beta_{i,\ i=1,\ \dots,\ 6}$, is parameters; and ε is error term.

Empirical Results and Analysis

Descriptive Statistics

Table 2 shows the descriptive statistics for all variables of current study (dependent; independent and control variables). In Table 2 below, the cash dividend payout ratio is 23.46% on average, which means that firms pay one-fifth of their earnings to their shareholders. For the cash dividend yield ratio (PAOUT), the mean is 3.04%, which is much lower than the interest rate that the banks in the Kingdom of Bahrain pay. Nearly 38.3% of sampled companies pay cash dividends. The mean M/B is 1.44 indicating market value is about one and half times of the book value, much more conservative. For ROE; the mean percentage is

7.0617 % with a standard deviation of 23.05655%. Concerning the firm size (FSIZE), it can be seen that on average, sampled companies have 5.3098 with a standard deviation of 0.94399. Also, the average of financial leverage ratio (FLEVER) for the total sample was 12.6659 % of the 240 companies.

Table 2

The descriptive statistics for all variables of current study

	N	Mean	Std. Deviation
Converm1	240	-32.6537	39.08140
M/B	240	1.4422	0.97525
PAOUT (%)	240	23.4665	67.42327
YIELD	240	3.0448	9.88436
DVSHR (%)	240	5.9865	12.96994
DUMV	240	0.383	0.4872
Log FISZ (BD)*	240	5.3098	0.94399
FLEVER (%)	240	12.6659	30.34614
ROE (%)	240	7.0617	23.05655

Note: Bahraini Dinar (BD)* is the currency of the Kingdom of Bahrain (at the end of December 2012 (US$1 = BD 0.377).

Regression Analysis

Table 3 presents regression results for the Basu asymmetric timeliness measure (panel A: for the full sample and panel B: divides firm year observations into good news and bad news samples based on whether the return was greater than or less than zero).

$$EPS_{it} / P_{it\_1} = \alpha_0 + B_0\, R_{it} + \varepsilon_{it}$$
(5)

$$EPS_{it} / P_{it\_1} = \alpha_0 + \alpha_1\, DR_{it} + B_0\, R_{it} + B_1\, R_{it} * DR_{it} + \varepsilon_{it}$$
(6)

Table 3

Regression results for the Basu asymmetric timeliness measure

Panel A: The full sample				
α_0		B_0		Adjusted R^2
101.444 (5.934)**		0.352 (1.537)*		0.856
Panel B: good news and bad news firm year observations				
α_0	α_1	B_0	B_1	Adjusted R^2
107.334 (3.150)**	0.946 (0.750)	0.388 (1.192)*	0.954 (1.552)*	0.124

Note: 1- * significant at the 0.05 level; ** significant at the 0.01 level.
2- t- statistics are in parentheses.

Concerning the full sample in Panel A, the adjusted R^2 is 8.56% which is similar to previous studies as Basu (1997) who reported R^2 is 7.99% for the full sample and R^2 is 10.09% for good news and bad news samples. Also, Pae (2008) reports the adjusted R^2 is 9.8 % for the full sample while, R^2 is reported for the full sample of 9.3% by (Hayn, 1995). The coefficient of returns is 0.325. For the second regression in Panel B for good news and bad news firm year observations, DR_{it} is a dummy variable that is equal to 1 if the stock market return for firm i in year t is negative, and equal to 0 if the stock market return for firm i in year t is positive). In this regression, the sensitivity of earnings to good news is captured by B_0 and the sensitivity of earnings to bad news is captured by $(B_{1+} B_{0)}$ which equal (0.954+ 0.388). The coefficient B_1 measures the difference in the sensitivity of earning to negative and positive returns. It is significant and implies that earnings is about (0.954+ 0.388)/ 0.388) = 3.45. Similarly, the findings of Pae (2008) study show that the coefficient on returns as the timeliness of earnings with respect to stock returns, bad news are more than eleven times as timely as earnings for good news (11.4 = 0.285/0.025). Overall, Table 3 shows that accounting conservatism actually works in the Bahraini capital market. These results are consistent with some earlier studies and strongly support H1.

Table 4
Model 1 (Consm1)

	Coefficient **B**	t
(Constant)	17.617	1.224
PAOUT (%)	-0.045	-1.006
YIELD	-0.240	-0.791
DVSHR (%)	-0.496	-(2.467)**
DUMV	-0.542	-0.404
Log FISZ (BD)	8.337	(3.219)**
FLEVER (%)	0.210	(2.136)*
ROE (%)	0.176	1.640
No. of Observations	240	
R^2	0.155	
Adjusted R^2	0.129	
F value	5.165	
P value	0.000	

Note:
1. * significant at the 0.05 level (2 – tailed); ** significant at the 0.01 level (2 –tailed)
2. Dependent, independent and control variables are defined in Table 1.
3. Converm1 is the dependent variable in the above model.

Concerning the relationship between accounting conservatism and cash dividends, OLS regression analysis was performed for the two measures of accounting conservatism (Consm1 and M/B ratios) as dependent variables. In Table 4 below, Model 1, Consm1 is the dependent variable; accounting conservatism was measured by Basu's (1997) measure, with an adjusted R^2 of 0.129. It indicates that 12.9% of the variance in Consm1 can be predicted from PAOUT; YIELD; DVSHR; DUMV; Log FISZ; FLEVER and ROE. More importantly, the model specification

(F=5.165 and the associated p-value with F= 0.000) shows a significant relationship between Consm1 and cash dividends variables and control variables, suggesting that the explanatory variables can be used reliably to determine accounting conservatism in Bahraini context.

Significant results are found in this model, for example; the coefficients for cash dividends proxies are all negative which means that the cash dividend policy is negatively related with accounting conservatism. This result suggests firms that apply more conservative accounting pay less cash dividends. Accounting conservatism can reduce the conflicts between shareholders and different stakeholders. Only one of cash dividends variables, DVSHR, total cash dividends/the number of shares of common stock outstanding, has a significant negative (-0.496)** relationship with Consm1. Moreover, ROE and FISZ have a positive relationship but non-significant with Consm1 which suggest that large and more profitable firms use more conservative accounting than small and less profitable firms. In contrast, FLEVER has a significantly positive association with Consm1 (t= 2.136 and p-value= 0.02). This finding implies that firms with more debts will seek to be more conservative accounting to mitigate the conflicts between shareholders and other stakeholders as creditors. This finding is consistent with prior studies (Ahmed *et al.*, 2002; Zhang, 2008). According to the previous discussion, the second research hypothesis (H2), which was developed earlier in the study, can be accepted.

Table 5
Model 2 (M/B)

	Coefficient **B**	t
(Constant)	0.034	0.315
PAOUT (%)	-0.001	(-1.965)*
YIELD	-0.008	(-3.408)**
DVSHR (%)	-0.003	(-1.754)*
DUMV	-0.334	-0.560
Log FISZ (BD)	0.044	0.023
FLEVER (%)	0.348	0.109
ROE (%)	0.123	-1.193
No. of Observations	240	
R^2	0.103	
Adjusted R^2	0.070	
F value	2.475	
P value	0.010	

Note:
1. * significant at the 0.05 level (2 – tailed); ** significant at the 0.01 level (2 –tailed)
2. Dependent, independent and control variables are defined in Table 1.
3. M/B is the dependent variable in the above model.

In Table 5 above, Model 2 M/B, a second measure of accounting conservatism, is statistically significant (p value is 0.010) in explaining the dependent variable, when measured by market to book ratio, with F-value of 2.475 and a lower value of adjusted R^2 of 0.070 which explain 7% of the variance in accounting conservatism M/B. Interestingly, Table 5 shows significant

negative relationships between M/B and three of cash dividends variables, PAOUT (t=1.965, p-value=0.02); YIELD (t=3.408, p-value=0.000) and DVSHR (t=1.754, p-value=0.01). These significant negative associations between M/B and cash dividends variables suggest that accounting conservatism has a significant impact on the dividends of firms. This result reveals that accounting conservatism can reduce cash dividends to shareholders therefore it can be considered one of the mechanisms that can help to reduce risks for the number of stakeholders as creditors and lenders. Such a finding is consistent with the results of prior studies (as Ball *et al.,* 2000; Watts, 2002; Ahmed *et al.*, 2002; Wang, 2009) that suggest accounting conservatism can resolve agency conflicts. This empirical result provides supportive evidence for the second hypothesis (H2) thus, it is accepted. Accounting conservatism has an impact on cash dividends. The three control variables, FISZ; FLEVER and ROE have positive associations with M/B. Such a result implies that large firms with more profit and debts use more conservative accounting to manage agency problems.

Conclusions and Future Research

The study investigates the association between accounting conservatism and cash dividends. It offers an interesting subject and complements the existing conservatism literature. The results of the current study should be of interest to a number of parties such as academics, lenders and standard setters. In Model 1, one of the cash dividends variables, DVSHR, has a significant negative relationship with Consm1. While, in Model 2, there are significant negative relationships between M/B and three of the cash dividends variables, PAOUT; YIELD and DVSHR. These significant negative associations between M/B and cash dividends variables suggest that accounting conservatism has a significant impact on the cash dividends of firms.

In both Model 1 and Model 2, the three control variables, FISZ; FLEVER and ROE have positive associations with accounting conservatism variables (Consm1 and M/B). Such a result implies that large firms with more profit and debts will seek to use conservative accounting to mitigate the conflicts between shareholders and other stakeholders as creditors and lenders. The findings of this study support H1 and H2. Accounting conservatism actually works in the Bahraini capital market and there is a significant negative association between accounting conservatism and cash dividends.

This study has a number of limitations. First, the research scope was limited to all listed companies in Bahrain. Second, the findings of such a study may not be generalisable to different countries at different stages of development, or with different business environments and cultures. Third, there are a number of measures of accounting conservatism. The empirical results obtained may differ with the choice of measure used and therefore uncertainty and significance of the results obtained from any particular measure will be questionable. However, a number of factors that can influence accounting conservatism and cash dividends are still uncovered in the current research and could be subject to further research. Future research could fruitfully build on the study's results by examining the effects of management motivations on cash dividends. Also, the governance role of conservative accounting on listed firms 'dividend (and other financial decisions) needs to be addressed in future research. It is interesting to consider whether, and to what extent debt covenants adjust reported accounting numbers to achieve conservatism in the contracting relationship.

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