

Do Stewardship and Accounting Conservatism Have A Role in Financial Reporting in Emerging Markets? Evidence from Iranian Accountants' Perceptions

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ABSTRACT

This study attempts to find out the Iranian Association of Certified Public Accountants' (AICPA) perception about the importance of accounting conservatism and management stewardship in the financial reporting. The results of the study show that IACPA's believe that stewardship should be kept as a separate objective in the conceptual framework of the financial reporting. Also conservatism should not be eliminated from the qualitative characteristics of the conceptual framework. The IACPA's think that the setting of international financial reporting standards (IFRS) is influenced by the political environment of developed countries and the convergence of IFRS would influence the wealth-distribution between different firms and different countries. They believe that standard setters don't consider the different economic environment of the countries in setting the standards. It is argued that, it is important to reconsider the objectives of financial reporting and to evaluate its current development.

KEY WORDS: Accounting Conservatism, Stewardship, IFRS, IACPA.

1. INTRODUCTION

Globalization is the process of eliminating all barriers so that countries appear as if they were one integrated country. In line with globalization, International accounting standards board (IASB) and financial accounting standards board (FASB) are conducting a joint project to develop a set of converged standards to use in the whole world. The purpose of the convergence is to develop a common set of accounting standards that is called International Financial reporting standards (IFRS). For this purpose, the IASB and FASB published a discussion paper titled "Preliminary Views on an improved Conceptual Framework for Financial Reporting" in 2006. In this discussion paper stewardship has been omitted from the objectives of financial reporting and decision usefulness is the only objective of financial reporting. This change has been made with the aim of providing information that is useful for potential and present users in making investment, credit and similar resource allocation decisions. Conservatism has also been eliminated from qualitative characteristics of the conceptual framework. Opponents claimed that IASB and FASB as accounting standard-setters intend to use fair values more pervasively and the historical cost principle has been abandoned. The primary use of information in financial reports is for investment decisions (equity and debt); stewardship is mentioned, but almost in passing. Information useful for stewardship purposes may or may not be useful for valuation purposes and vice versa (Benston et al. 2007).

So far, there has been mixed reviews about the negative consequences of IFRS. Proponents of IFRS's believe that standards that are set by two strong boards (FASB and IASB) would have high quality and the convergence of a set of high quality standards will increase transparency and comparability for optimal allocation of resources (Barth et al., 2008). On the other hand, the opponents believe that an IFRS monopoly eliminates the opportunity to compare alternative practices and learn from them. It also disallows the tailoring of financial reporting to local variations in economic, business, commercial, legal, auditing, regulatory, and governance conditions across the globe (Sunder, 2011).

The primary and main question of this study is whether stewardship and accounting conservatism are beneficial attributes from a professional point of view of the Iranian AICPA. Iran, as a country has some distinct attributes relevant to harmonization and global convergence issues, which include a big economy in Middle East. Iran's experience in adopting and implementing global accounting standards is likely to influence other developing countries. We focus on accountants perceptions because they use accounting standards to prepare and audit a set of financial statements for users. Emphasis on accountants perceptions about characteristics of accounting standards is consistent with the FASB's conceptual framework for financial reporting. According to the Statement of Financial accounting Concepts (SFAC No.1, FASB 1978), "financial statements are often audited by independent accountants for the purpose of enhancing confidence in their reliability."

A key distinction between our study and other, is the differences in the research design. Our research is basic research. The main motivation and purpose of our study is to contribute to the accounting literature on international accounting standard-setting by presenting the foundations for setting accounting standards in an emerging economy. The results of the study can also help the standard setters of developing countries in understanding and setting the accounting standards. The rest of this paper contains a brief summary of the relevant literatures and the development of questions and research method is described before analyzing and discussing the results.

2.LITERATURE REVIEW

Watts (2003) believed that if the firm contracts with various groups such as investors and creditors are adjusted based on accounting figures, due to conflicts of benefits between its managers and group, managers will try to manipulate the figures through bias behavior to their own benefits. He believes that accounting conservatism, by delaying the recognition of net income and net assets, reduces cash payment for performance-based compensation, taxation and dividends. He presents arguments that the accounting conservatism is still very significant in improving financial reporting; and accounting conservatism is an effective mechanism to limit biased behavior of the managers through delay recognition of income and assets, and timely recognition of losses and debt. In fact, conservatism can limit management's opportunistic behavior in reporting accounting measures used in a contract. This prevents the cash outflows by the form of dividend and company tax-and increases the firm's value in long term. The existence of accounting conservatism reduces the management's incentives and ability of manipulating accounting numbers and so reduces information asymmetry between management and shareholders. Consequently, earnings quality should be increased with the decreased earnings management (Basu, 1997; LaFond & Watts, 2008).

Ahmed and et al.(2002) confirmed their findings and showed that large firms used more conservative accounting methods than other firms. Their results also showed that firms facing more severe conflicts over dividend policy tend to use more conservative accounting. Their evidence is consistent with the notion that accounting conservatism plays an important role in mitigating bondholder-shareholder conflicted over dividend policy and in reducing firms' debt costs. Biddle et al. examined relations between accounting conservatism and bankruptcy risk. They found accounting conservatism to be negatively associated with bankruptcy risk. They also found that bankruptcy risk associates positively with accounting conservatism. They believe that their findings will help to inform continuing deliberations regarding conservatism's ongoing role as an important principle of financial accounting.

Beatty et al (2008) studied the impact of accounting conservatism on debt contracts. They showed that if a firm is not conservative enough from the lenders point of view than contract modifications meet their demands for conservative financial reporting. Li(2009) investigated association between accounting conservatism and the cost of capital and found that a higher level of conservatism in the financial reporting system of a country reduces the cost of equity and debt.

Raghavan and Zampelli(2010) investigated the relationship between conservative accounting practices and the sensitivity of executive pay to accounting performance. They estimated an econometric model of CEO compensation that incorporated the interaction of accounting conservatism and accounting performance. Consistent with optimal contracting theory, they found that the sensitivity of executive pay to accounting performance was higher for firms that report conservative accounting earnings. These findings supported the hypothesis that accounting conservatism, by limiting earnings management opportunities and improving the reliability of accounting performance measures, allows firms to formulate contracts that tie executive compensation more closely to accounting performance.

Whittington (2008) critically argues that IASB has replaced decision usefulness view with the view of stewardship. The change can have considerable effect on decisions about IASB's framework and standards. Thus, based on this change, concept of representational faithfulness has been replaced with the prior concept, reliability. In fact, the former concept assumes that financial reporting should present suitable information about the monitoring role of principal, but the latter concept focuses on which information is appropriate for decision making. Also, prudence has been excluded from the new framework of IASB. He believes some challenges have happened after the aforementioned amendments in IASB's framework. Due to the removal of reliability from the fundamental qualitative characteristics, the reliable measurement criterion conflicts with the new framework. Although reliability has been removed from the qualitative characteristics, IASB still apply reliable measurement criterion in its new standards. IASB has assumed that the acquired intangibles are reliably measurable. Stewardship view makes a filter to provide reliable information, whereas decision usefulness view might include any information which is value relevant, however unreliable.

Mihai and et al (2012) modeled the cost of equity capital as the expected return on the intrinsic value of a share, and computed it based on pre- and post-adoption samples. They find a decrease in the cost of equity capital as a beneficial result of IFRS adoption.

Fatih Dalkılıç and Limoncuoğlu(2011) study Turkish companies which have started to prepare their financial statements according to International Financial Reporting Standards (IFRS) since 2005. They say that the type and content of the information that will be disclosed in footnotes is not determined and a room left for professional judgment. The ISE (Istanbul Stock Exchange) Company cases presented in the study shows a significant discrepancy among disclosure policies related to footnotes. The ISE companies have a common problem about footnote disclosure policy; they are far behind from explaining the company specific circumstances, away from explaining the TAS 1 disclosure requirements and again away from giving comparable information. According to their view companies need to be guided through preparing their footnote disclosures and such a basic guidance can be prepared by TASB. Disclosing the coverage of ongoing court processes, opinions of experts and possible negative effects in case of losing files will be adequate for financial statement users.

Chan and et al. (2010) argue that one of the issues raised is that the IFRS are fair value based, and in some instances, recognizes unrealized gains and thus, include them in the income statement. They highlight the importance to resolve the issue on the size of profit which may be legally distributed to shareholders as dividend. As the IFRS treats the unrealized gains as income, a company may declare and pay cash dividend from the gains. It is immaterial that such gains may be “temporary” and may be reversed in the following financial year due to a change in the business environment. It is also immaterial that the company does not have ready cash to pay, for it can obtain cash through debt for the purpose of enriching its shareholders at the expense of its creditors.

Many studies have confirmed that there is a pressure from various groups such as, government, society, investors, the large multinational firms and big audit firms to develop their favorite accounting standards over accounting standards boards. Konigsgruber (2010) points out that IASB like FASB faces considerable political pressure to prescribe specific accounting policies and impose additional disclosure requirements. Obviously, standard setters, big eight countries, have considerable political pressures on IASB. It is possible that some pressures impede the IASB attempts to develop a high level quality standards. Indeed, the standard setters have the power to decide whether the new standards must be developed. Also, the compiling process of IFRS by IASB indicates that the process is fully political because the Accounting Regulatory Committee (ARC) which is comprised by civil servants from national ministers, European Parliament and Commission has veto to accept or reject new standards.

Larson and Kenny (2011) consider the financing system of IASB. They investigate the dependent of IASB to its voluntary donors and note that whether IASB can develop IFRS independently whereas it is possible that the donors involve in the standards setting process. One-quarter of IASB’s total donation and comment letters is from Big Four audit firms. Thus, they involve indisputably in IFRS developments and have so much influence. Vakili and Banihashemi(2009), critiqued globalization of accounting standards from a theoretical point of view. They concluded that developing common accounting standards for all of the world is a political issue that have been imposed by U.S accounting regulators and U.S economy environment will be a winner in this process.

Saghafi and Ebrahimi(2009), investigated relation between accounting standards and accounting information quality in Iran. They confirmed that implementation of international accounting standards have been improved some of the attributes of accounting information quality such as earnings persistency.

Mashayekh and Amini(2010), found that use of accounting standards has been increased earnings management in Tehran Stock Exchange listed firms, but value relevance of accounting figures such as earnings has been decreased.

Mashayekhi and et al. (2010), examined the effect of accounting conservatism on earnings persistence and earnings distribution in Tehran Stock Exchange listed firms. They showed a negative relation between accounting conservatism and earnings distribution. They also concluded that accounting conservatism could not predict more conservatism earnings.

3.research questions

Given the findings from last studies, the research questions are as follows:

- 1) Do you agree that stewardship should be kept as a separate objective of financial reporting?
- 2) Do you agree that conservatism is a desirable qualitative characteristic in financial reporting?
- 3) Do you agree that standard setters do not consider the different economic environment of the countries in standard setting?

4) Do you agree that the convergence of accounting standards would influence the wealth-distribution between different firms and different countries? 5) Do you agree that development of IFRS is influenced by the political environment of developed countries?/

5)What is the effect of the political environment of developed countries on the development of IFRS?

4.RESEARCH METHODOLOGY

Our research methodology is basic research. Basic research is driven by a researcher's interest in a scientific question. The main motivation is to expand man's knowledge , not to create or invent something. In other words, the main purpose of basic research is to help applied research to understand foundations of science. A survey was used to collect the responses of questions. The target population was Iranian CPAs, including practitioners in both public and private auditing firms. To the extent possible, we sought to select a sample that was representative of this population. A sample of approximately 400 professional accountants was chosen from the membership listings of Iranian Association of Certified Public Accountants (IACPA) and each practitioner was distributed a questionnaire. We have used a five-point Likert scale questionnaire to measure responses. Responses ranged from “strongly disagree=1 ” to “strongly agree=5,” with five total answer options. 183 questionnaire(45.75 percent) were returned. Data analysis conducted by T-Test analysis .

5.RESEARCH FINDINGS

5.1 Descriptive Statistics

Descriptive statistics of this research is given in Table 1 and 2. Table 1 shows Descriptive statistics educational degrees and Table 2 shows experience of respondents. Table 1 shows that 56 percent of the respondents had BA, 40 percent had MA and 4 percent Ph.D degrees. Table 2 show that the working experience of 9 percent of the respondents was under 5 years, 34 percent of them 5-10 years, 21 percent 10- 15 years and 36 percent had above 15 years experience.

Table 1. Educational Degrees of Respondents

Degree	Number	Percent
BA	103	56%
MA	73	40%
Ph.D	7	4%
Total	183	100%

Table 2 . Work Experience of Respondents

Experience	Number	Percent
Less than 5 years	16	9%
5- 10 years	62	34%
10-15 years	38	21%
More than 15 years	67	36%
Total	183	100%

5.2 RESULTS

The result of testing the responses is shown in table 3.

Table 3 . T- tests results of responses

Questions	Mean	Median	Std. Deviation	T-Statistic	Significance Level
1	3.14	2.78	1.21	2.27	0.026
2	2.7	2.41	1.13	5.11	0.000
3	3.47	3.23	1.09	8.000	0.000
4	3.88	3.71	1.05	12.03	0.000
5	3.43	3.35	0.988	5.48	0.000

6. Limitations of the study

There is some possibility that some respondents might have a bias toward providing average or non-committal answers to the questions in questionnaire. Because surveys collect data at a single point in time, it is difficult to expand results at different points in time, because population is changing.

7.summary and conclusions

The accounting standard setting process is a political process and this could raise negative consequences. In developing countries, due to the lack of a strong standard setting body, the standards are harmonized with international standards without considering their negative consequences. There have been a lot of researches about IFRS and its consequences but a lot of them have been done in the developed countries. Therefore, the environment of the developed countries has been considered in these researches. This study has attempted to report Iranian accountant's perceptions on eliminating stewardship from objectives and omitting stewardship from the qualitative characteristics of financial reporting.

The results of the study shows that IACPA's believe that stewardship should be kept as a separate objective of financial reporting in the conceptual framework. Also omitting conservatism from the qualitative characteristics of the conceptual framework on one hand and using fair value as a preferred measurement basis on the other would have unfavorable negative economic consequences. The IACPA's think that the setting of IFRS is influenced by the political environment of developed countries and the convergence of IFRS would influence the wealth-distribution between different firms and different countries. They think that standard setters don't consider the different economic environment of the countries in developing IFRS.

Since most studies on globalization of accounting standards are conducted in advanced capital market such as U.S.A and Europe, this research contributes the literature on IFRS with survey information on a developing country. Iran has a big economy in Middle East. Iran's experience in adopting and implementing global accounting standards is likely to influence other developing countries. Therefore, the results of this study can help to improve the quality of accounting standards and decrease the negative economic consequences of new accounting standards set by the national accounting standards bodies in any developing country. The evidence can also help accounting policy makers by identifying the information items valued by accounting profession and the main concerns on accounting information in developing countries. The outcomes of this research are sufficiently interesting to warrant an extension to other emerging economies particularly those in the Middle East region that have a similar social and economic environment.

8.suggestions of the study

The result of the research suggests that standard setting body of IFRS should consider the views of all of the countries and constituents and set the standards with regard to the economic and cultural environment to decrease the unfavorable negative consequences of the standard. The authors think that the existence of two sets of standards, national and international standards would increase the competitiveness of the standard bodies and lead to a high quality set of standards.

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