

Investigating the Relationship Between Conservatism Accounting and Earnings Attributes

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Abstract: We investigate the relationship between conservative accounting and earnings attributes, including persistence, predictability, value relevance and timeliness. In this study, the financial data between the years 2004 to 2008 of 145 listed companies in Tehran stock market have been accumulated. Using the Analysis of Correlation Coefficient and Regression Modeling, the research theories have been examined. The results show the effectiveness of conservative accounting on the earnings attributes. To measure conservative accounting in this study, the MTB ratio has been used. The research results confirm direct relationship between conservative accounting and qualitative characteristics including persistence, predictability and value relevance; so that the relationship is statistically meaningful. Furthermore, there was not any observed meaningful relationship between conservative accounting and timeliness of profit.

Key words: Conservatism accounting • Persistence • Predictability • Value relevance • Timeliness

INTRODUCTION

Conservatism is one of the conspicuous characteristics of financial reporting which has been combined with theory and practice of accounting for long time [1]. Quoted from Bliss (1924), Watt defined Conservatism as follows:

“Anticipate no profit, but anticipate all losses.”

In literature of accounting, this proverb has been interpreted as following:

“The accountant’s tendency to require a higher degree of verification to recognize good news against than to recognize bad news as losses” (Basu, 1997, p4).

According to Watts’ view (2003), Conservatism has been considered as an outstanding and dominant feature in accounting and financial reporting (statements) forum since early twentieth century [2]. In theoretical concepts of financial reporting, Technical Committee of Iranian Audit Organization has considered conservatism as one elements of qualitative property of reliability, but it used term Precaution instead of Conservatism [3].

«Precaution denotes graded application of care which requires in judgement on accounting estimations in ambiguous conditions so that revenues or assets are not

overestimated, or expences or liabilities are not underestimated than their real values.»

In fact, one can deem Conservatism as product of uncertainty and when accountants are faced with such ambiguity, they use Conservatism [4]. In view of Paek *et al.* (2001), Conservatism means accountants’ desire toward postponed recognition of revenue and ever-decreasing evaluation of assets [5]. Bliss (1924) defines Conservatism as follows: Conservatism means to identify all potential losses and lack of recognizing of probable profits [6]. Conservatism has been defined as continuous underrating of assets book net value to their market value [7]. Conservatism has been always underscored by accounting standards makers and it has a lot of practical applications based on requirements of these standards; for instance, one could imply such statement: “Using Least Cost Law (LCM) or sale net value in assessment of inventories” [8].

Accounting earnings and the related elements are considered as information which is taken into consideration when decisions are made by individuals [9]. Analyzers of bonds and securities, enterprise directors, investors and participant individuals in capital market draw their attention more to net profit figure as the latest information item of profit and loss statement. As the end product of accounting long run process which is highly appreciated and emphasized by users of accounting

information, profit has been computed under the influence of accounting procedures that are chosen by the management. Possibility of selection of accounting procedures gives an opportunity to management to make decision about time of recognition and measurement of costs and revenues. The management has a motive to persist non- conservative application of accounting procedures and enterprise growth rate. Exerting such viewpoint may decrease earnings quality management [10].

Useful information should create predictability for information users. Despite of the fact that accounting reported profit is considered as an appropriate guide for prediction of future cash funds, but some of existing limitations have led analyzers to deem earnings quality as a better index for their predications and decisions. Many factors may affect on earnings quality. One of such cases is Conservatism Accounting. Thus, one can assume that earnings quality corresponds to Conservatism Accounting. The present study mainly aims at testing the existing relationship between two subjects.

Study Literature: At this section of the essay, we explore into the literature about research two major subjects, namely, Conservatism accounting and earnings quality.

Conservatism and Earnings Quality: An immense flood of recent financial scandals all over the world, from Enron and WorldCom to Parmalat in Europe, has led to trigger finger of accusation toward financial reporting. Financial statements comprise of the main core of financial reporting process. Financial statement and on top of them profit and loss statement (net profit figure) is focused by investors. During recent years, subject of quality of reported profit has drawn attention of many researchers. One aspect of earnings quality is conservatism; that is, the higher profit is obtained by Conservatism, the higher quality it has [11] and [12]. Concept of Conservatism has a long history in accounting. After Watts (1993), Basu (1997) was a pioneer in conducting of researches on Conservatism. His findings signify presence of Conservatism and its exertion in financial reports [13]. In spite of the fact that many accountants are agreed on existence of Conservatism for drawing up financial statement, but no comprehensive and all- inclusive definition has been presented about it. Nevertheless, two main features of Conservatism have been examined in accounting texts: First, descending support of capital book value to its market value; and the second is to tending toward acceleration in identifying of costs and delayed recognition of revenues [14]. In paragraph 95 of

Financial Accounting Standards Board (FASB), Conservatism is also described as follows:

“If there are two estimations of the same receivable or payable fund in the future while incidence probability of both is identical, then Conservatism dictates using of the estimation which is less optimistic.”[10].

In view of financial statement makers, Conservatism is considered as an effort to select a certain methods from accounting accepted techniques that result in the following outcomes:

- Slower recognition of sale revenue;
- Faster recognition of cost;
- Evaluation of assets less than real values; and or;
- Evaluation of liabilities greater than real values [17]

Givol & Hayn (2000) indicated that Conservatism has experienced a growing trend during second half of twentieth century [18].

Technical Committee of Iranian Audit Organization has considered Conservatism as one of the elements of qualitative property of reliability within theoretical concepts of financial reporting; while it did not use term *Conservatism*, but it has used term *Precaution*. In theoretical concepts of the enclosed financial reporting to Iranian Audit Standards, the following description has been given about Precaution:

“At the same time, financial statements makers shall be accountable to the ambiguities that have inevitably shaded on many events and conditions. One of the typical ambiguities is to claims collectability, probable useful life for tangible fixed assets and number and amount of the related possible claims to the guarantee of the sold commodity. Such items are recognized by observance of precaution in providing the financial statements along with revealing of their nature and amount. Precaution is the graded application of the needed care that is required in judgement for conducting estimation in ambiguous condition so that the given revenues or assets are not to be overestimated and costs or liabilities are not to be underestimated than their real values.

Exertion of precaution should not lead to create hidden reserves or unnecessary deposits and/or assets and revenues shall not be mainly indicated than their real values; since, this leads to infringement of objectivism and it may affect on financial information reliability. (Technical Committee of Iranian Audit Organization, p 498)” [3].

One can attribute Conservatism effects to two items: First, financial reporting standards which require conservative reporting and the latter is the selected accounting procedures by management to provide financial statements. Often, the second aspect is given as Conservatism image on the related literature. Conservatism principle is basically deemed as an advantage to compensate for some of management's optimistic views and its tendency toward exaggeration in financial statements which have become evident during three first decades of twentieth century. Conservatism leaves the subject of resultant profits from maintenance since many accountants believed that by determination of the interested evaluation alternatives, users of financial accounting information will be probably misled. During recent years, the impact of the given concept has been reduced due to a pressure for revealing of more relevant and more reliable information. Conservative financial statement are usually unfair for current stockholders and they tend to support the future stockholders since enterprise net assessment may not include the future expectations; as a result, corporate normal equity will be priced with lower value than market pricing [19].

Penman and Zhang (2002) consider accounting Conservatism as selection of method and estimation from accounting which evidently shows assets book value lower than usual. Thus, during inflation conditions, choosing of LIFO technique instead of FIFO is a conservative method to identify inventory. Similarly, application of Least Cost in Market or (LCM) for allocation the given cost to Research & Development (R&D) expenditures, selection of depletion fast techniques and policies that lead to consider higher reserve for Bad Debts and recognition of the related accruals for guarantee, are conservative techniques which cause showing book net value of an economic unit lower than real value [20].

Watts (2002) defines Accounting Conservatism as follows:

It denotes necessity of attaching difference in demonstrating possibility of recognizing profit versus loss. According to the present definition of Conservatism, prediction of future profits should be able to be proved more than future losses.

Of important products of accounting system is financial reports. One of accounting items which are provided and given about financial reports (profit and loss statement) is net profit which has various applications. Calculation of net value for an economic

corporate is affected by accounting methods and estimations, so there is a possibility for management to manipulate the given profit. Since profit is considered as one of the important criteria for performance evaluation and determinant factor to identify value of economic incorporations, subject of earnings quality was raised. Managers are always responsible for selection and implementation of estimation and basic applied judgments like accounting principles. Thus, directors are eventually responsible for earnings quality. Theory of earnings quality was purposed for the first time by financial analyzers and Bourse brokers, since they felt that the reported profit might not indicate power of profit to the extent that it is embodied in mind. They found that prediction of future profits based on the reported results is a difficult task. Moreover, Analyzers understood that because of several weak points in measurement of accounting information, analysis and synthesis of corporate financial statements is a complex duty. The basic question is that why analyzers are not using the reported net profit and or corporate equity (without equalization) in their assessment and observe precaution. Answer is in that one should pay attention not only to profit quantity in determination corporate value, but also to its quality. Earnings quality means a potential ground for growth of profit and probability of realization of future profits. In other words, value of a given equity does not depend only on equity of each share of the corporation in current year, but it is subjected to corporate future expectancy and profitability power for the next years and coefficient of certainty to it. It seems in some cases that techniques of Conservatism in accounting will result in rising profits quality. It has been stated that Conservatism is resulted in lower profits, thus at first glance profits with higher quality are conservative.

Here, subject of time earnings quality is raised where financial analyzers determine to what extent the reported net profit reflects the real profit. About meaning of real profit, all investors believed that it is the profit which is resulted from normal transaction that is repeatable in the next fiscal years and create cash flows. Real profit is considered as profitability index for commercial unit. In view of investors, accounting profit is the best index for power of profitability of a commercial enterprise. Earnings quality is to express the reported profit honestly. One of the items which may affect on earnings quality is the method of presenting information about profit. That is the more relevant and reliable profit information is, the higher quality the given profit has [21].

Existing suitable opportunity for profit manipulation due to interest conflict as well as because of some intrinsic constraints of accounting which include a) existing inadequacies in estimations process and future predications, b) possibility to use several accounting techniques have led to this fact that the real profit of an economic enterprise differs from the reported profit in financial statements. Researchers and accounting professional practitioners deems importance of profit as one of the significant criteria of performance assessment and determinant factor for corporative value so it requires assessing the reported profit by the commercial units. To evaluate this profit, one concept is used which called earnings quality. Some of financial analyzers, who deem earnings quality as a normal, continuous, repeatable profit and creator of resultant cash flow from an operation, argued that earnings quality is a figure that lies between reported net profit and the resulting cash flow from operation minus non- iterative figures. By a briefly view on enterprise main goal (increase in stockholders' wealth), it is characterized that study on effect of Conservative accounting on profit qualitative properties is very important so that it tries to achieve to the given objective by determination of effect of Conservative accounting on each of profit qualitative characteristics. In this study, 4 cases of the most important qualitative features of profit have been taken into consideration:

- Earnings persistence
- Earnings predictability
- Value Relevance
- Earnings Timeliness

Earnings Persistence: Earning which is not resulted from unordinary and unexpected activities is more persistent. In other words, Earning duration and iteration are defined as profit persistence [22]. Sometimes, this concept is considered as the same as concept of variability and it denotes an earning with quality that does not vary. Persistence or consistency deals with this subject that to what extent a certain innovation (variation) may restore in realizing of future profits. Lype (1990) defines persistence as autocorrelation on earnings as follows: Irrespective of profit magnitude and innovation signs, persistence concerns to innovations in modern period and to this question that to what extent the continuous part of time series is converted into the profit? Investor may use persistent profit series in their assessments. From their view, profits are not volatile and temporary but they are

persistent. The more persistent the profit is the more power the given enterprise will have in order to keep current profits; thus, it is assumed that earnings quality is higher. To present some instances of profits with low quality, one could refer to allocation of low reserve for Bad Debts Account or for abnormal inventories as well as recognition of the related revenues to the next years as ones in current fiscal year.

Earnings Predictability: Earnings predictability refers to ability of prediction of profit from itself. Within a theoretical framework of Financial Accounting Standards Board (FASB), predictability has been purposed as some part of relevance and described as following:

It is quality of information which helps users to increase proper predictability of past or present results [22]. American Accounting Association (AAA) writes in Manifest of Accounting Theory that: "The comprehensive criterion is information profitability in formulation of standards." Almost without exception, the literature which exists in this field has related profitability subject to ease of the relevant decision- making. To make decision, one of the important and noticeable points is to result of decision that is obtained by prediction, because of relationship between decision result and future of determining result and decision outcome. Therefore, accounting information should have predictability feature in order to be able to help the investors in the course of ease of decision making [23].

Some researchers consider especially predictability as capability of past profits for prediction of next profits. Thus, in other words, predictability relates to reduction of deviations in profit variations (regardless of its sign, the more variation in profit causes decrease in predictability). Like persistence, researchers deem predictability as a function of trade model of the reported unit, economic factors and reporting techniques. While persistence and predictability have been well- defined conceptually with certain and appropriate characteristics, but in order to make this feasible for execution, they should expressed more clearly. The second empirical subject is to select a time period. If innovation in profit remains in profit time series forever it will be completely persistent and consistent, but if some reduction occurs during this time, it is lesser persistent. Accordingly, predictability refers to time series as well. Researchers often use one year predictions, but there is no theoretical basis for such selection. Third empirical issue is to select something which is to be predicted. The possible alternatives include

reported net profit, cash flows and net profit different subsets. By this fact, assessment of predictability becomes more complicated where for short term horizons, profit predictability may increase by profit smoothening. Concerning to profit smoothening (evenness), one should say that it is a deliberate and intentional measure for reduction of fluctuations in the reported profit during sequential periods at certain level of profit that is considered as enterprise normal level. Profit smoothness is a technique, in fact that by using accounting alternatives, manager may take some measure to change profit items within framework of Accounting Accepted Principles. Because of having a lot of information about profit innovation, managers are in a highly appropriate position to do this task. This measure which is taken by manager is called profit management. Knowing this point, this question may be raised that could someone conclude that if profit management leads to increased predictability, then earnings quality will also be increased?

Value Relevance: Earning is one of the better measurement indices for activities of an economic corporate [10]. Special focus is made on the related information of profit in financial reports. Therefore, the reported profit should assist investors in determination of enterprise value. In fact, computation technique and profit report are in such a way that they have certain characteristic in order to fulfill such goal. Purportedly, the given profit shall be relevant to equity value. Relevance tests for equity value are one of approaches toward relevance operational definition and the given reliability by FASB. This is because of this fact that (profit) accounting figures are relevant to equity value if they are able to explain variations in equity gain [24].

Earnings Timeliness: In order to make earning information relevant to users' decisions, they should be accessed by the users at the effective time. In other words, information should be on time. If profit relevant information is on time, then investors' expected yield (gain) will also be realistic. On the other hand, if this information is reported within shorter time intervals, because of high level accessible information for investors, information risk will be reduced within the enterprise. This point causes reduction in overall risk of investment in the enterprise and will decrease investors' expected gains [25]. As a qualitative feature, profit timeliness is based on this idea that accounting profit concerns to measure economic profit which is defined as a change in market equity value [26].

Synopsis of Research Literature: This study explores into the relationship between Conservatism Accounting and profit qualitative characteristics. First, it expresses definition and concept of Conservatism in accounting. Traditionally, Conservatism has been defined as the following proverb:

"Anticipate no profit, but anticipate all losses."

Then it was implied that researchers, analyzers and investors have to assess accurately it because of profit importance as one of the foremost criteria for measurement of performance of economic enterprises and determinant factor for their value. To evaluate profit, a concept is used which is called earnings quality.

There is no comprehensive definition for earnings quality and the popular definition of this term which is mostly agreed by financial analyzers is that they consider earnings quality as an ordinary, continuous, repeatable profit and creator of the resultant cash flows from this transaction. They believed that earnings quality is a figure which lies between reported net profit and operational resultant cash flows minus non- iterative items. So far, financial experts could not achieve to a profit-independent calculation that meets the given quality. In this situation, by conducting appropriate equalizations, financial experts can obtain to a range where it indicates more properly the quality of the reported net profit. Thus, concept of earnings quality is not a fix defined subject that could be obtained, but it is a relative concept that depends on its relevance to intellectual attitudes and approaches. Later, some studies which were indirectly relevant to this topic have been purposed briefly.

Study Background: After Watts (1993), Basu (1997) has been forerunner in conducting studies about Conservatism. His findings signified the existence of Conservatism and implementation of it in financial statements [13]. Givol and Hayn (2000) indicated that Conservatism along with some variations in investment funds might explain future gains for equities [20]. And also, findings of Penman and Zhang (2002) express that Conservatism accounting may lead to earnings quality. Ahmed *et al.* (2002) have investigated into a mutual relationship between Conservatism and financial costs. Their findings show that if the exerted Conservatism is increased in preparation of financial statements, financial procurement costs will be reduced [7]. Francis *et al.* (2004) examined the effect of profit characteristics on capital cost. They studied Conservatism as one of profit features, but they did not find any relation between Conservatism

and capital cost which was tolerated by commercial enterprise [26]. Study by Frankel *et al.* (2007) signified that by increase in Conservatism, profit distribution has been reduced among stockholders [27]. Kim and Jung (2007) indicated that Accounting Conservatism might decrease tax costs [6]. Paek *et al.* (2007) found that as it was predicted by Dechow (1994), increase in Conservatism may lead to reduce profit persistence [5]. Like Roychowdhury & Watts (2007), Kurdestani and Langeroodi (2008) examined the bilateral relationship between two measurement criteria of Conservatism in Iran. Their findings stated that there is negative relation between profit asymmetric reaction and ratio of assets net market value to their book value. Profit asymmetric reaction, non- operational accrued items, negative skewness of profit distribution to cash flows and ratio of market value to assets net book value, further persistence of profit negative variations to its positive changes, the equalized (offset) asymmetric reaction and estimated hidden deposits are some techniques which have been used by researchers to measure rate of Conservatism [28]. Bita Mashayekhi, Mehdi Mohammad Abadi and Reza Hesarzadeh (2009) examined the impact of Accounting Conservatism on profit persistence. They concluded that by increase in Accounting Conservatism, distribution of stock profit (equity) is decreased in the enterprises which were accepted in Tehran Security and Exchange Organization (SEO). Similarly, according to the obtained results from the given study, the mentioned researcher has not commented about acceptance or refusal this hypothesis that profit persistence would be simultaneously decreased by increase in Accounting Conservatism [8]. In their study, Schiper and Vincent (2003) investigated into assessment criteria of earnings quality and showed that earnings quality depends on type and value of the concluded contracts based on accounting information, in addition to the prevalent criteria [29]. Chan *et al.* (2004) examined the relation of information content of earnings quality with equity future gain and they concluded that there was a negative relationship among accrued items and equity future gain [30]. Scholer (2004) defines earnings quality as a relationship between accruals and cash flows. With respect to this result, they argue that Conservatism could support creditors' interests against stockholders [31].

In their study, Ball and Shivakumar (2005) came to the result that non- bourse enterprises have lower quality than Bourse incorporations because of existing lesser demand for financial reports [11]. Ahmed (2004) concluded in his study that earnings quality has a

significant and inverse relation with market reaction (response) [32]. Lugee (2004) tested earnings quality in the given study with respect to conceptual framework of Financial Accounting Standards Board (FASB) and concluded that enterprises earnings quality will be improved when organizational proprietorship is increased within them. Thus, the constituent items of corporative profit will have higher relevance reliability [33]. Chan *et al.* (2004) examined the relation between information content of earnings quality with equity future gain and came to the result that there was a negative relation among accrued items and equity future gain [30]. Hanlon (2005) explored the relationship among tax and earnings quality and concluded that persistence of accruals and cash flows is lower for the enterprises with stark difference between corporative books and tax declaration letters [34]. Braua (2006) in a study has examined measurement criteria of earnings quality by using of qualitative characteristics of the mentioned financial information within theoretical framework of FASB. The results from exploration on elements of each of earnings quality dimensions showed that in comparison between enterprises with higher relevance and reliability of profit and those incorporations where their profit relevance and reliability are low, they have higher profit coefficient and greater explanation power of price- profit regression [35]. Khajavi and Nazemi (2005) examined relation among earnings quality and equity gain by focusing on accruals role. According to study findings, mean value of corporative equity gain is not affected by accruals value and the related elements [5]. Noravesh and Majidi (2005) in a research studied on a relationship among earnings quality and capital cost within Iranian Bourse enterprises. Study results showed that during test period (1999-2004), except for 2000, there is an inverse relation among earnings quality and capital cost [36]. Saghafi and Kurdestani (2004) examined the relation between earnings quality and market reaction to cash profit. Results of study indicated that investors in Tehran Security and Exchange Organization (SEO) do not consider earnings quality of the enterprises at time of any reaction to cash profit variations [10]. Kurdestani and Majdi (2007) has explored the relationship among profit qualitative features and capital cost of normal equity. The result of research showed that enterprises with desired qualitative feature have lower capital cost for their equity [8].

Research Hypotheses: In this study, the relationship between Conservative Accounting and profit qualitative properties has been examined in order to provide for the following scientific question.

Does Conservatism accounting affect on profit qualitative properties?

In order to find answer to the above question, research hypotheses have been codified as follows:

- Hypothesis 1: Conservatism accounting has a significantly effect on earnings persistence.
- Hypothesis 2: Conservatism accounting has a significantly effect on earnings predictability.
- Hypothesis 3: Conservatism accounting has a significantly effect on value relevance.
- Hypothesis 4: Conservatism accounting has a significantly effect on earnings timeliness.

Methodology: The present research is of empirical studies type. In conducting the present study, some documents from Tehran SEO as well as RAHAVARD NOVIN software have been collected and extracted. Similarly, for gathering the related information of results of previous studies and study literature, some other sources have been used including books, magazines, essays and internet websites. Our statistical sample comprises of the information from 145 enterprises which have been accepted in Tehran SEO. They have been analyzed within time period (2004- 2008) in order to examine the relationship between variables for testing of research hypotheses. The collected data have been computed by using of Excel software and analyzed via SPSS and E-Views software. Data analysis has started in descriptive statistics by computation of central indices including mean, median and discrepancy indices, standard deviation, skewness and kurtosis. These indices have been implemented separately by year as well as in general. Following this trend, we examined normality of dependent variable. We used Panel Analysis to synthesis of models and the merged data.

Computation Method of Conservatism Accounting: Researchers use three criteria to assess Conservatism:

- Net Assets Criteria;
- Criteria of earnings and accruals items;
- Criteria of earnings-stock return relationship

All these criteria are based on time asymmetry effect in identification of the reported accounting profits and losses, especially net assets, profit and accruals [2].

First category denote the criterion of ratio of equity Market To Book value (MTB) and was used by Stober

(1966) to measure Conservatism [28]. At the present study, the above criterion has been used for Conservatism evaluation.

The Applied Models for Evaluation of Earnings Attributes: In this study, Earnings Attributes have been evaluated by using models (1-3) including persistence, predictability and profit relevance to equity value and profit timeliness.

Earnings Persistence: Has been estimated for assessment of earnings persistence in model (1) as follows.

$$E_{j,t} = \beta_{0,j} + \beta_{1,j}E_{j,t-1} + \epsilon_{j,t}$$

Explanatory variable coefficient $E_{j,t-1}$ i.e. $\beta_{1,j}$ in model (1) which is a first order regression type denotes profit persistence. This model has been periodically estimated for 5 years in order to assess earnings persistence every year. In this technique, data for one year are deleted from beginning of the given time period in the study and then data of one year are added to this model from the final years. For example, based on data from 2000 through 2004 profit persistence has been assessed for 2004 and according to data from 2001 to 2005, profit persistence in 2005 which are followed by data from other years of study have been evaluated. When the obtained value for explanatory variable coefficient, $\beta_{1,j}$, is nearer to unit (1), then profit persistence is greater and if it approaches more to zero (0), then profit is more temporary.

Earnings Predictability: Francis *et al.* used the following model to assess earnings predictability:

$$\text{Predictability} = \sqrt{\sigma^2(V_j)}$$

In this model after estimation of model (1), square root of calculation error and the obtained greater (smaller) values refer to greater (smaller) value of profit predictability [25].

At the present study, profit predictability has been evaluated based on Model (1). Accordingly, the resulting determination coefficient from estimation of Model (1) has been considered as profit predictability value [22].

Value Relevance: It has been estimated for assessment of this qualitative property in Model (2).

$$RET_{j,t} = \beta_{1,j}E_{j,t} + \beta_{2,j}\Delta E_{j,t} + \epsilon_{j,t} \text{ Model} \quad (2)$$

The resulting determinant coefficient from estimation of Model (2) has been considered as earnings relevance property index for equity value. Relevance of explanatory power in equity gain variations is indicated by accounting profit.

Earnings Timeliness: It has been estimated to assess earnings timeliness property in Model (3) as follows.

$$E_{j,t} = \beta_{0j} + \beta_{1j} \text{NEG}_{j,t} + \beta_{2j} \text{RET}_{j,t} + \beta_{3j} \text{NEG}_{j,t} \text{RET}_{j,t} + \varepsilon_{j,t} \text{ Model (3)}$$

The resulting determinant coefficient from estimation of Model (3) with minus sign has been considered as index of profit timeliness property. The resultant greater (smaller) values refer to profit lesser (greater) timeliness. In Models (1-3) which they have been used to evaluate four qualitative properties of profit, variable are defined as followings:

- $E_{j,t}$: Net income before extraordinary items (j) in year t.
 $\text{RET}_{j,t}$: Stock return (j) in year t.
 $\Delta e_{j,t}$: Net income variations before extraordinary items proportional to last year
 $\text{NEG}_{j,t}$: Loss index is equal to one (1) if $\text{RET} < 0$, unless it will correspond to zero (0).

Research Findings: At the present study, first Conservatism has been evaluated based on MTB criterion, then based on estimation Models (1) to (3) and by using data from 2000 to 2008, index for all four profit qualitative properties have been calculated for 2004- 2008 and used as basis for testing of hypotheses. Table (1) has shown a summary of statistical quantities of study variables.

To increase reliability of study results, normality in dependent variables has been examined. As it seen in the following tables, significance level (P- value) for persistence, relevance and timeliness is greater than 0.05

Table 1: Descriptive statistics of research data

	Std. Deviation	Median	Mean
Predictability	78745.222	11564.83	39748.99
Persistence	0.7477350.39646	0.39646	0.43772
Predictability logarithm	1.49662	9.3557	9.4488
Value relevance	0.293316	0.60804	0.57472
Timeliness	0.309104	0.65402	0.61595
MTB	0.9451102	1.260683	1.563064

during different years. Therefore, data for the mentioned variables follow up normal distribution. Significance level (P- value) for predictability is less than 0.05 within several years; thus, dependent variable does not follow up normal distribution. One of methods for data normalization is to use transforms (especially logarithmic transform). To normalize this variable, logarithmic transform has been used. As it seen in the following table, values of significance levels are higher than 0.05, thus it requires using logarithmic transform for this variable in analyses.

Test results for Hypothesis -1: In this section, Panel Analysis has been used to examine and estimate the overall model. The reason for using this method is type nature of data. This is because of the fact that in Panel Analysis, data have been gathered by Cross- Section Time Series techniques. Independence of observation is not restored in data which have been collected in this way; since, there are several observations of each enterprise within several years where these observations are interdependent. In other words, in this type of analysis, number of data is number of enterprises times to number of years.

First hypothesis states: Conservatism accounting has a significant effect on profit persistence. Model (5-1) has been estimated to test this hypothesis:

$$Y_{it} = \beta_0 + \beta_1 \text{MTB}_{it} + \varepsilon_{it} \text{ Model (5-1)}$$

Where Y1 is predictability variable.

Results of Panel Analysis are given in the following table:

Probability value (or significance level) F is 0.000. Since this value is lesser than 0.05, thus null hypothesis is rejected at certainty level 95%. That is there is significant model. Value of determinant coefficient or R^2 is 0.19. Namely, 19 percent of changes in dependent variable are expressed by MTB. Value of the given determinant coefficient is practically noticeable, although it is not so high. Value if Durbin- Watson Statistic is 1.54 which shows lack of autocorrelation.

As it is seen in the table, t value is 6.94 for MTB and t value for the abscissa is 0.424. This signifies rejection of null hypothesis for MTB and non- rejection of null hypothesis for the ordinate.

Thus this model is written as following which express existence of a direct relationship between MTB and profit predictability.

Table 2: Test results of Hypothesis -1

Dependent Variable: Persistence				
Method: Pooled Least Squares				
Prob.	t-Statistic	Std. Error	Coefficient	Variable
0.672	0.424	0.069	0.029	C
0.000	6.939	0.038	0.261	MTB?
0.438		Mean dependent var	0.192	R-squared
0.748		S.D. dependent var	0.169	Adjusted R-squared
2.148		Akaike info criterion	0.707	S.E. of regression
2.169		Schwarz criterion	196.238	Sum squared resid
2.156		Hannan-Quinn criter.	-422.318	Log likelihood
1.544		Durbin-Watson stat	48.154	F-statistic
		0.000	Prob(F-statistic)	

Table 3: Test results for Hypothesis -2

Dependent Variable: Predictability Logarithm				
Method: Pooled Least Squares				
Prob.	t-Statistic	Std. Error	Coefficient	Variable
0.000	63.355	0.145	9.187	C
0.036	2.108	0.079	0.167	MTB?
9.449		Mean dependent var	0.112	R-squared
1.496		S.D. dependent var	0.087	Adjusted R-squared
3.640		Akaike info criterion	1.490	S.E. of regression
3.660		Schwarz criterion	872.323	Sum squared resid
3.648		Hannan-Quinn criter.	-716.955	Log likelihood
1.815		Durbin-Watson stat	4.443	F-statistic
		0.036	Prob(F-statistic)	

$$Y_{1it} = 0/261 MTB_{it}$$

Test Results for Hypothesis-2: The second hypothesis expresses: Conservatism accounting has a significant effect on profit predictability. Model (5-2) has been estimated to test Hypothesis -2:

$$Ln(Y_{2it}) = \beta_0 + \beta_1 MTB_{it} + \varepsilon_{it} \text{ Model (5-2)}$$

Where variable Y_2^{Ln} is profit predictability logarithm.

Results from Panel Analysis are given in the following table:

Probability value F is 0.036. Since this value is lesser than 0.05, thus null hypothesis is rejected at 95% of certainty level. That is there is significance model. Value of determinant coefficient or R^2 is 0.11.

Value of Durbin- Watson Statistic is 1.81. Value of t is 2.11 for MTB, while t value for ordinate is 63.35 and this implies rejection of null hypothesis for MTB and also rejection of null hypothesis for abscissa.

Therefore, this model is written as following where it denotes that there is direct relationship between MTB and profit predictability.

$$LnY_{2it} = 9/18 + 0/167 MTB_{it}$$

Test results for Hypothesis- 3: Third hypothesis states: Conservatism accounting has a significant effect on profit relevance to equity value. Model (5-3) has been estimated to test this hypothesis:

$$Y_{3it} = \beta_0 + \beta_1 MTB_{it} + \varepsilon_{it} \text{ Model (5-3)}$$

Where variable Y_3 denotes profit relevance to equity value.

Results of Panel analysis are given in the following table:

Probability value F is 0.035. Since this value is lesser than 0.05, therefore null hypothesis is rejected at 95% of certainty level. Namely, there is a significant model. Value of determinant coefficient or R^2 is 0.09. Durbin- Watson

Table 4: Test results for Hypothesis- 3

Dependent Variable: Value Relevance				
Method: Pooled Least Squares				
Prob.	t-Statistic	Std. Error	Coefficient	Variable
0.000	18.407	0.028	0.523	C
0.035	2.118	0.016	0.033	MTB?
0.575		Mean dependent var	0.113	R-squared
0.293		S.D. dependent var	0.088	Adjusted R-squared
0.381		Akaike info criterion	0.292	S.E. of regression
0.401		Schwarz criterion	33.512	Sum squared resid
0.389		Hannan-Quinn criter.	-73.253	Log likelihood
1.758		Durbin-Watson stat	4.486	F-statistic
		0.035	Prob(F-statistic)	

Table 5: Test results for hypothesis- 4

Dependent Variable: Timeliness				
Method: Pooled Least Squares				
Total pool (balanced) observations: 395				
Prob.	t-Statistic	Std. Error	Coefficient	Variable
0.000	20.831	0.030	0.627	C
0.659	-0.441	0.016	-0.007	MTB?
0.616		Mean dependent var	0.000	R-squared
0.309		S.D. dependent var	-0.002	Adjusted R-squared
0.497		Akaike info criterion	0.309	S.E. of regression
0.517		Schwarz criterion	37.625	Sum squared resid
0.505		Hannan-Quinn criter.	-96.117	Log likelihood
1.632		Durbin-Watson stat	0.195	F-statistic
		0.659	Prob(F-statistic)	

Statistic value is 1.76. Value of t is 2.12 for MTB while t value is 18.41 for ordinate that signifies rejection of null hypothesis for MTB as well as rejection of null hypothesis for the ordinate. Therefore, the model is written as following where it denotes that there is a direct relationship between MTB and profit relevance to equity value.

$$Y_{3it} = 0.523 + 0.033 MTB_{it}$$

Test Results for Hypothesis-4: Fourth hypothesis expresses: Conservatism accounting has a significant effect on profit timeliness. Model (5-4) has been estimated to test this hypothesis:

$$Y_{4it} = \beta_0 + \beta_1 MTB_{it} + \varepsilon_{it}$$

Where variable Y_4 is timelessness.

Results of Panel Analysis are given in the following table:

Probability value F is 0.659. Since this value is greater than 0.05, therefore null hypothesis is not rejected 95% certainty level. That is there is no significant model. Value of determinant coefficient or R^2 is 0.000. Durbin- Watson Statistic value is 1.63. Value of t is -0.44 for MTB, while t value for ordinate is 20.83. This signifies non- rejection of null hypothesis for MTB, but rejection of null hypothesis for the ordinate. Thus, there is no significant model.

CONCLUSION

At the present study, relationship between Conservative accounting and profit qualitative properties has been tested. Research findings indicate:

- There is positive significant relationship between Conservatism accounting and profit persistence. This finding denotes that managers increase profit persistence by using of Conservatism accounting.

Some evidences show that the enterprises which use Conservatism accounting further, have profit persistence higher than ones use it lesser, so they experience less profit persistence.

- There is a positive significant relationship between Conservatism accounting and profit predictability. The corporations which utilize Conservatism accounting further will experience more profit predictability than enterprises that use Conservatism accounting lesser.
- There is a positive significant relationship among Conservatism accounting and profit relevance to equity value. The enterprises which use Conservatism accounting further, their reported profit could explain equity gain variations more.
- No significant relationship has been seen among Conservatism accounting and profit timeliness.

Accordingly, one can conclude that enterprises which use Conservatism accounting further, their profit qualitative properties are more favorable. Such findings may add to importance of Conservatism accounting. Conservative accounting procedures prevent directors from opportunist behavior and exaggerated optimism in giving profit and may lead to present report of more reliable profit.

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