

The Relationship between Conditional Conservatism and Financial Crisis

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Abstract

Profit and loss invoice is the main accounting information. Investors pay the priority attention to net profit as the latest information item of profit and loss invoice. Conservatism has a great influence on investment and companies' financial crisis. The main purpose of this research is studying the relationship between conditional conservatism and financial crisis in accepted companies in Tehran Stock Exchange during time period of 2009 up to 2014. Statistical society is used by screening (omissive) model for selecting a sample which is studied in 122 companies. Current research methodology is applicative by aiming, its type is correlated, its model is panel data and for analysis by software of EVIEWS8. Also, obtained result by first subsidiary hypotheses represent a straight relationship between firm size and companies' financial crisis and second subsidiary hypotheses represent a straight relationship between financial leverage and companies' financial crisis. There is not a meaningful relationship between reserved cash fund and financial crisis in third subsidiary hypotheses. There is a meaningful relationship between sale growth and financial crisis in fourth subsidiary hypotheses. There is a straight and meaningful relationship between tangible properties and financial crisis in fifth subsidiary hypotheses. In sixth subsidiary hypotheses, there is a negative and meaningful relationship between growth opportunity and financial crisis.

Keywords: flow of free cash fund, functionality of profit prospect, corporative rule, firm size

1. Introduction

Conservatism is as an affective factor on accounting process for a long time which is adverted by experts. There is different evidence which indicates the existence of conservatism since a long time ago. Remained historical indications of commercial companies in Gregorian Year 15th century indicate accounting was conservative in medieval Europe (Basu, 1997). Also, Chaut Field believes that the basis of conservation is in medieval. At that time, fief master surrender their own estate to their steward to manage the estate. Soon steward found out that having a conservative situation is the preparation of protecting themselves. Asymmetric information between aware and unaware investors cause to create conservatism in financial invoices (LaFond, 2006).

In Statement of Financial Accounting (SFAC) number 2, Financial Accounting Standards Board (FASB) defined conservatism like this: warily reaction to uncertainty and indetermination in order to assurance of enough attention to uncertainty and available risks in commercial conditions and situations. But FASB and International Accounting Standards Board (IASB) have deleted conservatism from their conceptual framework in year 2010. The reason was objectivity in violation. FASB ratiocinated in conceptual framework draft of financial report that conservatism because to create asymmetric information, so, investor insights will reduce the future cash flows. Conversely, Kothari ratiocinate that wider economic outcomes of accounting standards has high importance, while, their role in stock assessment is in second importance (second class) (Kothari, 2009).

The current studies which register the dispute between conditional and unconditional conservatism, create a motivation for detailed study of accounting conservatism. Studies indicates a point that inherently conservatism appears conservative by accounting unconditionally form or by recognition good and bad news in time conditionally. Obtained documents indicate that conditional and unconditional conservatism play different role in contract conclusion, prescription, taxation, assessment and asymmetric information reduction and there is a negative (positive) correlation between them in short time (long time). Continuously, they suggest the auditors and supervisors mainly emphasize on unconditional conservatism. Lawsuit risk cause to stimulate both of them

and managers has more control on conditional conservatism at least in short time and prefer un-conservative operations for professional progress. Taken forecasts based on conservatism reduce further bankruptcy risk, in done current studies is confirmed in the field of cash improvement and information specifications. Specially, they induct that accounting conservatism reduce the output cash flows by reduction of high investing of investment, reduction of risk change, delay in forcing of economic losses, enhancing reserve and reduction of agent costs.

Forecast in financial crisis and companies bankruptcy has still been one of significant topics for investors, creditors and governments. It is needed in case of recognizing companies which are involving financial insolvency in time, because, it is possible to help by using appropriate exploitation from investing opportunities and better appropriation of resources. So, firstly, offering necessary warning, it would be possible to caution companies against financial insolvency so that considering the warning, would be able to do necessary action. Secondly, investors and creditors recognize appropriate investing opportunities from inappropriate opportunities and invest their resource in appropriate opportunities.

Conservatism in accounting is a kind of tool for efficient contracts (such as management premium contracts and debt) which allows reducing agent cost (Watts, 2003). Conservatism allows both financial health level and financial distress level to increase the available cash flow. When cash flow is not under the distress, it causes to prevent increasing agent costs so that the available cash flow will increase (Louis, 2009).

Conservatism directly do the role of increasing the available cash flow and indirectly do the role of information caused to reduction of cash investment, preventing investment with current low net value, devaluation of agent costs and enhancing reserve to reduce bankruptcy risk. Because, bankruptcy is a kind condition which there is not enough cash flow so import and export resources of a company is not enough for deal with corporate commitments (Givoly, 2007). Therefore, the necessity of the research would be appreciated strongly so we study about the relationship between conditional conservatism and financial crisis in accepted companies in this research.

One of the applicative purposes in this research is offering necessary evidence in order to answer the research questions. Also, the results can be used in accepted companies in stock exchange, investors, companies managers, Tehran Stock Exchange Organization, researchers and students.

2. Theoretical Background and Literature Review

In time of financial crisis, commercial department managers tend to indicate the corporate profit positively with the publication of good news such as recognizing profits which has still not realized (Biddle et al., 2010).

Watts believes that if corporate contracts will be adjusted to different groups such as investors, creditors based on accounting figures, company managers will try to manipulate the figures with self-interest with doing tendentious manners because of the existence of interests among managers and those groups. For example, it will increase profits and properties and will reduce debts. In this case, conservatism counteracts manager tendentious manners as an effective contract mechanism by postponing in recognition of profit, property and recognition of loss and debt, too (Watts, 2003).

Cataclysm of current financial disgraces in the world from Enron and WorldCom in America till parliament in Europe is caused to be accused the financial reporters. Financial invoices and profit and loss invoices (net profit figure) is in the priority of investors. In recent years, topic of reported profit quality is more significant for researchers. Conservatism is one of the features in profit quality, it means whatever profit conservatism is further, and its quality would be higher (Dechow, 2009).

Basu in year 1997 defines conditional and unconditional conservatism like this. "Conservatism means necessary and different susceptibility for recognition of earnings and costs which leads to understatement in profit and properties." This definition indicates conditional conservatism.

In recent researches, conservatism is divided in two categories: first, subsequent method conservatism which is independent of news and is named unconditional conservatism. Arrival method is some kinds of accounting standards which reduce the profit like independent of current economic news. For example, identification of advertising and research costs and also cost development in real time, even, having positive expectation in future cash flows are in this category.

Lin and colleagues in year 2014, was studied about the relationship between accounting conservatism, characteristic investors and manipulation in profit in their research and they concluded that great companies have conservative financial reportage. There is lower possibility to manipulate in profit. Also, there is an inverted relationship between profit management and characteristic investors stock. In this case, although financial

invoices of great companies tend to conservatism, characteristic investors stock can create the motivation to managers in order to increase the profit management.

Bigellia and colleagues in year 2014 studied about financial conservatism in private firms. In this research they selected a sample of 21959 Italian companies for year 1998-2006 which is according to main hypotheses of investment structure and financial providing in order to find financial conservatism in these firms. The research results indicate private firms which are conservative; they have more intangible properties, less tangible properties and less effective fiscal rate. Moreover, the results show conservative firms launch to increase cash fund and financial leverage before investing.

Francis and colleagues in year 2013 studied of accounting conservatism advantages to stockholders based on evidence of financial crisis in their research and they conclude there are meaningful and positive relationship between conservatism and firm value along current crisis.

Bikki Jaggi and Hua Xin in year 2013 in research of conservative accounting and forecasted profit management expressed the conservatism cannot be used as a replacement for all forecasted profit managements. Instead, it would be as a replacement for informative forecasts, not for opportunistic forecasts. Moreover, conservatism acts as a replacement for forecasted profit managements less than analysts. Also, it is reported that managing affairs firms play a significant role in selecting between conservatism and forecasted profit management in order to reduce asymmetric information. Firms with efficient power prefer the conservatism.

Watts and Zhu in year 2012 have studied about the relationship between accounting conservatism and commercial departments' value in financial crisis time in their research. They found out the firms which have further accounting conservatism, their stock negative efficiency is less so that they have borrowing ability and more investment. The research conclude that there a positive relationship between accounting conservatism and stock efficiency when brokerage costs will increase.

Vichitsarawong and Eng in year 2010 have studied about the effects of Asia financial crisis in conservatism and in time profit based on documents and evidence by Hong Kong, Malaysia, Singapore and Thailand in their research. They have concluded the conservatism level was low in financial crisis of 1997 in countries Hong Kong, Malaysia, Singapore and Thailand. So, managers would like to give good news as soon as possible and give bad news with delay. The result of their research indicated using conservatism after Asia financial crisis will be increased. The result was mentioned using conservatism or accounting conservative process is useful after financial crisis period.

Kousenidis and colleagues in year 2009 have studied about the effect of conservatism and lack of conservatism on accounting information value in their research and obtained to a nonlinear relationship between the conservatism level and value of net profit information in accepted firms in exchange organization. They also obtained the conservatism measurement by Basu model and information measurement by efficiency regression and profit. They concluded if profits will be with high or low conservatism, the information would be low.

Casy and Bartczak in year 1985 in their research used operating cash flow data to predict financial distress. The results indicated operative cash flow cannot predict extra rather than commitment ratios. Instead, they showed that not considering to ratios of cash flow was inappropriate in bankruptcy research by Altman and the others. In this research, two kinds of ratios will be used; first, cash fund is the result of operations with current debt. Second, cash fund is the result of operations with total debts.

William Beaver in year 1966 was the first person who his research concludes to establish a model to predict bankruptcy. He used financial ratios as predictors of failure by univariate analysis. Beaver defined firms' disability to do its financial commitments as financial bankruptcy. He believed that failure to pay the outstanding stock profit, disability in paying bond, exorbitant draft compared to the bank account caused to firms' financial failure.

3. Research Hypotheses

3.1 Main Hypotheses

There is a meaningful relationship between conditional conservatism and financial crisis.

3.2 Subsidiary Hypotheses

1. There is a meaningful relationship between firm size and financial crisis.
2. There is a meaningful relationship between financial leverage and financial crisis.
3. There is a meaningful relationship between reserved cash fund and financial crisis.

4. There is a meaningful relationship between sale growth and financial crisis.
5. There is a meaningful relationship between tangible properties and financial crisis.
6. There is a meaningful relationship between growth opportunity and financial crisis.

4. Research Methodology

Since we are finding a meaningful relationship between research variables in this research, study about dependant and independent variables which is in correlative researches category. So, research methodology in view of nature and content is a kind of correlation which acts like after-event methodology to find out correlation between variables.

Studying this research is in the inductive and deductive framework. It means that theoretical background and literature review are in the deductive format by library studies, articles and sites and in the inductive format by gathering data to confirm or reject the hypotheses.

In any researches, gathering real data have a high importance according to their purposes. In this research, we can use the library methodology with helping books, Persian and Latin articles and thesis in order to study the theoretical background and literature review. Then, research data will be extracted by gathering data of selected companies refer to audited financial invoices, explanatory notes, annually reports of stock exchange by new gift software, scheme maker refer to Kadal site and Iran Financial Data Processing Center.

Needed real data in this research will be gathered by real information of firms in Tehran Stock Exchange. In this research we will act like Kokran formula for sample volume determination based on below criterion:

1. According to demand information from year 2009, the companies which are accepted in Tehran Stock Exchange the maximum up to the end of Esfand 2009 and their names should not be eliminate till the end of year 2014 from the mentioned firms list.
2. Financial period should be leading to 29th Esfand with increasing the comparability.
3. It should not have fiscal year change during studied period.
4. Balance sheet should be at least in consecutive three years including cash properties.
5. Their stock should be in transacted exchange actively in the mentioned period.

According to the conditions and mentioned limitations, totally 122 companies are selected as research statistical sample among all accepted companies in Tehran Stock Exchange.

5. Research Variables and Model

5.1 Research Model

Research model in this research is as below for statistical hypotheses test:

$$\text{Financial Crisis}_{i,t} = \alpha + \beta_1 \text{conservation}_{i,t} + \beta_2 \text{size}_{i,t} + \beta_3 \text{leverage}_{i,t} + \beta_4 \text{cashholding}_{i,t} + \beta_5 \text{salesgrowth}_{i,t} + \beta_6 \text{Tangibility}_{i,t} + \beta_7 \text{M/B}_{i,t} + \varepsilon_{i,t}$$

Financial crisis: in firms

Conservation: conditional

Size: firm

Leverage: financial

Cash holding: reserved

Sale growth

Tangibility: property

M/B: growth opportunity

β : value relationship of any variables

5.2 Research Variables

5.2.1 Financial Crisis

Financial crisis is the situation which financial institution or financial properties loss their value greatly at once. We will use Altman Model (1983) for measuring financial crisis in this research.

5.3 Conditional Conservatism

Good news (data which is indicated future profit increasing) identify later than bad news (data which is indicated future profit reduction) in financial invoices. We will use Watts and Khan Models (1983) for measuring financial crisis in this research.

5.4 Firm Size

It means natural logarithm of total properties.

5.4.1 Financial Leverage

Financial leverage is an amount of debt which a firm accepts for buying more properties. It obtains from total debts to total properties.

5.4.2 Reserved Cash Fund

It is calculated by division of cash fund and its equivalent to total firm properties.

5.4.3 Sale Growth

It is calculated by the difference of current year sale and last year sale to last year sale.

5.4.4 Tangible Properties

It is obtained by sum of stable property to total properties.

5.4.5 Growth Opportunity

Growth opportunities are tantamount with market value ratio to stock owners' law book value.

6. Results

6.1 Test Results of Research Hypotheses

Main Hypotheses: There is a meaningful relationship between conditional conservatism and financial crisis.

In order to the test, this hypothesis is interested by offered model estimate results. Odds amount (or meaningful level) F is equal to zero. Since the level is less than 0.05, zero assumption will be rejected in assurance level of %95, it means meaningful model. Method amount of Watson's camera is 1.885. So, this amount indicates the absence of correlation. Determined factor described around %23 of variable changes depend on via independent variables and model control.

Totally, the result indicates that criterion variable factor of conditional conservatism is minus 0.002833 which is indicated conditional conservatism negative effect on firms financial crisis so according to the method (t), criterion variable factor of conditional conservatism is meaningful. According to above cases, we can name research main hypotheses as confirmed one. It means that there is meaningful and negative relationship between conditional conservatism and financial crisis, in other words, if conditional conservatism will be increased, firm financial crisis level will be decreased. Obtained result of first hypotheses is adjusted to Biddle and colleague's research (2013) by meaningful relationship while it is conflicted with Francis and colleague's research (2013) by correlation type. (Directly or on the contrary)

Table 1. Research model estimation result

$$\text{Financial Crisis}_{i,t} = \alpha + \beta_1 \text{conservation}_{i,t} + \beta_2 \text{size}_{i,t} + \beta_3 \text{leverage}_{i,t} + \beta_4 \text{cashholding}_{i,t} + \beta_5 \text{salesgrowth}_{i,t} + \beta_6 \text{Tangibility}_{i,t} + \beta_7 M/B_{i,t} + \varepsilon_{i,t}$$

variables	Estimate Factor	Standard Error	Method (t)	Supposition
C	-11.19207	0.380315	-29.42840	0.0000
conditional conservatism criterion	-0.002833	0.003260	-0.869109	0.0038
firm size	0.542168	0.023646	22.92899	0.0000
financial leverage	2.735646	0.292198	9.362287	0.0000
reserved cash fund	0.685260	1.921823	0.356568	0.7215
sale growth	-1.359034	0.356557	-3.811550	0.0002
tangible properties	1.570931	0.515751	3.045913	0.0024
growth opportunity	-0.278559	0.076358	-3.648041	0.0003

determination factor	0.235
Damping determination factor	0.226
camera- Watson	1.885
method F	27.5311
odds (method F)	0.0000

6.2 Discussion and Conclusion

Forecasting financial crisis and firms' bankruptcy is still one of the significant cases for investors, creditors and governments.

Data asymmetry among conscious and unconscious investors in a firm cause to emerge conservatism in financial invoices (Lafond, 2006).

Accounting conservatism cause to increase liquidity, net properties and net profit in both wholesome firms and firms which are in financial crisis. In this case, it will be prevented to progress the crisis and bankruptcy (Zang, 2008).

The main purpose of this research is studying about the relationship between conditional conservatism and financial crisis in accepted firms in Tehran Stock Exchange during time period of 2009 up to 2014. Statistical society is used by screening (omissive) model for selecting a sample which is studied in 122 companies. Current research methodology is applicative by aiming, its type is correlated, its model is panel data and for analysis by software of EVIEWS8.

6.3 Test Results of Research First Subsidiary Hypotheses

There is a meaningful relationship between firm size and financial crisis. In factors meaningful study according to offered results in the table, since there is possibility of method (t) would be less than 0.05 for factor of firm size variable, as a result, it will be confirmed existence of meaningful relationship between firm size and financial crisis in assurance level 95%. So, with research first subsidiary hypotheses of the accepted research and with assurance 95%, we can say there is a meaningful relationship between firm size and financial crisis. Being positive for the ratio of variable (0.542168) represents the existence of a straight relationship between firm size and financial crisis. It means that there is a meaningful and positive relationship. In the other words, if firm size increases, firms' financial crisis level will increase, too. Obtained result of the research by first subsidiary hypotheses is adjusted with result of the research by Francis and colleagues (2013) while, it is conflict by correlation type. (Directly or on the contrary)

6.4 Test Results of Research Second Subsidiary Hypotheses

There is a meaningful relationship between financial leverage and financial crisis. In factors meaningful study according to offered results in the table, since there is possibility of method (t) would be less than 0.05 for factor of financial leverage variable, as a result, it will be confirmed existence of meaningful relationship between financial leverage and financial crisis in assurance level 95%. So, with research second subsidiary hypotheses of the accepted research and with assurance 95%, we can say there is a meaningful relationship between financial leverage and financial crisis. Being positive for the ratio of variable (2.7356462) represents the existence of a straight relationship between financial leverage and firms' financial crisis. It means that there is a meaningful and positive relationship between financial leverage and financial crisis. In the other words, if financial leverage increases, firms' financial crisis level will increase, too. Obtained result of the research by second subsidiary hypotheses is adjusted with result of the research by Francis and colleagues (2013), Hong and colleagues (2011) while, it is conflict by correlation type (Directly or on the contrary).

6.5 Test Results of Research Third Subsidiary Hypotheses

There is a meaningful relationship between reserved cash fund and financial crisis. In factors meaningful study according to offered results in the table, since there is possibility of method (t) would be more than 0.05 for factor of financial leverage variable, as a result, it will not be confirmed existence of meaningful relationship between financial leverage and financial crisis in assurance level 95%. So, with research third subsidiary hypotheses of the accepted research and with no accepted assurance 95%, we can say there is not a meaningful relationship between financial leverage and financial crisis. According to above information, we cannot confirm the research third subsidiary hypotheses. It means that there is a meaningful relationship between reserved cash fund and financial crisis. Obtained result of the research by third subsidiary hypotheses is conflicted with result of the research by Francis and colleagues (2013).

6.6 Test Results of Research Forth Subsidiary Hypotheses

There is a meaningful relationship between sale growth and financial crisis. In factors meaningful study according to offered results in the table (5-4), since there is possibility of method (t) would be less than 0.05 for factor of sale growth variable, as a result, it will be confirmed existence of meaningful relationship between sale growth and financial crisis in assurance level 95%. So, with research forth subsidiary hypotheses of the accepted research and with assurance 95%, we can say there is a meaningful relationship between sale growth and financial crisis. Being negative for the ratio of variable (-1.359034) represents the existence of a reverse relationship between sale growth and firms' financial crisis. It means that there is a negative and meaningful relationship between sale growth and financial crisis. In the other words, if sale growth increases, firms' financial crisis level will decrease. Obtained result of the research by forth subsidiary hypotheses is adjusted with result of the research by Francis and colleagues (2013), Bigdeli and colleagues (1390).

6.7 Test Results of Research Fifth Subsidiary Hypotheses

There is a meaningful relationship between tangible properties and financial crisis. In factors meaningful study according to offered results in the table, since there is possibility of method (t) would be less than 0.05 for factor of tangible properties variable, as a result, it will be confirmed existence of meaningful relationship between tangible properties and financial crisis in assurance level 95%. So, with research fifth subsidiary hypotheses of the accepted research and with assurance 95%, we can say there is a meaningful relationship between tangible properties and financial crisis. Being positive for the ratio of variable (1.570931) represents the existence of a straight relationship between tangible properties and firms' financial crisis. It means that there is a straight and meaningful relationship between tangible properties and financial crisis. In the other words, if tangible properties increase, firms' financial crisis level will decrease, too. Obtained result of the research by fifth subsidiary hypotheses is adjusted with result of the research by Francis and colleagues (2013).

6.8 Test Results of Research Sixth Subsidiary Hypotheses

There is a meaningful relationship between growth opportunity and financial crisis. In factors meaningful study according to offered results in the table, since there is possibility of method (t) would be less than 0.05 for factor of growth opportunity variable, as a result, it will be confirmed existence of meaningful relationship between growth opportunity and financial crisis in assurance level 95%. So, with research sixth subsidiary hypotheses of the accepted research and with assurance 95%, we can say there is a meaningful relationship between growth opportunity and financial crisis. Being negative for the ratio of variable (-0.278559) represents the existence of a reverse relationship between growth opportunity and firms' financial crisis. It means that there is a negative and meaningful relationship between growth opportunity and financial crisis. In the other words, if growth opportunity increases, firms' financial crisis level will decrease, too. Obtained result of the research by sixth subsidiary hypotheses is adjusted with result of the research by Francis and colleagues (2013).

6.9 Suggestion Based on Research Result

Using obtained results of the research main hypotheses (There is a meaningful relationship between conditional conservatism and financial crisis), Stock Exchange Organization can publish more comprehensive information about the relationship between conditional conservatism and financial crisis and more detailed information for stockholders and investors according to the research results and similar researches. Moreover, investors, financial analysts and stockholders can take appropriate decisions for investment with using the research results.

1. Study of the relationship between how to sort the firms machinery and financial crisis
2. Study of the relationship between financial providing and financial crisis
3. Study of the relationship between fund flow and financial crisis
4. Study of the relationship between cash fund flow invoice and financial crisis
5. Study of the relationship between current properties and financial crisis
6. Study of the relationship between earning growth and financial crisis

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