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The Effect Mitigating Creditors-Shareholder Conflicts over Dividend Policy Accounting Conservatism: Evidence from Iran

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Abstract: This study tries to investigate the relation of conflict of interest between creditors and shareholders regarding dividend-payout policy to conservation (precaution). The hypothesis developed in this study is: companies faced with more severe conflict of interests between creditors and shareholder regarding dividend-payouts policy, have more conservation accounting. The statistical with 120 firms were selected as statistical sample by sampling method of systematic deletion. The period under study is a nine-year period (1999-2007). And the statistical method of study is cross sectional regression. The results showed that there was a significant relation between conflict of interest between creditors and shareholders regarding dividend-payout policy and conservative accounting.

Key words: Accounting conservatism · Accruals · Operational uncertainty · Leverage · Dividend payout ratio

INTRODUTION

Watts [1] suggest that conservatism likely evolved from the contracting role of accounting[1]. He argues that accounting conservatism helps avoid in appropriate distributions to claim holders. Consistent with watts [1], we argue that conservatism mitigates conflicts of interest over dividend policy between shareholders and creditors. Specifically, we hypothesize that (1) firms experiencing more severe creditors and shareholders dividend policy conflicts adopt more conservative accounting and (2) firms that use more conservative accounting in cure a lower debt cost.

Conservative accounting reduces the earnings and retained earnings amounts used in debt contracts to constrain dividends. Thus, choosing more conservative accounting is one may firm can reduce the risk to creditors that it will pay excessive dividends to shareholders. This risk reduction is likely to be more important when creditors-shareholders conflicts over dividend policy and more severe. Moreover, we expect that if mangers choose more, conservative accounting then creditors will accept a lower rate of return in light of the reduced risk of dividend over payment.

Cautious (conservative) is application degree of care that is required in applying of judgment for doing estimation in ambiguous situation so that income or assets aren't more than real costs or debts are not less than real. Exercise caution not lead to hidden reserves or unnecessary reserves or on purpose shows the income and assets less than real and costs debts more than real.

Our measure of conservatism is based on givoly and hayn [2], who argue that conservative accounting leads to persistently negative accruals. In the long run, unbiased accounting results in the cumulative amount of net income before depreciation and amortization converging to operating cash flows. Thus, as both positive and negative accruals reverse over time, net cumulative accruals should approach zero. In contrast, conservative accounting results in a persistent pattern of negative accruals over time. This suggests that a firm's mean accrual. Over a reasonably long period provides an accounting based, firm-specific proxy for conservatism.

Because we cannot directly observe the extent to which managers voluntarily make conservative accounting choices. Our two proxies for conservatism may reflect GAAP Mandated conservatism as well as manager's choices of accounting.

[1] Statement of concepts no. 2 (FASB 1980) defines conservatism as "a prudent reaction to uncertainty to try to ensure that uncertainty and risk inherent in business situations are adequately considered.

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The study's results contribute to our understanding of the real economic effects of accounting conservatism. We provide evidence that accounting conservatism mitigates conflicts over dividend policy. Although prior studies have documented the presence of conservatism in debt contracts, we believe this is the first study that provides evidence suggesting that conservatism plays an important role in efficient debt contracting. The paper proceeds as flows: First, section 2 gives are view of the literature review and hypothesis including the role of conservatism mitigating dividend policy conflicts and our hypothesis, explanations for conservatism, measuring creditors-shareholders conflict over derided policy and accrual based measure of conservatism. Then prior research is presented in section3. Section 4 describes methodology of the methodology of the research and deals with date analysis. Research and findings are presented in section 5.Finally, section 6 present discussion 8 conclusions derived from this research.

Literature Review and Hypothesis

Role of Conservatism in Mitigating Dividend Policy Conflicts: Agency theory suggests that fixed and residual claimants a firm have conflicting interests over divided policy [3]. In particular, over payment of divided can transfer wealth prom creditors to shareholders by reducing the assets available for meeting creditors' fixed claims and hence increasing the default risk pro creditors. Efficient contracting theory suggests that it is in the interests of all parties to mitigate this conflict. To address this conflict, creditors typically include dividend policy restrictions in debt contracts [4-7].

Kalay [5] finds that firms used two types of dividend restrictions in their public debt contracts: direct and indirect. Direct restrictions specify an upper bound on dividends in terms of cumulative net earnings or retained earnings [8].

Measurement of accounting numbers used in specifying restriction on dividend policy plays an important role in debt contracting. Conservative accounting directly affects the earnings and retained earnings amounts used in debt contracts to constrain dividends, in that conservative accounting leads to lower (cumulative) reported earnings. Similarly, conservative accounting implies tighter restrictions on dividend policy by reducing the measures of assets in various balance sheet ratios that appear in debt contracts. In short, when debt contracts impose accounting based restrictions on dividends; more conservative accounting reduces the likelihood that the firm will make dividend payments to shareholders.

Debt contracts in corporate conservatism in at least two may. First, bondholders can explicitly require the use of conservative accounting. Second, managers might implicitly commit to consistently used conservative accounting in order to build a reputation for conservative financial reporting. Mailgram and Roberts [9] argue that reputational concerns my effectively check mangers' willingness to renege on such and commitment by engaging in ex post opportunistic accounting choices.

Ahmed and *et al*. [10] finds that accounting conservatism help: (1) mitigate bondholders-shareholder conflicts over dividend policy and (2) reduce Firm's debt costs.

In sum, we expect that when creditors-shareholder conflicts over dividend policy are potentially more severe, borrowing firms are likely to use more conservative accounting. The creditors firm's manager's willingness to choose more conservatism. However, holding the costs of conservatism accounting. The creditors firm's manager’s willingness to choose more conservatism. However, holding the costs of conservatism constant, we expect cross-section difference in conservatism to be related to the severity of creditors-shareholders conflicts over dividend policy. Our hypothesis is as follows.

H1: Firms that face more server creditors-shareholders conflicts over dividend policy adopt more conservative accounting.

Explanations for Conservatism: I devote most of this section to the contracting explanation. My reason is that it is the original of conservatism and I think it has implications for the information perspective used by standard-setters. Also, although the contracting explanation in the literature emphasizes the formal contracts between parties to the firm (such as debt).

Watts [11] defines conservatism as differential verifiability required for the recognition of profits versus losses. Beaver & Ryan [12] define conservatism as a persistent downward bias in book value relative to market value. In the absence of one unifying definition, conservatism has typically been measured many ways by examining properties of either balance sheet or income statement information such as asymmetric timeliness in earnings [13], downward bias in book values relative to market values [12, 14]. and downward bias in earning. Beaver & Yan [12], watt [11] and Givoly and Hayan [2] discuss-these alternative approaches in depth. Some, such as Basu [13], Define conservatism as the practice of reducing earning in response to "bad news", but not increasing earnings in response to "good news". Zhang [15] models conservative accounting and valuation from this perspective.

Cautious (conservative) is application degree of care that is required in applying of judgment for doing estimation in ambiguous situation so that income or assets aren't more than real costs or debts are not less than real. Exercise caution not lead to hidden reserves or unnecessary reserves or on purpose shows the income and assets less than real and costs debts more than real.

Measuring Creditors-Shareholder Conflict Dividend Policy: We use three proxies for creditors-shareholders conflict over dividend policy: operating uncertainty, the level of dividends (as a percentage of assets) and leverage. Firms that face a relatively high degree of operating uncertainty, such as demand or input price uncertainly are more likely to experience large positive or negative shocks to their earnings and asset values. Large positive shocks that are unsuitable will tend to inflate retained earnings, possibly resulting in overpayment of dividends. In other words, greater uncertainty about future profits implies a greater risk that current dividends transfer too many resources to shareholders [1]. Thus, the higher the operating uncertainty, the higher the operating uncertainty, the more severe the creditors-shareholder conflicts over dividend policy. We measure the borrowing firm's operating uncertainty by the standard deviation of its return on asset.

As a second proxy for creditors-shareholders conflicts of interest over dividend policy, we use the level of dividends, measured as a percentage of assets. In a firm pays a low level of dividends and then creditors are less likely to be concerned about dividend overpayment. Conversely, paying a relatively high level of dividends potentially exacerbates the more severe creditor-shareholder conflicts over dividend policy.

Our third proxy for the severity of creditor-shareholder conflicts is leverage, measured as the ratio of lorry-term debt to asset. Ceteris paribus, higher leverage implies a relatively larger claim on the firm's assets by creditors. From a creditor perspective, higher leverage intensifies the conflicts of interest with shareholders and the concern over excess distribution. Thus, firms with high leverage likely experience greater creditor-shareholders conflicts over dividend policy.

Accrual-based Measure of Conservatism: Givoly and Hayn [2] focus on the income-statement effects of conservatism over extended. They are that conservative accounting leads to persistently negative accruals, in contrast with the expected pattern of accrual reversals. This suggests that a firm's means accrual over a reasonably long period provides a firm-specific proxy for conservatism. Consistent with Givoly and Hayn [2], we use accruals before depreciation as a proxy for conservative accounting. Specifically, we use the sum of total accruals excluding depreciation.

Deflated by assets and averaged within a sample period as our accrual-based proxy for conservatism. We also multiply this measure by -1 so it is increasing in the amount of negative accrual and refer to it as CONACC.

Management can exercise discretion over the conservatism with which they record most of these items in terms of the amount and timing. However, these accruals also reflect economic characteristics unrelated to conservatism, such as growth in operation [2].

$$measure\ of\ consrvatism = \frac{operating\ accruals}{total\ assets\ in\ the\ first\ period} \quad (1)$$

Where:

Operating accrual (OPACC) =Δ AR+Δ INV+ Δ PE- Δ AP- Δ TP

Δ AR: Changes in accounts receivable

Δ INV: Changes in inventory account

Δ PE: Changes in prepaid

Δ AP: Changes in accounts payable

Δ TP: Changes in payable tax

Prior Research

Domestic Research: Salary [16] investigated to the relationship between discretionary accruals and conservative accounting. Results indicate that there are significant relationship between discretionary accruals and conservative and in capital market of Iran there are not relationship between accruals and conservative.

Baghbany [17] studies "measuring accounting conservatism" in Iran. Propose of this study was identify factors affecting on conservative in Iran's environment and provide a model of measurable for criteria of conservative accounting. Results show that conservative decreased in samples. And this is due to decrease in accrual efficiency and cash assets.

International Research: Hendriksen and van breda [18] state "conservatism is, at best, a very poor method of treating the existence of uncertainty in valuation and income. At its worst, it results in a complete distortion of accounting data. Penman and zhang [14] suggest that conservatism results in tower quality earning.

Although many prior studies examine the relation between accounting choice and debt conversant, the more general role of conservatism in debt contracting has not received much attention. Prior research documents that debt contracts often require use of conservation accounting methods [19]. Leftwich [20] finds that modifications to GAAP in debt conservatism plays in mitigating bondholder-shareholder conflicts, or on the association between conservatism and a prim's lost of debt. Answers Ahmed [10] examine, the role of accounting conservatism in mitigating bondholder-shareholder conflicts over dividend policy and in reducing debt costs, however, they finds that accounting conservatism help: (1) mitigate bondholder-shareholder conflicts over dividend policy and (2) reduce firm's debt cost.

Data and Methodology: This study inductive and makes use of past information and historical financial statements. This empirical research describes events in Tehran stock exchange (TSE). And it is also a correlative since it seeks to investigate the relation between dependent factors. In order to gather theoretical, library research was selected and the books in the libraries to gather with articles found in interest were used. We chose TSE listed companies as a population (including 445 companies) and then select some sample based on the following conditions:

- The entities should be listed before 1998.
- The entities should not activate in financial or banking industries.
- The entities should be activating running 1997-2009.
- The entities should not change their financial periods.
- The entities should availability of information is required.
- The entities activity should be manufacturing (no investment).

Based on these conditions 120 companies qualify choose as the samples in this study.

Data Analysis: We employ the following model, estimated in both level and changes, to explain cross-sectional variation in conservatism and test hypothesis. The model includes our three proxies for creditor-shareholder dividend policy conflicts, as well as control variables for profitability and firm size, sale growth. Our dividend policy conflict proxies and control variables are measured as none-years averages, consistent with the estimation of our conservatism proxies:

$$CONACC = \beta_0 + \beta_1 LEV = + \beta_2 DIV + \beta_3 STDROA + \beta_4 SALESGRO + \beta_5 SIZE + \beta_6 ROA + \varepsilon$$

CONACC: the accrual-based conservatism proxy, defined as the mean of total accruals (net income before extraordinary items plus depreciation expense less operating cash flows multiplied by -1 and deflated by assets;

$STDROA_i$ = The standard deviation
DIV_i = Firm i's common dividends divided by its total assets;
LEV_i = Firm i's long-term debt divided by its total assets;
ROA_i = Firm i's net income before extraordinary, divided by its total assets (a control for profitability);
$SIZE_i$ = The natural log of firm i's total assets (a control firm size)
$SALES\ GRO_i$ = The annual percentage change in firm i's sales (a control for sales growth);

Hypothesis 1: predicts positive coefficient on STDROAi, DIVi and LEVi, our three proxies for the severity of bondholder-shareholder conflicts over dividend policy.

The additional variables in our tests control for (1) profitability (2) size, (3) sales growth.

Profitability and firm size are potentially associated with alternative motivation for and costs of conservatism, with hi assumes constant.

For low-profitability firms, the reduction in profits associated with conservative accounting would be relatively costly. In other word, more profitable firms can better afford conservative accounting choices. We include ROA in the model to control for this potential cost of conservatism and we expect firms with higher ROAs to use more conservative accounting. However, note that more negative accruals imply both lower ROA and higher CONACC values. Thus, the mechanical, negative relation ROA and con Acc could dominate the expected positive relation between conservatism and profitability Watts and Zimmerman [1] argue that firms facing high political costs will tend to use more conservative accounting. Consistent with this argument, Zmijewski and Hagerman [21] show that large firms use more conservative accounting methods. Accordingly, we include the natural log total assets in the model to control for this alternative motivation for conservatism. We expect large firm to make more conservative accounting choices. An additional motivation to control for total assets in that it helps to ensure that any observed positive relation between conservatism and dividends-to-assets or leverage is not

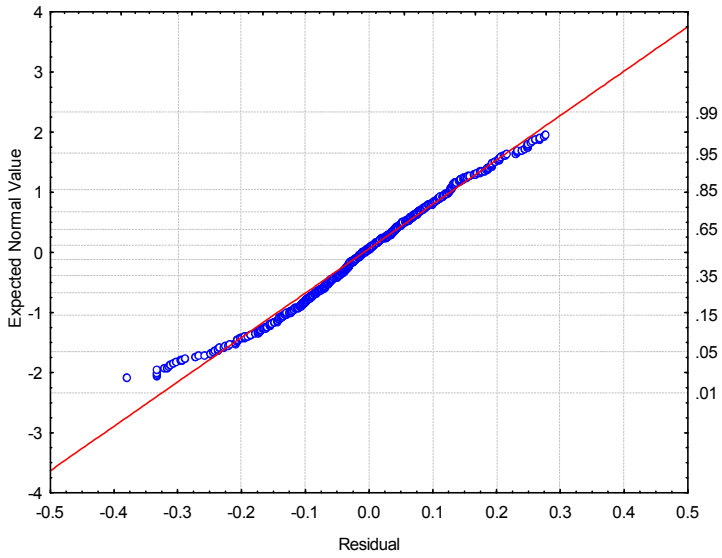

Fig. 1: Normal P-P.

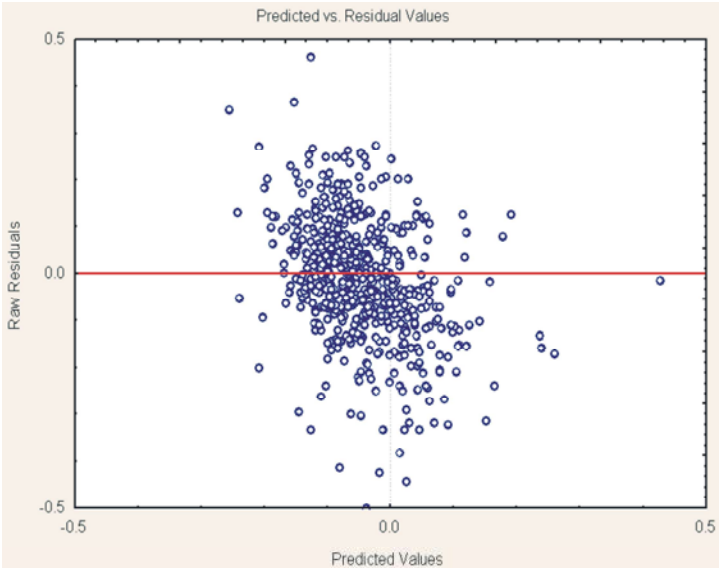

Fig. 2: scatter of standardized residuals against standardized prediction

Table1: regression statistics.

Durbin-Watson	Adj R^2	R^2	R
1/832	0/297	0/304	0/551

Table 2: reported the ANOVA in table 2.

	Sum of squares	Df	Mean square	f-value	p-value
Regression	12/121	6	2/020	44/352	0/000
Residual	27740	609	0/046		
Total	39/861	615			

Table 3:

p-value	T-Value	Std	Estimate	
0/128	-1/523	0/092	-0/141	Constant
0/000	5/239	0/093	0/485	LEV
0/001	3/283	1/290	4/233	DIV
0/042	2/036	0/112	0/227	STDROA
0/039	2/064	0/011	0/024	SALEGRO
0/402	0/839	0/007	0/006	SIZE
0/000	-6/668	0/061	-/406	ROA

According to top table, regression model fitted to data:

CONACC = -0/141+0/485 LEV + 4/233 DIV + 0/227 STDROA+ 0/024 SALEGRO + 0/006 SIZE - 0/406 ROA

Table 4: summary of the result of test of hypothesis.

Testing hypothesis	Dependent variable	Independent variable	Regression model	Model's Coefficients determination	modified Coefficients determination	H_1
1	Conservation	Interest conflict (STDROA DIVLEV)	-0/141+0/485 LEV +4/233DIV+ 0/227 STDRO + 0/024 SALEGRO + 0/006 SIZE -0/406 ROA	0/304	0/297	**confirmed**

induced mechanically by lower asset rules in the denominator of the rations. In other, words, the coefficient on DIV is the incremental effect of dividend policy holding constant the book value of total assets.

Finding and Results: In order to analysis the hypothesis, dependent and in dependent variables were studied and measured. Also in this study used ANOVA and normal p-p and scatter Fig rue. The results are described below: hypothesis is: "firms that face more severe creditors-shareholders conflicts. according to Table 1, Coefficient of determination is equal to 0/304, it means that 0/30 percent of changes in dependent variables are explained by independent variables.

As we show the p-value is equal to zero that which is less 0/05, it means that the lack of correlation between variables is rejected (with 5 precept sure).

We reported the coefficients in Table3:

Also according to normal prob. Plot; raw residuals, we can accept data normal (Figure 1).

Also at residual statistic in this model showed that there are not remote observations (Figure 2).

DISCUSSION &CONCLUSION

According to tables, p-value for DIV- is equal 0/001, for LEV is equal zero and for STDROA is equal 0/042. It means that there is positive relation between DIV, LEV and STDROA on conservatism. There for H1 confirmed. In other word, firms that face more severe creditors-shareholders conflicts about dividend policy, those adopt more conservation accounting (with 95 percent sure). In table 4 we reported the summary the result of test of hypothesis in Table 4:

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