

The Effect of Mandatory Corporate Social Responsibility on Accounting Conservatism in Tehran Stock Exchange Corporations

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Abstract *The present research investigates the effect of mandatory corporate social responsibility (CSR) components on accounting conservatism in Tehran stock exchange corporations. The information panel regression analysis has been applied to a sample of 100 listed corporations in Tehran stock exchange during the period 2011-2016. The results show that the mandatory CSR components have a negative effect on the accounting conservatism in Tehran stock exchange corporations. The indicators of cash flow and depreciation cost ratios have a positive effect on conservatism. This research will help managers develop effective CSR policies required to achieve a better financial performance in the long run. It also provides insights for corporations on the role of CSR in acquiring future profits.*

Key words Social Responsibility (SR) components, cash flow ratio, depreciation cost ratio, accounting conservatism

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1. Introduction

Today, many scholars believe that for reasons such as privatization and transfer of economic power from governments to organizations, and therefore, shrinkage of governments, they do not have enough resources and power to solve social and environmental problems. Thus, the organizations should help the governments in this regard. Although in recent years, there have been significant global advances in corporate social responsibility (CSR), and managers and organizations pay a lot of attention to this concept, the Iranian executives and organizations are somewhat alien to this concept.

One of the reasons for this lack of progress in Iran may be the government's economy. However, the attitude and insight of the senior executives of organizations toward this issue were also affective to some extent. There are different views regarding the legitimacy and value of adopting the principles of social responsibility (SR) by corporation. Some scholars believe that social problems should be solved by the governments. They believe that the organizational resources are not enough for solving the social problems and should not be wasted for solving the social problems (Aguilera *et al.* 2007; Albinger *et al.* 2000; Aupperle *et al.* 1985; Becker *et al.* 2006; Berger *et al.* 2007). Another group of experts believe that although the governments are responsible for solving the social problems, the participation of organizations in this area is also helpful. This group of experts believe that since nowadays the economic power is transferred from the governments to the organizations, the participation of organizations in solving the social problems is vital and necessary (Tsoutsoura, 2004).

On the other hand, the adoption of SR principles for organizations is costly. These costs may include purchasing new equipment that will lessen the environmental damages, altering the management structure or creating more stringent quality controls. The benefits of adopting the principles of CSR for organizations are brand enhancement and credit enhancement, possibility of attracting more capital resources due to high business credit, decrease of the risks of accidents and bitter events, improvement of the working environment and, consequently, increase of the profit and the ability to attract and retain staff, which reduces displacement, absence and training costs. Most scholars believe that the SR costs are short-term

and their benefits are often long-term. SR is in fact a kind of investment for the future for gaining a sustainable and long-term competitive advantage. Senior executives with short-term vision do not tolerate the short-term costs of SR (Bhattacharya *et al.* 2008; Bhattacharya *et al.* 2009; Birth *et al.* 2008).

2. Literature review

One of the issues that is observed today, despite the increase of the level of awareness and knowledge of the users of financial statements, is the strong reliance on the numbers of financial and accounting reports to decide on investment. The quality of financial reporting reflects the accuracy of financial reports on disclosing information about the operations of the corporation in order to inform investors. According to the conceptual no. 1 of the Financial Accounting Standards Board, financial reporting should provide useful information assisting the actual and potential investors in making reasonable decisions.

The amount of conservatism in the preparation of financial statements or the quality of accrual items presented in these reports are the criteria by which the quality of the financial reporting can be measured (Cheng & Kang, 2016). Conservatism is a feature of financial reporting, that is, the use of higher degrees of certainty to identify and record the advantages and pleasant news, and the use of lower degrees of certainty to identify and record the disadvantages and unpleasant news (Sadipta, 2015). According to the theory of uncertainty, there is basically uncertainty in the nature of events. Accounting and financial reporting are also no exception. The principle of conservatism or precaution is one of the first and most important ways of dealing with the ambiguity of the transactions and events of the economic unit. In recent research, it has been argued that businesses should not merely generate profits and increase shareholders' equity, but also it should take responsibility for employees, the environment and the community. This theory as the CSR has become a feature of the corporations. CSR is the consequent of four components of economic, legal, moral and humanistic responsibilities (Khan and Watts, 2009; Aras *et al.* 2010; Cooper and Wagman, 2009; Kayuni and Tambulasi, 2012).

The European Commission considers CSR as a concept including issues such as environmental issues and social reporting and corporation interactions with multiple stakeholders, in addition to reporting on business activities. To summarize, we can define CSR as the requirement to respond to and meet the expectations of external stakeholder groups, including customers, suppliers, distributors, environmental guards as well as production or servicing unit locals, along with the domestic stakeholder groups, including owners, stockholders and unit employees. Accordingly, one of the duties of the corporations in the field of SR is to help improve the economic situation and the welfare of the community. In addition, the accounting conservatism of the corporation as a financial reporting agent is also aimed at providing accurate information for the correct financial decision-making and consequently, the economic growth. Therefore, the present study examines the relationship between mandatory CSR and accounting conservatism in corporations admitted in Tehran Stock Exchange.

In 2015, in a study entitled "Market Problem with Primary Supply Pricing", Ibutson investigated the pricing issues among 120 corporations listed in New York Stock Exchange during the years 1965-1969. In his research, he found that corporations offering their shares to the public for the first time through the stock exchange offer stocks at a price below the intrinsic value so that from the date of supply to the end of the first trading month in the stock exchange has generated an average of 11.4% positive returns.

Tian (2011) evaluated the less systematic pricing of Shanghai and Shenzhen exchanges. His sample included 1397 new corporation from 1991 to 2004. His findings indicate that there is a significant negative relationship between the confidential information and the primary stock returns. He attributed the low-pricing sales to the risk of investment in the primary market and government regulation, since the government regulations would result in quotas in the initial supply and limit the supply of shares. Bagat and Rangan (2012) conducted a comprehensive study on the relationship between accounting information and stock valuation in new corporations in the US stock exchange. In addition to the role of accounting information, other variables such as growth opportunities, percentage of ownership of the primary stockholders before and after the initial offering of shares and the credibility of the investor's bank providing the initial supply of shares were entered in their model. Selecting 1655 sample corporations during the year 1986-2001, they found that in addition to accounting variables such as net profit, book

value and sale, other factors such as the percentage of major shareholders' ownership and the credibility of the investor's bank providing the initial supply of shares also play a significant role in lowering the price of new shares.

Bolton et al. (2012) conducted a comprehensive study on the relationship between profit management and pricing with less value in 34 countries throughout the world. Their research results showed that in countries with high profit quality, lower prices are rarely determined for stocks, especially in countries where their markets have higher liquidity. Therefore, investors in lower-quality countries set lower stock prices in the early supplies. Adeyemo *et al.* (2013) evaluated factors influencing corporate social responsibility in Nigerian manufacturing companies. The population of the study covered all the staff of the selected manufacturing companies in Ibadan (Nigerian Breweries, Nigerian Bottling Company, Procter and Gamble, Yale Nigeria limited and Eagle Flour Mill). Purposive sampling method was used to select ten (10) respondents from each organization totaling 50 respondents. The result identified factors that influenced CSR practices as competition, employees demand, government policy, organizational culture, and customer demand respectively. Klein (2014) explicitly investigated the role and importance of accounting information on the valuation of primary public supply stocks. The results of the research showed that there is a positive and significant relationship between stock price share and earnings per share and book value of each share before the date of supply.

Odetayo *et al.* (2014) studied an empirical investigation of corporate social responsibility and profitability of Nigerian banks. To achieve the objectives of this study, data were collected from annual reports of sampled six banks, for the period of 10 years (2003 – 2012). Simple regression analysis was employed as a statistical technique to analyze data collected using STATA 11. The regression results revealed that there is a significant relationship between expenditure on corporate social responsibility and profitability of Nigerian Banks. The study concludes that Nigerian banks recognized the importance of corporate social responsibility for sustainable development and they are performing their obligation to the society.

Dincer and Dincer (2015) explored the impact of corporate social responsibility (CSR) on organizational commitment of internal publics especially employees. The study uses a web-based survey research method and employs hierarchical multiple regression analysis to explore the predictive ability of four dimensions of CSR on three dimensions of organizational commitment, from the perspective of employees. The research shows that while the ethical-legal dimension of CSR is a significant predictor of three dimensions of organizational commitment. So, a relational outcome in relationship management theory, practitioners can incorporate ethical-legal CSR in CSR strategy, implementation and communication.

Mwatsika and Chitulu (2016) found that CSR activities are more pronounced in health with 80 percent of firms involved, 72 percent in education, 64 percent in physical infrastructure development, 56 percent in environmental conservation and 32 percent in girl child and orphanage support. None of the surveyed firms focused on CSR activities in supply chain, customer and/or employee relations dimensions. The main reasons for engaging in CSR activities were to give back to the community with 93 percent of the surveyed firms and 86 percent considering CSR as part of a marketing strategy to gain publicity and build corporate image. They found that managers of firms surveyed perceived that there was no relationship between the CSR activities their firms engaged in and the firms' financial performances despite a smaller percentage of respondents acknowledging the effect CSR activities had in increasing operating costs of their firms.

3. Research data and model

The statistical population of this research includes all corporations admitted in Tehran Stock Exchange during the years 2011-2016. The number of these corporations is 550. It should be noted that the selection of the corporations listed in Tehran Stock Exchange as the statistical society is due to the fact that they have the most accessible statistical information about the Iranian corporation.

The sampling method in this study is a systematic exclusion which includes:

Corporations whose financial information is available and their financial year end by the end of March. The corporation should not change its financial year between 2011 and 2016, and should not have operational interruption.

According to the conditions, 100 corporations were selected as the statistical sample of this study.

In this research, we intend to investigate the relationship between SR and accounting conservatism of the listed corporations in Tehran Stock Exchange. In addition, we test the following hypotheses:

The relationship between SR and accounting conservatism in the accepted corporations in Tehran Stock Exchange. The relationship between cash flow ratio and accounting conservatism in the accepted corporations in Tehran Stock Exchange. The relationship between depreciation cost ratio and accounting conservatism in the accepted corporations in Tehran Stock Exchange.

According to the assumption, the research model is as follows:

$$EARN_{it} = \alpha + \beta_1 CSR_{it} + \beta_2 SOE_{it} + \beta_3 CSR_{it} * SOE_{it} + \beta_4 CFOA_{it} + \beta_5 AGE_{it} + \beta_6 ROA_{it} + \beta_7 InvCy_{it} + \epsilon_{it} \quad (1)$$

Where:

EARN is the corporation's net income, which is the variable of accounting conservatism, CSR is the social responsibility variable, and SOE is the virtual variable. If the government has the CSR, SOE value is equal to 1; otherwise, it is zero. CFOA is the ratio of the corporation cash flow, InvCy is the corporation depreciation cost ratio, AGE is the corporation age, ROA is the corporation return on assets, i is the corporation, t is the year, α is the intercept, β s are the tip line or coefficients of the independent variables of the model, and ϵ is error term.

4. Reliability of research variables

The first step in model estimation after collecting statistics is to examine the stability or reliability of the variables. For this purpose, Fischer's reliability test is used for the combined data. Based on this test, P-value is less than 5%, and all of the research variables are reliable. This means that the mean and variance of variables over time and covariance of variables have been constant in the different years. Consequently, the use of these variables in the model does not result in false regression. The results of the study in Table 1 show the reliability of all variables.

Table 1. Fisher's reliability test results for research variables

Variable	Statistics	P- Value
EARN _{it}	527.982	0.0000
ROA _{it}	478.038	0.0000
CSR _{it}	563.677	0.0000
SOE _{it}	478.147	0.0000
CFOA _{it}	457.168	0.0000
InvCy _{it}	509.565	0.0000
AGE _{it}	467.829	0.0000

Table 2. Summary of the results of research model estimation through random effects method

Dependent Variable: corporation return on assets				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
ROA _{it}	-1.097700	0.440510	-2.470005	0.0390*
CSR _{it}	1.016044	0.350885	2.880045	0.0232*
SOE _{it}	1.398652	0.642635	2.172922	0.0491*
CFOA _{it}	-0.672233	0.21017	-3.199143	*0.0178
InvCy _{it}	0.013825	0.040150	0.344340	0.2290
AGE _{it}	-0.017451	0.040977	-0.425875	0.4401
C	2.042480	0.941768	2.177059	0.0395
R-squared	0.99	F-statistic	12.340362	
Durbin-Watson stat	2.08	Prob(F-statistic)	0.001464	

According to the Table 2, the explanatory variables explain 99% of conservative accounting changes. Moreover, the coefficients show that a 1% increase in corporate asset yields leads to a 1.09% decrease in accounting conservatism. A 1% increase in CSR leads to a 1.01% decrease in accounting conservatism. A 1% increase in virtual variable leads to a 1.39% decrease in accounting conservatism. A 1% increase in corporate cash flow ratios leads to a 0.67% decrease in accounting conservatism. Furthermore, the coefficients of the corporation depreciation cost ratio and the corporation age are not significant. The Durbin-Watson statistics in this model is equal to 2.08, which indicates that there is no correlation between the sentences.

5. Conclusions

CSR refers to the cohesion and unity of the organization's activities and values to reflect the profits of all stakeholders, including shareholders, customers, employees, investors and the general public in the organization policies and performances. In other words, the organization must always consider itself as a part of the community and feel responsible to the community and work towards improving the public welfare independent of the corporation's direct profits. The results show that the variable coefficient of SR variable in the estimated model is 1.012466. Therefore, this effect is positive and the research hypothesis is accepted accordingly. In addition, the amount of cash flow variable is equal to the negative number of 0.679. Therefore, it has a significant negative effect on the accounting conservatism. Considering the results obtained from this research as well as the removal of conservatism from qualitative characteristics of financial reporting in the drafting of International Accounting Standards, it is proposed to the Audit Organization as the Custodian and the Reference Officer for National Accounting Standards to consider this issue and do the following measures considering the effectiveness of this qualitative feature:

1. Given the importance of the issue, it is suggested that efforts be made to promote understanding of the managers and suppliers of corporate capital in the application of desirable conservative practices in the corporation.
2. Given that the effectiveness of the application of various types of conservatism in the financial statements on the corporation's stock value, managers are encouraged to make reasonable assumptions about the preparation of financial statements and to refrain from providing too conservative reports.
3. According to the result, the users of financial statements are advised not to rely on the financial statements of the corporations in their decisions, especially in corporation with high growth opportunities, but to consider the corporation owners, and other SR features, because given the obtained result, it can be observed that cash holdings have a significant effect on the application of various types of conservatism in financial statements, and the reports presented can be contradictory to reality.

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