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RELATIONSHIP BETWEEN CONSERVATISM AND INCOME SMOOTHING

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Abstract

In researching this article, the relationship between conservatism as one of the qualitative characteristics of accounting information and income smoothing discuss and try to answer this question is that, if firms bankrupt the smoothing action figures profit as compared to the non-bankrupt firms have more conservative behavior in financial reporting?

Keyword: Income smoothing, conservative, bankrupt companies, profit and loss

JEL Classification: M41

I. Introduction

The growing size and complexity of their growing economic activity on the one hand and the need for accurate information regarding the accounting and financial reporting on the other hand, leads to important institutional changes in thinking and theories of accounting and the rise analytical methods and modern management accounting is. One of the most important changes in emphasis and attention gains and losses that were previously on the balance sheet, which was leading to something called earnings management. Earnings management as a conscious process steps within accepted accounting principles for a profit report the level of interest is defined. Reported operating profit close to the target profit level through accounting manipulation is performed. One of the purposes of manipulation, income smoothing is reported. Therefore, income

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smoothing can be considered part of earnings management through accounting manipulations to do that can have a significant impact on the quality of financial reporting.

On the other hand, conservative financial reporting is a common characteristic, can be understood as an approach to lack of confidence in the financial reporting process as challenges, which, however, does not stand in accounting principles, but can have a significant impact on the valuation of assets and the determination of net income. Terms conservatism this concept is often used in accounting for assets and liabilities and revenues and for the least amount possible fees may be paid to the report. Conservatism also means that should cost as much as possible later (or earlier) were identified. Hence, the assumption is that much better than pessimism in financial reporting optimism. The International accounting standards board's conceptual framework (IASB), as defined conservatism that "should not overstate assets and liabilities and revenues and expenses is shown below."The board theoretical framework discussed above, suggests that conservative than the show deliberately overstating income and assets and liabilities and costs also does not permit the deliberate will, because in this case, the objective of financial statements is not the reliability and quality would not be proper. Therefore, earnings management due to lower revenues from the show deliberately and intentionally overstating the cost can be an apt description of conservatism (Manuel et al., 2005). Cohen et al (Kohen et al., 2007), a study of earnings management after Sarbynz Oxley Act (SOX) concluded that the level of earnings management after the application of the law is reduced. They also found that in the course of applying the law of real earnings management has increased, while Zhou and Beet in 2006, found in his research, companies that provide a conservative financial reporting could have more earnings management behaviour. The Zhou, the companies that provide a conservative financial reporting, pay less earnings management (Zhou, 2008). Since the concepts of accounting conservatism and smoothing different applications for financial reporting, and each one can be alone significant impact on the quality of financial reporting and thus market efficiency investment behaviour of investors, creditors, analysts and the general users of financial statements have, therefore, concluded that the study the relationship between these two components useful step toward completing the literature on the economic environment of the capital market in Iran.

Since previous research has been approved by the directors of insolvent companies during bankruptcy to protect themselves in the capital markets to smooth

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income figures are, therefore, the following question in mind that the researcher led to research on the relationship between conservatism and income smoothing component of bankrupt companies were active in Tehran stock exchange. Is bankrupt companies that act to smooth the profit figures (losses) are compared to the non-bankrupt companies, a more conservative behaviour in financial reporting?

II. Measure of conservatism

According to Gregory and liquids (Gregoriou & Skerratt, 2007), introduction of accrual accounting provides a context for applying conservatism. For example, conservative application requires to store inventory or investment losses, depreciation factor. The identification of these losses and reserves associated with reduced profit accounting, but no effect on cash flows. So naturally items and cash flows should be applied to the conservative influence. Gyvly and Hine (Givoly & H ayn, 2000), focusing on a specific definition, non-operational accruals (optional) for were used to measure conservatism.

As described above, when the identification and reporting conservatism events the first applies to financial management and inevitably faced with ambiguity and uncertainty of selecting a choice between two or multiple choice, and second, how to select and run the lowest possible lead to retained earnings. Gyvly and Hine because of accruals and discretionary (non-operational) that on the one hand, accrual accounting conduit for applying conservative and on the other hand, the power exercised by the directors in the absence of certainty, about the rise of conservatism provides. Total accruals and discretionary accruals (non-operational) is calculated as follows:

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

$OACC_{it} = \Delta (AR_{it} + I_{it} + P_{it}) - \Delta (AP_{it} + TP_{it})$

$NOACC_{it} = ACC_{it} - OACC_{it}$

ACC = total accruals

I = Inventories

NI = net Income before extraordinary items

AR = accounts receivable

DEP = depreciation

P = advance

CFO = operating cash flow

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AP = accounts Payable
OACC = operating accruals
TP = taxes payable
NOACC = (non-operational accruals (optional

Gyvly and Hine results from each year that passed, non-operational accruals from the previous year were significantly negative (smaller) is. Accordingly, they concluded that, over time, is more conservative. This means that over time, managers have chosen ways to minimize the cumulative profit led. It is also the top model, worth noting that the lower accruals are non-operational, would be more conservative.

III. Analysis of results

Hypothesis 1: bankrupt companies' smoothers profit in the profit margin conservative act. As seen in table 1, the correlation between variables is equal to 0.38 indicates a weak correlation between conservatism and income smoothing is very much in line. On the other hand, since the value of pi (P), 0.0568 and more than 0.01 alpha, so the hypothesis of no correlation between bankrupt companies smoothers profit (loss) in the profit (loss) margin of conservatism can't be denied. In other words, with a 99 percent chance of bankrupt companies' income smoothing in the Profit margin behave more conservative.

Hypothesis 2: bankrupt companies, non-profit (loss) of the Income conservative operating margin. As you can see in table 2, the correlation between variables is equal to 0.86 and going in different directions, indicating a strong correlation between conservatism and companies are non-profit. On the other hand, since the value of pi (P), 0.0007 and alpha of less than 0.01, so the hypothesis of no correlation between bankrupt companies, non-profit (loss) in the profit (loss) margin of conservatism is rejected. In other words, the probability of a 99% interest in the non-bankrupt companies Profit margin conservative act.

Hypothesis 3: bankrupt companies smoothers gains (losses) on interest rates before conservative act. As in table 3 below, the level of correlation between variables is equal to 0.5, which indicates a moderate correlation between conservatism and smoothers much in line with earnings. On the other hand, since the value of pi (P), 0.0198 and more than 0.01 alpha, so the hypothesis of no correlation between bankrupt companies smoothers gains (losses) on interest rates before and conservatism can't be denied. In

other words, with a 99 percent chance of bankrupt companies' income smoothing in the profit before behave more conservative.

Hypothesis 4: bankrupt companies, non-profit (loss) in the profit before conservative act. As you can see in table 4, the correlation between variables is equal to 0.61, which indicates a relatively strong correlation between conservatism and corporations, non-profits and going in different directions. On the other hand, since the value of pi (P), 0.006 and less than alpha 0.01, so the hypothesis of no correlation between bankrupt companies, non-profit before and conservatism rejected. In other words, with a 99 percent chance of bankrupt companies and non-profit in the profit before conservative act.

Hypothesis 5: bankrupt companies smoothers Profit in the Profit particularly conservative act. As seen in table 5, the correlation between variables is equal to 0.52 indicates moderate correlation between conservatism and income smoothing is very much in line. On the other hand, since the value of pi (P), 0.03 and 0.01 is greater than alpha, so the hypothesis of no correlation between bankrupt companies smoothers profit (loss) in the profit (loss) is not particularly conservative rule. In other words, with a 99 percent chance of bankrupt companies' income smoothing in the Profit Special behave conservatively.

Hypothesis 6: bankrupt companies, non-profit (loss) of the Income special act conservative. As you can see in table 6, the correlation between variables is equal to 0.06, which indicates a relatively strong correlation between conservatism and going in different directions and the non-profit companies. On the other hand, since the value of pi (P), 0.0061 and 0.01 is less than alpha, so the hypothesis of no correlation between bankrupt companies, non-profit (loss) in the profit (loss) for the conservative rejected. In other words, the probability of a 99% interest in the non-bankrupt companies Profit particularly conservative act.

IV. Content

In order to study the logical answer to the question whether the directors of bankrupt companies who try to smooth income figures are conservative have more or managers non? To answer this question, correlation between variables through the Pearson correlation test, the relationship between smoothers companies profit for

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companies with conservative and non, at three levels: profit margin, operating and special it's done.

According to the results of the above tests, it was determined that no significant differences in relation to associated companies and accounting firms to conservative non smoothers are the conservatives. In other words, we can say that in each of the three levels of earnings, there is no relationship between income smoothing (loss) by the conservatives in bankrupt companies there, and while this is exactly the picture above is true for non-firms. This means that in each of the three levels of profitability, it was found that bankrupt firms that are not smooth out your profit and loss figures, the more conservative.

Finally, with regard to the results of previous research that income smoothing behavior were proved in bankrupt companies, as well as adding the results previous research results it can be concluded that managers of bankrupt companies to maintain itself in the capital markets (with Given the present circumstances, the company's bankruptcy) is a system of one of the variables smoothing or conservative attempt to influence the profit and loss figures themselves, to achieve their goals fashion they concluded that the results of the study in 2008, Zhou said, companies are more conservative financial reporting provided they pay less to earnings management, conform.

Table 1- The results obtained from the test hypothesis 1

The test statistic	The amount Statistics	degrees of freedom	P-Value	a factor of importance	Value Possibility	correlation coefficient
T-statistics	T=2/0014	24	0/0568	0/01	0/99	0/3782

Table 2- The results obtained from the test hypothesis 2

The test statistic	The amount Statistics	degrees of freedom	P-Value	a factor of importance	Value Possibility	correlation coefficient
T-statistics	T=5/0121	9	0/0007	0/01	0/99	0/585

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Table 3 - The results obtained from the test hypothesis 3

The test statistic	The amount Statistics	degrees of freedom	P-Value	a factor of importance	Value Possibility	correlation coefficient
T-statistics	T=2/5439	19	0/0198	0/01	0/99	0/5

Table 4 - The results obtained from the test hypothesis 4

The test statistic	The amount Statistics	degrees of freedom	P-Value	a factor of importance	Value Possibility	correlation coefficient
T-statistics	T=3/1264	16	0/006	0/01	0/99	0/6158

Table 5 - The results obtained from the test hypothesis 5

The test statistic	The amount Statistics	degrees of freedom	P-Value	a factor of importance	Value Possibility	correlation coefficient
T-statistics	T=3/0063	24	0/03	0/01	0/99	0/52

Table 6 - The results obtained from the test hypothesis 6

The test statistic	The amount Statistics	degrees of freedom	P-Value	a factor of importance	Value Possibility	correlation coefficient
T-statistics	T=2/4911	11	0/0061	0/01	0/99	0/06

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