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Research article

Accounting Conservatism and Corporate Governance's Mechanisms: Evidence from Tehran Stock Exchange

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Abstract

Accounting conservatism is one of the main characteristics of financial reporting, which has been incorporated in accounting theory and practice for a long time. Watts (2003) provides four explanations for the accounting conservatism; contracting, shareholder litigation, accounting regulation, and taxation. Conservatism can be a tool for efficient contracts and by limiting the field for opportunistic behavior of managers, cause be protect the interests of stakeholders and increase the company's value. The main objective of this study is investigating the relationship between corporate governance and conservatism in financial reporting of listed companies in Tehran Stock Exchange. In this study, to operationalize the conservatism coupled used Feltham and Ohlson (1995) and Givoly and Hayn (2000) model; and used by institutional ownership, board independence, board size, duality and membership of CEO on Board as proxy for corporate governance. To investigate this relationship used the multiple regression models. Findings of investigation of 146 companies (1259 firm-years) listed in Tehran Stock Exchange in the 2001 to 2012 by unbalanced Panel model representative, relation between conservatism and corporate governance was not significant. However, there was a significant positive relationship between profitability and conservatism.

Keywords: corporate governance, conservatism, corporate governance's mechanisms

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Introduction

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Accounting conservatism is one of the main characteristics of financial reporting, which has been incorporated in accounting theory and practice for a long time. Watts (2003a) provides four explanations for the accounting conservatism; contracting (debt contracts, executive contracts, and firm governance), shareholder litigation, accounting regulation, and taxation. As traditional definition, accounting conservatism: don't forecast any profit, but forecast all loss. Basu (1997) argues that accounting conservatism has been established for at least 500 years in Europe. Basu's claim is supported by the historical evidence that traces the lower of cost and market rule back to Italy in the 15th century, and to France in the 17th century (Littleton, 1941).

An extreme form of conservatism in practice generally means that a company should "anticipate no profit, but anticipate all losses" (Bliss, 1924). Watts (2003) believed that loss arising from overestimate the assets and profits assessment, in comparing to the benefits of assessment underestimate the assets and profits is observed more in political process. This phenomenon, incentives for standard-providers, authorities and companies provide to conservatism put on their agenda (Kim and Jung, 2007; Watts, 2003).

Basu (1997) quoted Penndorf acknowledges the historical records of the early 15th century about partnership Firms show accounting in medieval Europe was conservative. Despite of long history conservatism concepts in accounting and increases conservatism over time, however, to date**,** coherent and acceptable definition of conservatism has not provided so that can be accepted by everyone (Kim and Yang, 2007; Francis and Martin, 2010).

Basu (1997) defined conservatism as requiring a higher degree of verifiable to identification good news such as profit vs. bad news, such as loss. Feltham and Ohlson (1995) as well as the conservatism, defined choice and use of consistently accounting policies that are resulting in underestimate report net assets of the company. Basu (1997) definition of conservatism is based on loss and profit and Feltham and Ohlson (1995) is based on the balance sheet, so that have try in assessment underestimate the assets or overestimate report liabilities. Givoly & Hayn (2000) provided combination definition of conservatism that is based on balance sheet and income Statement perspective which has been trying in decrease retain earning. They defined conservatism, choose of accounting policies in uncertainty terms, so that is resulting minimum amount for assets and incomes and have minimal effect on equity.

Wolk et al (2013) define conservatism identification the slower profits and the assessment of less assets. They also expressed the view providers of financial statements; conservatism is an attempt to choose among accepted accounting practices that may result slower revenue recognition, early recognition of costs, underestimate the assets assessments or overestimate the debts assessments.

According to Watts (2003), explanation of contracting is the most important explanations of conservatism; because it is one of the major sources of conservatism (Watts, 2003). The result of researches such as Ball & Shivakumar (2005) and Watts (2003), suggests that conservatism potentially is useful in reducing the agency problems associated with managers' investment decisions. Ball & Shivakumar (2005) believe if managers already know that the losses will be recognized timely manner; the first, they are less willing to invest in projects with negative NPV, and secondly, the likely immediately act in line with limitation economic losses due to investments with the poor performance.

Watts (2003) knows conservatism a mechanism of efficient in contracts between company, creditors and shareholders that cause be more efficient the contracts and contractors will protecting the opportunity behavior of management. In addition conservatism can to protect auditors and company against lawsuits (Scott, 2012). Conservatism is derived from contracts with various individuals and groups. According this interpretation, accounting conservatism to consider the moral hazard created by various groups that have information asymmetric, asymmetric returns, limited horizons and limited liability are included. For example, conservatism can be limit opportunity behavior of managers in reporting methods and accounting policies used in contracts (Scott, 2012; Watts, 2003).

Corporate Governance is set of systems, processes and structures that using intra-organizational & out-organizational mechanisms seek preserve the rights of stakeholders, accountability, clarifying and equity in the business (Rezaei, 2012). Existing literature on accounting shows that corporate governance is an important factor in increasing the efficiency of contracts (Scott, 2012). Despite the attractiveness and importance of the issue of corporate governance and conservatism for study, but it must be cite that the matter has received little attention in Iran; so, the studies done in Iran were not from high variety. Due to the overlap conservatism and corporate governance objectives, expected there is relationship between these two important issues in accounting. The purpose of this study was to investigate the impact of corporate governance on conservatism. For this purpose, the first; examine concept of conservatism and corporate governance and the reasons for its justification. In the 3rd section; also after literature review related to the field present research hypotheses. The findings will be analyzed in the 4th section and ultimately, in the final section of this study is devoted to conclusions.

Conservatism

Studies offer different reasons for the causes of conservatism and various views on conservatism. The accountant transcends the conservatism of the proverb, 'Do not count your chicken before they are hatched,' saying, 'Here are a lot of chickens already safely hatched, but for the love of Mike, use discretion and don't count them all, for perhaps some will die.'(Hatfield, 1927). Ball and Shivakumar (2005) used conservatism as a measure of earnings quality, and Francis et al. (2004) assumed that conservatism is one of the desirable attributes of financial statements because it increases transparency. On the other hand, Penman and Zhang (2002) suggest that conservatism results in lower quality of earnings because conservative accounting practices accelerate expensing of investment costs, thus reducing income and generating hidden reserves, when the firm's investment expenditures grow (Kim & Yung, 2007).

Accounting conservatism has long been adopted into accounting procedures in theory and practice. FASB's Concepts Statement No. 2 defines accounting conservatism as a "prudent reaction to uncertainty to try to ensure that uncertainty and risks inherent in business situations are adequately considered" (FASB, 1982).

Examples of conservatism in generally accepted accounting principles (GAAP) include the lower of cost or market principle, expensing research and development costs and advertising costs, and proscriptions against recognizing internally generated goodwill.

Conservatism can be defined as a downward bias in net book value of assets than their economic value that due to inconsistent and incomplete identification economic in accounting profit. Standard sitting and researchers, who presented various definitions of conservatism, that is similar above definition. For example, The AICPA has been defined the conservatism through accounting practice in identification profit and loss; So that the losses recognized upon the occurrence and profits when realized. Reserves are clearly evident in FASB's conceptual framework: "Conservatism in financial reporting should no longer connote deliberate, consistent understatement of net assets and profits". And then in paragraph 95, the FASB conceptual framework indicates that: "Conservatism no longer requires deferring recognition of income beyond the time that adequate evidence of its existence becomes available or justifies recognizing losses before there is adequate evidence that they have been incurred" (FASB, 1980, Para. 95).

Also, Technical Committee of auditing organization in Iran, in the conceptual framework of financial reporting, considered the conservatism as a one of the components of the quality characteristic, but did not use "conservatism" word, but instead of it used "prudence" word that: "financial statements providers should be repel with that kind of uncertainty is inevitable, pervades the many events and circumstances. Such these uncertainties include: ability to collect receivables, the probable useful life of tangible fixed assets and the number of probable claims relating to the guarantee of goods sold. Such cases, observing precautions in the preparation of the financial statements and accompanying disclosures of the nature they identified. Prudence is application degree of care in the exercise of judgment need to estimate in uncertainty terms. So those have not provided incomes or assets, overestimate and the costs or debts underestimate.

As long as for performance reporting, management used the criteria and accounting standards, moral hazard's problems always will exist in financial reporting. The Managers to increase their personal interest in use of accounting standards that is the basis information to investors, bias functioned and in the transmission information create noise. If the limits which opportunistic behavior of the manager confine is not exit, then; the accounting figures contained in financial reports prepare and present bias. But conservatism by requiring its verifiable confine opportunistic and bias behavior of the managers. In practice conservatism is neutral bias behavior of the manager and delay benefit identifiable as a result less shown net assets and profit (Ataheryan 2012).

Conditional and Unconditional Conservatism:

Beaver and Ryan (2005) suggest that two types of conservatism exist: unconditional and conditional conservatism. Unconditional conservatism (hereafter, UC) means that aspects of the accounting process determined at the inception of assets and liabilities yield expected unrecorded goodwill. This conservatism is due inability of standard setting in determine of relevant circumstances. As result, standards setters adopt rigid uniformity policy (Wolk et al, 2013). Examples of UC include immediate expensing of the costs of most internally developed intangibles, depreciation of property, plant, and equipment that is more accelerated than economic depreciation, and historical cost accounting for positive net present value projects. Studies on UC model empirically investigated the implications of UC, focusing on how it yields dependent biases in accounting numbers that are usually dependent on growth.

Conditional conservatism (hereafter, CC) exists if book values are written down under sufficiently bad news but not written up under good news (i.e., asymmetric recognition of loss and gain). Examples of CC include the lower of cost or market accounting for inventory, and impairment loss of long-lived tangible and intangible assets. A body of prior empirical research beginning with Basu (1997) investigates the implications of CC, focusing on why and how it implies that earnings are more positively associated with current stock returns when they are negative than when they are positive (Kim & Yung, 2007).

Modern accounting researchers recognize that conservatism has the effect of accelerating the recognition of economic losses and deferring the recognition of economic gains (e.g. Basu, 1997; Watts, 2003a). Therefore, economic losses are reflected in earnings faster than economic gains, under conservatism. This property of conservatism is described by Basu (1997) as the asymmetric timeliness of earnings, which has become the anchor for a number of empirical and theoretical works on accounting conservatism in recent years (for literature reviews, see Watts, 2003b; Ryan, 2006).

The asymmetric timeliness of earnings property of accounting conservatism, as described above, highlights the inter temporal nature of accounting conservatism: the recognition of unverifiable or unrealized economic gains in earnings are delayed until they subsequently become verifiable or realized in later periods. Thus, in a typical life cycle of a firm, earnings tend to lag economic income by several accounting periods. In the early stages of the life of the firm where investment outlays tend to be high and revenues low, earnings tend to be lower than the economic income of the firm; but in the mature stage of the firm, where revenues are larger and more stable, earnings tend to catch up with the economic income or even exceed it (Monahan, 2005; Zhang, 2005). However, one should not argue that accounting conservatism is not always “conservative” simply because it may lead to lower earnings in one period and higher earnings in another. To make that argument would be to entirely miss the main purpose of accounting conservatism, which is to create a higher standard of verification for recognition of good news, as a mechanism for coping with economic uncertainties. Thus, the inter temporal properties of earnings are merely a consequence of that main purpose of accounting conservatism, rather than the cause of it (Wang, 2009).

The most common example of conservatism is the “lower of cost and market” rule of inventory valuation. This well-known rule states that inventory values should not be written up when the market value of inventory exceeds its cost, but should immediately be written down when the market value falls below the cost. According to a renowned accounting historian, R. H. Parker (1969), the lower of cost and market rule was firmly established somewhere in the 19th century. George O. May reportedly said that by the time he entered the accounting profession in England in 1892, the rule had already been well established. This suggests that conservatism probably has been around since the 19th century at the latest, while some researchers argue that the time is even longer (Wang, 2009).

However, there is negative relation between unconditional and conditional conservatism. It means if exist unconditional conservatism, then not exist conditional conservatism. Roychowdhury and Watts (2004) empirically show that UC as proxy by the market to-book ratio is negatively associated with CC as measured by asymmetric timeliness. For example, when cost research & development recognize as cost (not asset), recognize of loss of asset impairment not required in future period. (Iatridis, 2011; Wang, 2009)

Corporate governance

Historical roots of corporate governance

Disclosure of unlawful and hidden aid 17 major U.S. companies to Republican Party in 1973 that to Story of Watergate is known, Internal controls and financial disclosure issue from a new perspective is focus on professional associations and regulatory bodies.

Corporate governance is the system which companies by using them is guidance and control, so it is associated mainly with the problems of management and ownership. Sloan (2001) provides a perspective on financial accounting and financial economics, corporate governance can be defined as follows: “a mechanism that eliminates the incentive problems arising from the separation of management and financing companies.” thus, corporate governance is a mechanism to solve agency problems.

Some definitions, know corporate governance is much more than just a relationship between the company and suppliers of capital and emphasize on broader aspects of the stakeholders. OECD, corporate governance is defined thus: “A set of relationships between management, board, shareholders and other stakeholders of the company.” Corporate governance also provides the structure through it, company objectives codified and characterized tools these objectives and how to monitor the managers’ performance. Demanded Corporate governance should create incentives to Board and management, to the goals that benefit the company and its shareholders to seek and to facilitate effective monitoring. An efficient and effective system of corporate governance within the company and the economy as a whole helps to provide a degree of trust that is necessary for the performance of a market–based economy.”

However, conflicting evidence has been obtained recently. The crises in the world’s major corporate governance mechanisms weakness available that led to accounting scandals and failure of the firms revealed. Regulatory bodies in response to these events adopted new corporate governance principles to control any future conflicts of interest. The biggest event is set of corporate governance in 2001 that America Congress forced Sarbanes-Oxley law (SOX) approved in 2002 and the importance of corporate governance in order to align the interests of executives and shareholders to ensure that outstand (Clark, 2004). This perspective, will be considered corporate governance from view of an external force and non-relevant to the company’s operations and financing arrangements.

Corporate Governance and Business Ethics characterized as one of the most impressive aspects of the 21th century that of regulations in force, to one of the strategic business imperatives and moral deformity organizational culture. Effective Corporate Governance, will help to Management to further improve the sensitivity and attention of the Board than some of the duties of forgotten improve; Auditors, regulatory authorities, investment banks, consultants and financial analysts, to force them to perform their duties and improve public confidence toward performance and activities of the organization (Rezaei 2012).

Corporate governance necessity arising from is conflicts of interest stakeholders. Conflict of interest that It is interpreted as agent issue a conflict is due to two main reasons, the first, each of the participants have different goals and preferences and the second is that each of them did not have complete information about actions, knowledge and other preferences, it is clear, this separation, with assuming the absence of effective mechanisms of corporate governance functional, cause managers to act in their interests and not the interests of the shareholders.

Recent research suggests that each researchers review from different perspectives corporate governance rule of law systems. Gilen and Starks (1998) defined corporate governance law system, regulations and factors that control company operation. They express the corporate governance include structures identifies the company operating limits. This series of structures including participants in activities such as managers, employees, suppliers, investors, returns of each participant, and each of the activities (as quoted Rezaei, 2012).

Clapper and Lau (2002) showed good corporate governance has positive correlation to operational efficient and market value and these relationships are in countries where have weaker legal system is more prominent. Research shows that investor protection laws are significant differences among the different countries that are part of these differences are due to different in legal principles. In addition Research results indicate that differences in rules and its act among many countries is exist to effect on ownership structure, cash dividend cost, accessibility to external sources finance and market value. The results, indicated although companies can independently protect investors and partly to improve shareholder rights, suitable corporate governance system in the corporate level is not successor reform and strengthening the legal system and cannot be fill strong infrastructure vacancies, so, in the countries with weaker legal systems have a lower average level of corporate governance (corporate governance conference).

A comparative study of factors affecting corporate governance in Malaysia, Turkey, Poland and Iran (corporate governance conference). Show far away Iran to other countries. Table 1 shows the details of the most important issues in this review.

Table 1- Comparison of some factors affecting corporate **governance in Malaysia, Turkey, Poland and Iran.**

	Malaysia	Turkey	Poland	Iran
Percentage of sufficient ownership for general meeting	Two / more stockholders with 10% shares up	5%	10%	According to Commercial law Article 95 –holders of 20% stocks
Board system (Structure)	Single-level system with mix of non-executive, executive members	First Tier	Second Tier	First Tier
Presence independent member in Board	The research shown in 1998 there is good mix of independent/depended members. The evident indicate sometimes, the members are control stockholders that rule of the firm emphasize on trusteeship them, It is difficult to implement in practice.	No, Board members should be stockholders.	Control Board should not include CEO.	In regulation of corporate governance pointed it.
Usual being use of Board Committee	Yes, auditing committee is usual at least 3 members that should be majority is independent	Yes, auditing committee is usual 1-5 members that elected by annual general assemble for 3 years.	Stockholders is owned 5% capital and more can be request appoint auditing committee.	No- but In regulation of corporate governance pointed it.
Disclosure of information to executives and board members	Yes, disclosure Cumulative fees	Yes, The cumulative fees amount write in reports and the audit report Board members changes. insider auditors and management should be reported to Istanbul Stock Exchange	Yes, Information about the managers and board members should be included in reports and updated regularly	Yes , disclose cumulative fees
Disclosure of Ownership	Yes, Ownership threshold in past of 5% to 2% decline but; understand the company's ownership structure is difficult.	Yes, if private ownership pass Threshold of nearly 10% or holders 10% equity and more than 1% of the buy / sell Should be subject to disclose the Capital Markets for Board and Istanbul Stock Exchange	Yes, when Private ownership threshold of 5 and 10% of the voting rights of a listed company shall pass should be announced to Securities and Exchange Commission and Anti-Monopoly	Yes, But totally understand the ownership structure and identify the ultimate owner is difficult.

			agencies	

As conservatism, there is no consensus definition about corporate governance. Significant differences in the definition of Corporate Governance based on the cultural, economic situation, and others, can be seen in every country. Corporate governance is the system which companies are controlled using by them, so it is associated mainly with management and ownership issues. Some definitions, knows corporate governance much more than just a relationship between the company and suppliers of capital and emphasized within broader aspects of the stakeholders. Corporate governance provides the structure which through it the company objectives developed and achievement tools to these goals and also appear how to monitoring on performance of managers. Optimum corporate governance should be create to the Board and management appropriate incentives to goals that benefit the company and its shareholders to follow, and also background provide to monitor effectively and efficiently. Sloan (2001) provides a perspective based on financial accounting and financial economics defines corporate governance as a mechanism that cause eliminates incentive problems arising from the separation of management and finance of company (as quoted Rezaei, 2012).

Fama and Jensen, argued that the separation ownership from management and control in modern corporations creates asymmetric information are between managers and investors. Separation ownership from management is not only reason of create the agency between shareholders and managers, but also the distribution of shareholders in large number of small shareholders could also be the reason for it (Wolk et al, 2013).

Related Literature

Rezazadeh & Azad (2008) studied Asymmetric Information and conservatism in financial reporting in 81 companies during the period 2002 to 2007. They used Basu model to measure the Asymmetric Information Bid & Ask and showed there is Asymmetric Information between investors and the degree of conservatism applied in the financial statements significant positive relationship.

Khoshtinat and Yousefi (2006) also have studied Symmetry and Asymmetric Information with conservatism. They had shown that Asymmetric Information between informed and uninformed investors led to change to conservatism, however, conservatism is not leads to Asymmetric Information. Their results are inconsistent with the recommendations of the FASB that state: “Conservatism can lead to Asymmetric Information”.

Ebrahimi kurdlor and Shariary (2009) investigated the relationship between conservatism and political costs and showed there is a negative relationship between the size and intensity investment with conservatism and there is between the degree of competition in the industry and state ownership has a positive significant relationship with conservatism.

Banimahd and Baghbani (2009) investigated the effect of conservative accounting, government ownership, firm size and leverage ratio of losses companies. In order to they investigated 48 lost companies out in Tehran Stock Exchange during the period 2001 to 2006 and found there is direct relationship between conservative accounting with lost companies. They argued conservative accounting mechanism for the effective contracts and management biased behavior concerning over-view of lost corporate profits.

Kordestani and Haddadi (2009) examined the relationship between conservatism and cost of capital and found, there is significant negative relationship between cost of capital and conservatism based on the asymmetry time profit. And also there is significant positive relationship between conservatism and cost of capital based on market value ratio to book value of equity.

Ball et al. (2000) find that financial reporting of common law country firms is much more conservative than that of code law country firms. Ball et al. (2002) also find that four Asian countries (Hong Kong, Malaysia, Singapore and Thailand) are closer to code law countries than to common law countries in the conservatism of financial reporting. Bushman and Piotroski (2006) explore financial reporting incentives created by an economy’s institutional structure (legal and political institutions). They empirically analyze the relation between key characteristics of country-level institutions and conditional conservatism.

Givoly and Hayn (2000) found an increasing tendency of accounting conservatism over time based on accumulation of non-operating accruals, the timeliness of earnings with respect to bad versus good news, characteristics of the earnings distribution and the market-to-book ratio. Since then, conservatism has been an important issue in accounting research.

Ahmed et al. (2002) showed that firms facing more severe conflicts over dividend policy tend to use more conservative accounting, and that conservatism is associated with a lower cost of debt after controlling for other determinants of firms' debt costs. Their evidence is consistent with Watts (2003) in that accounting conservatism is helpful in increasing efficiency in bondholder shareholder contracting.

Giang (2007) showed that conditional and unconditional conservatism performs different roles at interpretation conservatism. Conventional interpretation lead to conditional conservatism and litigations interpretation lead to both conditional and unconditional conservatism. He also found that to increase in unconditional conservatism, conditional conservatism decreases. Therefore is necessary establishing a balance between them.

Chi et al (2007) found the companies with larger board and higher percentage institutional ownership have lower demand for conservatism. On the other hand, having the higher percentage ownership of duty directors to more demand is related to conservatism.

Lafound and the Roy Chadry (2008), in a research focused on this topic that whether the conservatism due to agency problems between managers and shareholders is changed or not. They believe that must demand for conservatism, positively change with agency problems. They are considering management ownership as an Inverse Proxy of agency problems, according to their prediction found that there is a negative relationship between conservatism and management ownership.

Lafound and Watts (2008), in their study investigated, whether the agency problems arising from asymmetry information can be increased demand for conservatism or not. Their study results showed higher level of asymmetry information between outside investors and company managers, related with being conservative more profit and increases in asymmetry information lead to be more conservatism. In general, confirmed their results research, study hypotheses shown that conservatism is a stable response to shareholders to reduce agency costs due to asymmetry information between outside investors and managers.

Garcia et al (2009) found there is a significant positive relationship between the strength of corporate governance system and conservatism.

Ahmad & Dolman (2007) showed there is a significant negative relationship between conservatism and inside managers’ percentage ownership and there is significant positive relationship between outside shareholders percentage and conservatism.

Francis and Martin (2010), similarly, via proof the issue which conservatism in time of existence agency costs due to asymmetric information leads to decisions being profitable they showed that the conservatism, is a mechanism that create this incentive in managers will avoid poor decisions-making investments.

Hypotheses development

Governance system can be defined as a system where companies are directed and controlled. So the board of directors position as a leadership institute undertake role of care and control on executives function in order to protect of interests ownership shareholders, has become more important. In the following, we will introduce incentives to ensure the effectiveness of the Board's corporate recommended in corporate governance system (HassasYegane and Baghomian, 2006).

It is noted that in some countries (such as Australia, America, England, etc.), there are certain organizations that measuring and scoring corporate governance. Given that there is no such matter in Iran and the firms are not rankings in terms of corporate governance, so it will be different. A lot of research has been done and show that it can be proxies used for the corporate governance. The study used from many corporate governance mechanisms (such as the percentage of institutional ownership, board independence, board size and duality). In addition, the CEO can be chosen from board members or elected outside the board members. According to highlight the role of CEO at the company and corporate governance, it can also affect strategy and corporate governance. Lack of membership CEO in the board can be cause to coordinate (alignment) and reduce the potential confliction; on the other hand, lack of his membership shall provide the field for the participation of another person in the board and create another thought to corporate. Obviously, given the specific role of CEO, if he/she also isn't a board member of board, he can still be represented at meetings of the company's strategy and give comment. Therefore, in this study the issue will also examine and use corporate governance mechanisms as proxy.

H1: There is a significant relationship between corporate governance and conservatism.

Separation of Chairman of the Board and CEO roles (Duality)

One of the most controversial issues unresolved issues in corporate governance system in the world, especially the United States, is oneness Chairman of the board and CEO. There is no law, regulation or standard in the United States which requirement to separate the functions of CEO and Chairman of the board. However, corporate governance reform in other countries (such as Britain) promotes the separation of the two posts (Rezaei, 2012).

Proponents of agency theory while emphasizing the separation of duties both Chairman of the board from CEO Suggest while membership of the Board of the company should also be independent current affairs the company and thus have better control over the management of high-risk programs, while proponents "Stewardship Theory" also believe that this dual role (a CEO and a Chairman of the board), improve performance. Although some researches have shown the companies that considered this separation have no performance in the level of their competitors, but mainly studies have shown that the managing director with dual strong easier able to manipulate profits.(Rezaei , 2012).

Imposing more stringent thus is modified: "Duties of Chairman of the board and CEO should not be undertaking the single person". Ironically, the main points of the above proposals and other recommendations made by Higgs, considered in General Law approved in July 2003. The scope of the corporate governance system, including issues in the England than United States, more active it (quoted Rezaei, 2012).

Under "Iran Commercial Law", the board must appoint at least one person as CEO. Managing board may or may not is member of Board and determination his Jurisdiction time vacancy and wage was undertake the board and his dismissal by the board is possible at any time.

Non-executive Managers

The Enron collapse in 2001 attracted the attentions on the effectiveness of non-executive managers (non-ordered) board. On the other hand, the Higgs Report (2003) in England also unanswerable response to influence managers (non-executive) inefficient, considered in Enron simulated companies.

From view of agency theory, presence of independent non-executive managers (non-ordered) in board and their regulatory functions as an independent person, remarkable help to reduce conflicts of interest between shareholders and managers in meetings. It should be noted that corporate executives play an important role in creating appropriate combination of executive/non-executive managers' play among the members of the board. Such a combination is the basic elements of an efficient and effective board, because, while the executive manager, who provided valuable information about the activities of the company, non-executive managers with professional and fair view, judge about managers' decisions.

Thus, the board with having the expertise and independence and regulatory authority, considered a potentially strong mechanism corporate governance system. (quoted Rezaei, 2012).

In continue some rules of Iran Commercial law review concerning discussion board. Articles 107 to 143 of the Commercial law have described in detail the issue of board of companies. According to the Articles:

- The managers elected by the General Assembly founder and the General Assembly ordinary (Commercial law, Article 108). Executive management duration specified in the statute but it will not exceed a period of two years (Article 109).
- Board structure should be the highest Chairman of the Board as an authority in Iran; the chairman was appointed by the Board and can be removed at any time by vote of the Board (Article 119).

* Board must be appointed at least one entity as managing director. Managing director can be may or may not a member of Board and define the powers and his tenure and wage undertake the board and his dismissal by the board at any time is possible. Unfortunately, in the Commercial law of Iran the managing director approved by three-fourths vote of the General Assembly could be chairman of the board simultaneously. (Ie, derived from Article 124); this is largely proper corporate governance will be undermined.
* Commercial law Articles 129 and 134 discussed about transactions and their relationship of the Board of Directors and management team, including Trade restrictions the Board and Managing Director (Article 129), prohibition of loans or credit from the company for CEO and board members. however, Article 132 of this Act loans or credit obtaining to allow for members of the Board and CEO, banks and credit institutions, if this is done under normal terms and conditions.
* About non- executive members (independent) the board, Commercial law is subject their wages paid just as fixed and tight of presence. Non- executive members except the case and commission the board General Assembly was approved and commission has no right against his management position receive any money (ie , Article 134).

Iran Commercial law is silent about combination of non-executive and executive board members.

Institutional shareholders

Institutional shareholders have potential influence management activities through ownership directly; and indirectly through the exchange of their shares, respectively. Influence of institutional shareholders indirect can be very strong. For example, institutional shareholders may in form a group avoid from investing in a particular company and thereby increasing the cost of capital company, because capital attraction for the companies it will be more expensive and harder (as quoted Rezaei; 2012).

Another potential role for large institutional shareholders to provide a reliable mechanism for transferring information to the financial markets or in other words is other shareholders. According to Chidambaran and John (2000), large institutional shareholders may confidential information that acquire from managers transfer to other stakeholders. But for such surveillance may be acceptable, it is necessary large shareholders to invest in long-term preserve and sufficient stock to adjust the monitor to have trouble free use (as quoted Rezaei; 2012).

According to Jiang and Kim results (2000), any level of institutional ownership in Japanese firms' increases, less asymmetry information between managers and other interested parties will be on the market. Companies that are so much greater institutional ownership, stock prices related information to future profits reflect faster than companies that have low institutional ownership (as quoted Rezaei 2012).

Board Size

Studies show that the board size can also be effective factor on corporate governance. larger board this enables the company enjoy of ideas and expertise many people and cause be enhance the expertise of the members of the Board; Although standard size cannot be identified and increase the size of the company could bring undesirable consequences. For example, to increase the size of the company may be time consuming and costly to coordinate decisions, because they each have different view (Rezaei 2012).

And integrate these ideas and individual can reduce the board effectiveness. According to the above mentioned and theoretical principles, research hypothesis is formulated as follows.

Methodology

Sample and Research Design

This study is a quasi-experimental research in the field of Positive research and is a form of application research from the view of objective. The methodology is inductive and Ex-post design and its statistical method is correlation research. Companies' data of consolidated and has been examined by a multiple regression model. Above data mining Rahavard software and with financial statements data adjusted and for preparation of data; used Excel and for analysis of data used software SPSS 19 and EVIEWS 6.

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Sample and Data Source

Statistical population of research is all the companies listed in Tehran Stock Exchange during the period 2002 to 2012. The sampling technique, elimination method according to predetermined criteria. Companies that have the following criteria were selected as a sample:

1- Among are not investment firms, banks, insurance and intermediation.
2- Their fiscal year has been end of March.
3- Before 2002 are accepted in Tehran Stock Exchange.
4- The data research required about them is available.

According to the above criteria, the first 146 companies were selected for the survey that information some variables about them was not available. Hence this study was used only firms-year which all variables were available. Thus there was 1259 observation that not only there is perfect information, but the information considered relevant to the different years and unbalanced panel data have been used to assess relationships.

Models and variables used

The model used in this study is multiple linear regression model that due to the research literature and basic theoretical extraction is designed.

$$\mathbf{Cons}_{\mathbf{it}} = \beta_1 + \beta_2\mathbf{Inst}_{\mathbf{it}} + \beta_3\mathbf{BZ}_{\mathbf{it}} + \beta_4\mathbf{Indepent}_{\mathbf{it}} + \beta_5\,\mathbf{Duality}_{\mathbf{it}} + \beta_6\,\mathbf{CEO}_{\mathbf{it}} + \beta_7\,\mathbf{SIZE}_{\mathbf{it}} + \beta_8\mathbf{LEV}_{\mathbf{it}} + \beta_9\mathbf{ROA}_{\mathbf{it}} + \beta_{10}\,\mathbf{OL}_{\mathbf{it}} + \varepsilon$$

Where the dependent variable:

$\mathbf{CONS}_{\mathbf{it}}$: Is degree of Conservatism of company **i** in year **t**, and dependent variable of research. To conservatism assessment, use several methods and models. In this study applied to model of Feltham and Ohlson model (1995).

The idea underlying the use of MTB (or BTM) as a measure of accounting conservatism is that, *ceteris paribus,* a conservative accounting system tends to depress the net book values of a firm relative to the firm's 'true' economic value. Therefore, a higher MTB (and a lower BTM) implies a higher degree of accounting conservatism, and vice versa. The MTB measure is strongly rooted in the analytical work based on the Residual Income Valuation Model (RIVM). Feltham and Ohlson first introduced accounting conservatism in the RIVM context, and characterize conservatism as a tendency to bias downwards the book value of a firm relative to its market value. This manifestation of conservatism has been carried into later analytical works on conservatism such as Beaver and Ryan (Wang, 2009). Thus, this study was calculated to summarize the degree of conservatism:

$$CONS_{it} = \frac{MV_{\mathrm{it}}}{BV_{\mathrm{it}}}$$

In this relationship:

MV_{it}: The market value of equity of firm i in the end of year t.

BV_{it}: The Book value of equity of firm i in the end of year t.

Independent variables

Several proxies have been using for corporate governance. In this study, five variables of institutional ownership, board independence, size of board, duality and membership CEO in the board, were used as proxies of corporate governance.

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$\mathbf{Inst_{it}}$: Represents the percentage of institutional shareholders of a company **i** in year **t**. For this purpose the percentage ownership of banks, insurers, pension funds, investment companies and the firms that their main activity is to invest in companies.

$\mathbf{Indepent_{it}}$: Percentage of non-executive members of the board of the company **i** in end of the year **t**, which indicates the degree of board independence.

$\mathbf{BZ_{it}}$: Board members the company **i** at the end of **t** is an indication of the size of the board.

$\mathbf{Duality_{it}}$**:** Show the separation of the CEO and chairman of the board duty the company **i** in year **t**. As in mentioned year CEO be simultaneously Chairman of the Board, for the company number 1 and otherwise zero (0) to be.

$\mathbf{CEO_{it}}$: Represents the CEO membership of firm **i** in board in year **t**. As mentioned year CEO is board member for company number 1 and otherwise zero (0) to be.

Control variables:

$\mathbf{SIZE}_{it}$: Represents the size of firm **i** in year **t**. Watts and Zimmerman (1986) have argued that larger firms are more likely to face political costs and are more willing to use conservatism. We expected larger firms use more conservative accounting. So in this study, firm size consider as a Control variables. To determine the firm size used from Ln of total assets.

$\mathbf{ROA}_{it}$: Represents turnover assets firm **i** in year **t**, which is used to assessment the performance of companies reviewing. As stated previously, Concluded contracts (Debts contracts, executive and corporate governance); litigation, accounting and tax regulations were factors affect the demand for conservatism. Ahmed et al. (2002) showed that firms facing more severe conflicts over dividend policy tend to use more conservative accounting and that conservatism is associated with a lower cost of debt. Their evidence is consistent with the explanation that accounting conservatism helps in increasing efficiency in bondholder-shareholder contracting, and the return on assets was considered as a control variable; so in this study, the profitability variable that calculated by divided Earning before Tax to total assets, was considered as control variable (Kim and Jung, 2007).

$\mathbf{LEV}_{it}$: Financial leverage firm **i** is in year **t** concluded by divided total debt to total assets. Financial leverage acquired as total debt divided by the total assets. Financial leverage represents other creditors' claims on the assets of the company; according to these contracts and the power that the groups bring could be applied force to conservatism; so the financial leverage considered as a control variable (Kim and Jung, 2007; Scott, 2012).

$\mathbf{OL}_{it}$: Is the Dummy Variable. If the company **i** in year **t** have a loss before Tax number 1 and the otherwise is zero. Sometimes companies have loss before interest and tax. Considering that this situation may the company has less incentive conservatism, as a result the factor could affect the company's motivation for conservatism. Hence, to identify and monitor the above effect used this variable.

Results

Descriptive Statistics

Statistical population of the research presents in panel 1, separately each industry.

Panel 1: population separately each industry Statistical

Industry Name	Drug Industry	basic metals	Cement and Plaster	Ceramic & Tiles	Rubber and Plastics	mineral and non-metallic products	Machinery and equipment	Vehicle and Parts Manufacturing	Chemical	Food	Other Industries	Total

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Number	24	16	15	10	9	8	8	27	17	5	7	146
Percentage	16%	11%	10%	7%	6%	6%	6%	18%	12%	3%	5%	100%

In panel 2, presented descriptive statistics of the study variables include conservatism as the dependent variable of research and corporate governance mechanisms as the independent variable and also control variables include firm size, leverage and profitability.

Panel 2: Descriptive statistics

	Cons (F&O)	Cons (G&H)	INST	B Z	Indepent	Duality	CEO	Size	Lev	ROA
Mean	2.448	-0.04	0.4281	5.0365	0.6469	0.0167	0.8896	5.7717	0.6512	0.1475
Median	1.747	-0.017	0.3710	5	0.6	0	1	5.6988	0.6613	0.1221
Maximum	19.73	0.78	0.9908	7	8	1	1	8.0087	1.0793	0.7001
Minimum	-4.88	-1.3	0	3	0	0	0	4.5374	0.0414	-0.3127
Std. Dev.	2.39	0.29	0.3461	0.3316	0.2813	0.1281	0.3135	0.5723	0.1722	0.1402
Observations	1259	1259	1259	1259	1259	1259	1259	1259	1259	1259

Conservatism index Mean that calculated by model Feltham and Ohlson (1995) is approximately 2.5 and conservatism index used Givoly and Hayn (2000) is equivalent 4% of assets. In other words, 4% of the Assets of the Companies in this research consist from nonoperation accruals. On average, 43% of the company's shares are under ownership investors institutional, while also some corporations were almost as institutional owners. And some of these investors were not considered further. The member of board is also 5 and on average, 65% of them were non-executive. In the other hand, Iranian companies generally have 5 members of board and 45% of them have administrative position. In addition, in the majority of Iranian companies duality observed and CEO simultaneously has not the position of chairman of the board. The noteworthy is that in the majority of Iranian companies CEO is a board member and board members tend to one of the members appointed to this position. The average of assets of these Companies is 589 billion Rials. The average of leverage the companies is 65% that represent claim other groups supplier shareholders' equity exception stockholders than to company assets. In other words, on average, 65% of the resource requirements of firms have been financed by creditors and other institutions. Profitability average of companies that calculated by divided Earning before Tax on total assets is 15% ; it means the companies surveyed had an average of 15 % of its assets could be earned Earning before Tax.

Inferential statistics

In panel 3 presented Variance Inflation Factor (VIF) and tolerances relate to study variables. In statistics, the VIF quantifies the severity of multicollinearity in an ordinary least squares regression analysis. It provides an index that measures how much the variance (the square of the estimate's standard deviation) of an estimated regression coefficient is increased because of collinearity. As shown in the figure, all VIF is less than 5, which indicates the absence of severe multicollinearity between the study variables.

Panel 3: Result of VIF test

Variable	ROA	LEV	SIZE	CEO	INDEPENT	B Z	INST

VIF	*1*	*1.03*	*1.02*	*1.1*	*1.03*	*1.01*	*1.1*
TOLERANCE	*0.95*	*0.78*	*0.8*	*0.9*	*0.97*	*0.99*	*0.9*

For selection data analysis model and use of data Panel / Pool used F-Limer test. Due to statistic and the significance level the results of the test that is (3.54) and (0.000) sequence p-value <0.05; so, the zero hypotheses of this test is based on the pool data is reject and therefore used panel data. Panel 4, shown F-statistic and significance level of the F-Limer test.

Panel 4: F-statistic and significance level of the F-Limer test

Effects Test	Statistic	d.f.	Prob.
Cross-section F	3.540377	(132,1055)	0.0000
Cross-section Chi-square	438.941218	132	0.0000

To determine the fixed or random effects, used Husman Test. Panel 5 shown, Chi-square test and level of significance Husman test. Because of reject the zero hypotheses (based on combined data and random effects) and accept the opposite hypothesis (based on data compilation and fixed effects), the model is type of panel and fixed effects. In the present study used from Panel model by using Cross-Section fixed Effect.

Panel 5: F-statistic and significance level of the Husman test

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	121.220536	9	0.0000

In panel 6 presented results of the model using Feltham and Ohlson (1995).

Panel 6: results of the model using Feltham and Ohlson

Variable	**Coefficient**	**Std. Error**	**t-Statistic**	**Prob.**
INST	-0.308653	0.292967	-1.053541	0.2923
BZ	0.207997	0.144499	1.439440	0.1503
INDEPENT	-0.328747	0.151729	-2.166675	0.0305
DUALITY	-0.448180	0.379309	-1.181571	0.2376
CEO	0.174077	0.161770	1.076082	0.2821
SIZE	-2.734724	0.174874	-15.63823	0.0000
LEVERAGE	6.427976	0.384127	16.73397	0.0000
ROA	8.491772	0.524842	16.17968	0.0000
OL	0.903475	0.187693	4.813588	0.0000
C	11.86815	1.363929	8.701447	0.0000

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Cross-section fixed			
R-squared	0.671738	Mean dependent var	2.319607
Adjusted R-squared	0.626845	S.D. dependent var	1.927706
S.E. of regression	1.177566	Akaike info criterion	3.277855
Sum squared resid	1429.648	Schwarz criterion	3.891290
Log likelihood	-1780.462	Hannan-Quinn criter.	3.509191
F-statistic	14.96303	Durbin-Watson stat	1.759499
Prob(F-statistic)	0.000000		

According to hypothesis of this study is expected to be a significant relationship between conservative and corporate governance. T-statistics and significance level related to corporate governance variables, include institutional ownership, board size, board independence, duality and CEO membership in the board suggests that the 99% confidence level, there is no significant relationship between corporate governance and conservatism.

Durbin-Watson statistic is (1.76) and as regard this statistic is between (1.5) to (2.5), so there is not autocorrelation between the residual models. F-Fisher probability is (0.000); the result indicates that the entire model is statistically significant. The R-squared indicates the explanatory power of the independent variables, which in this study Adjusted R-squared was (0.63) which statistically significant and indicates that the explanatory variables are well chosen.

In addition, there is significant negative relationship between firm size and conservatism. This confirms the assumption of political power can be developed that interpreted by Solomon and Siegfried (1977). According to this hypothesis, larger firms enjoy a privileged power of political and economic than smaller firms. These companies' uses its economic power and Lobbying are intended influence laws and political cost hypothesis in the company isn't very true. Some researchers believe that the political cost hypothesis may not be true in developing countries; because of in these countries government is inevitable that to achieve economic objectives and national development, interact and cooperate with large companies and these companies have not a lot of tend to profit reduction and conservatism. (Sarvestani, 2012). In addition, financial leverage and profitability have also positive relationship with their conservatism.

Supplementary tests

Givoly et al (2007) showed for assessment the conservatism different models should be used simultaneous. They show that the Basu model (1997) is different from other models with regard to the reporting of industry type, country and time period is different, should be used from different models.

According to the substantially inflation rate in Iran in recent decades has experienced; presumably different Book to Market due to using historical cost system which has been unable in identification of market value and is not relevance with conservatism. This difference could be due to out of control economic factors of the company and have no relevant to the company's policies and conservatism and other factors. As regards some Researchers surveyed weakness of this model and show that this Proxy model is too weak for research. Such as criticisms true that can be pointed to Jeffrey Callen (2013).

He says in this article: The market to book ratio (or its inverse) seems to proxy for many things in the literature: growth and growth options, (normalized) firm value, monopoly power, uncertainty about average profitability, information asymmetry, a risk factor, and unconditional conservatism. A proxy that covers so much territory is probably a poor proxy for any given specific construct. As a measure of firm value, monopoly power, growth, and uncertainty about average profitability, the market to book ratio is problematic if only because the denominator (book value) is a function of accounting policies such as conservatism (whether conditional or

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unconditional). I know of no theory based on primitives that relates the market to book ratio to information asymmetry or unconditional conservatism although it is likely affected by both conditional and unconditional conservatism.

We also believe Market to Book criterion have main weakness and may be influenced by other factors beyond the control of the researcher and the research impact. Also due to the argument Givoly et al (2007) for more reliability and comparability, this model is more appropriate model for Iranian companies to measure conservatism.

Givoly and Hayn (2000) propose a measure of conservatism that focuses on *nonoperating accruals* as a subset of the firm's book value. The rationale behind using negative accruals is that accounting conservatism uses the mechanism of accruals to defer the recognition of economic gains and accelerate the recognition of economic losses. Through such a process of delaying gains and accelerating losses, the level of accumulated accruals in a firm gradually becomes more and more negative.

Givoly and Hayn (2000) measure both operating and non-operating accruals. Using a sample of 896 firms. They show that the total cumulative nonoperating accruals for these sample firms decreased significantly in the sample period 1965 to 1998. However, they found that for the same period total operating accruals of these 896 firms had increased. On a net basis, the increases in operating accruals were not large enough to offset the decreases in non-operating accruals. Therefore, total accruals (operating plus non-operating accruals) decreased over the sample period. They argue that this trend of increasing negative accruals is a manifestation of increasingly higher degrees of accounting conservatism during the sample period.

One strength of the G&H measure is that it is a firm-specific measure of conservatism. Another strength is that G&H is generally easy to implement, as it does not require too many data items. Furthermore, the G&H measure is not market-based, which makes it more widely applicable than the market-based measures (Wang, 2009)

The rationale behind using negative accruals as a measure of accounting conservatism is that accounting conservatism uses the mechanism of accruals to defer the recognition of economic gains and accelerate the recognition of economic losses. Through the process of delaying gains and accelerating losses, the level of accumulated non-operating accruals in a firm gradually becomes more and more negative (Givoly and Hayn, 2000).

Other benefits that can be considered for this model, unlike models such as Basu (1997) or Feltham and Ohlson (1995), is not based - market and it's functional. As a result, this model can be for private companies and companies that their market prices are not available, were used or when there is uncertainty on the efficiency of the market (Wang, 2009). In summary, degree of conservatism calculated in this study:

$$CONS_{it} = (-1)\frac{NOACC_{\text{it}}}{TA_{\text{it}}}$$

$$NOACC_{\text{it}} = TACC_{it} - OPACC_{it}$$

$$TACC_{it} = (NI_{it} + DEP_{it}) - CFO_{it}$$

$$OPACC_{it} = \Delta(AR_{it} + I_{it} + OCA_{it}) - \Delta(AP_{it} + OCL_{it})$$

In this regard:

NOACC $_{it}$**:** Non-operating accruals of firm **i** in year **t**.
TA $_{it}$**:** The total assets of firm **i** in year **t**.
TACC $_{it}$**:** Total accruals of firm **i** in year **t** by the net income (NI) before depreciation calculated minus cash flows operating (CFO).
OPACC $_{it}$**:** Operation accruals of firm **i** in year **t** by changes in the accounts receivable (AR), Inventories (I) and other current assets (OCA) and the change in accounts payable (AP) and calculated other current liabilities (OCL).

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Givoly and Hayn (2000) argued that more negative non-operational accruals indicate more conservatism. Therefore, in this study above ratio multiplied by the -1 to say the above ratio is larger conservatism become more and the results of interpret the research may be more understood.

In panel 7 presented results F-Limer test for model's Givoly and Hayn (2000). F-Statistic and Prob, show the appropriate model used for Pool Data.

Panel 7: F-statistic and significance level of the F-Limer test

Effects Test	Statistic	d.f.	Prob.
Period F	1.637839	(11,1238)	0.0827
Period Chi-square	18.189797	11	0.0773

In panel 8 presented results of the model using Givoly and Hayn (2000).

Panel 8: Result of model using Givoly and Hayn

Variable	**Coefficient**	**Std. Error**	**T-Statistic**	**Prob.**
INST	-0.006824	0.016407	-0.415927	0.6775
BZ	-0.007736	0.017551	-0.440799	0.6594
INDEPENT	0.030683	0.027790	1.104109	0.2698
DUALITY	-0.020591	0.039595	-0.520051	0.6031
CEO	0.012704	0.014679	0.865435	0.3870
SIZE	0.067182	0.010230	6.566889	0.0000
LEVERAGE	0.001203	0.029747	0.040437	0.9678
ROA	0.185980	0.039165	4.748680	0.0000
OL	-0.071241	0.026551	-2.683201	0.0074
C	-0.428121	0.113477	-3.772764	0.0002

Weighted Statistics

R-squared	0.060286	Mean dependent var	-0.034512
Adjusted R-squared	0.053515	S.D. dependent var	0.299086
S.E. of regression	0.292542	Sum squared resid	106.8903
F-statistic	8.903132	Durbin-Watson stat	2.286710
Prob(F-statistic)	0.000000		

As is evident between corporate governance and conservatism model Givoly and Hayn (2000) observed no significant relationship. Hence the hypothesis using the conservatism model will be rejected.

Conclusions

Conservatism is one the main instrumentals in financial reporting that make use caution in the recognition and measurement of income and asset. Conservatism can be a tool for more efficient contracts and to limit tendency for opportunistic behavior of the managers is protected from outsider users. In addition conservatism can be protecting of Company and even independent auditors against lawsuits. Due to the asymmetric utility functions individual; that roots is in prospect Theory; and the possibility of opportunistic behavior accession, accounting conservatism could be appropriate tool to neutralize opportunistic behavior. On the other, appropriate corporate governance also provides mechanisms for the control of opportunistic behavior and provides efficient contract. This study examined the relationship between corporate governance and conservatism. In this regard, used conservatism model Feltham and Ohlson model (1995) and for supplementary test of the Givoly and Hayn model (2000). To investigate the relationship it used multivariate linear regression model. The Results of the survey of 146 companies listed in Tehran Stock Exchange during the period 2002 to 2012 (1259 firm-years) shown that there is no significant relationship between corporate governance and conservatism.

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