Full Length Article

Corporate Governance Mechanisms and Accounting Conservatism: Evidence from Pakistan

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This study examines the impact of corporate governance mechanisms on accounting conservatism in Pakistan. A sample of 100 firms is drawn from non-financial companies listed on Pakistan Stock Exchange from 2009 to 2015. Corporate governance mechanisms often pave the way for the expropriation of minority shareholders at the hands of controlling shareholders and also support to hide their professional misconduct via conservative accounting reports. Multivariate panel data regression analysis is employed as the estimation procedure. The results show that some corporate governance mechanisms are related to accounting conservatism. This study reports an empirical evidence of a positive association between institutional shareholding and accounting conservatism as well as the negative association between board size, CEO duality, managerial ownership and accounting conservatism in case of listed firms in Pakistan. However, some corporate governance attributes that were not previously examined in Pakistan like CEO turnover, and gender diversity on board is found to have no significant impact on accounting conservatism. The results suggest that users of financial statements should consider the corporate governance mechanisms while evaluating non-financial listed in a country like Pakistan where corporate governance is undergoing an evolutionary process and numerous familycontrolled firms exist.

Keywords: Accounting Conservatism, Corporate Governance, CEO Turnover, Gender Diversity on Board.

1. INTRODUCTION

The imperfections in governance structures and false manipulation of earnings are recognized as major reasons for some well-known corporate collapses. These include the collapse of entities like Enron, HIH, One Tel, World Call etc. (Lavelle, 2002 and Horwath, 2003). The urge to investigate the cause of this imperfection as well as reasons to manipulate the earnings by listed firms, motivated the researchers to look into financial

Address of Correspondence Muhammad Bilal Saeed mbfsaeed@gmail.com Article info Received Feb 12, 2018 Accepted June 03, 2018 Published June 30, 2018 reporting issues. There is no denial of the fact that there exists a difference in the corporate environment of an emerging and a developed market. Since in developed markets, the ownership is dispersed with an environment that offers more protection to the investor (Morck, et. al. 2000 and Young, et. al. 2008). In case of emerging markets, like Pakistan, the investor protection is weak and ownership is concentrated in families. This complexity in governance structures paves the way for the controlling end to overdue the rights of minority shareholders and seal it in by following conservative accounting procedures. The epicenter of this study is to explore the connection between corporate governance stature and accounting conservatism in Pakistan. For this purpose, various reported and new corporate governance variables whose relationship has not yet been examined with conservatism like CEO turnover and gender diversity on board especially with reference to Pakistan are analyzed.

The link between corporate governance and accounting conservatism can be addressed in the light of the significance of conservatism in contracting. Hence the connection can be explained by two theories i.e. the agency theory and the positive accounting theory. There are no two opinions over the matter that the managers are acting as agents on behalf of the owners who are holding the principal position in the firms. It is also an observed phenomenon that the ownership is mostly dispersed i.e. many small investors are holding the position as owners. The owners always require the managers to act in accordance with their interests. To ensure that their interests are safeguarded properly some rules, procedures, guidelines etc. are set forth. These rules, policies, procedures etc. offer guidelines to the managers to act in line with the interest of the owners and limit them to work in their own interest. The managers are the ones who are running the firms. The investors are sitting outside the firms but require complete information. This need of the investors to remain informed compel them to set forth such guidelines or install such mechanisms that support conservatism. Another viewpoint that tries to address the link between Corporate Governance and Accounting Conservatism is positive accounting theory. This perspective is linked with the importance of Accounting in any firm. No one can deny that a large number of contracts are there in a firm. The first and the foremost contract is between the managers and the owners. The owners require

complete information and Accounting is a way to provide them with this information. The owners evaluate the performance of the managers on the basis of accounting numbers and then decide about the compensation that should be offered to them. In the absence of Accounting Conservatism, the managers will overestimate the profits and assets thus concealing the true picture and attempt to demand more compensation.

This study expands the literature that addresses the influence of governance mechanisms installed in the firms with the extent of conservatism exercised in reporting accounting records. This study is helpful for the researchers in understanding various underpinning theories especially in the context of developing economy like Pakistan. The findings of this study are helpful in providing an insight to regulatory bodies working in Pakistan so that they can formulate policies and procedures in the very best interest of the firms working in Pakistan. By analyzing the results of this study, the regulatory bodies can revisit the listing requirements, disclosure reports etc. The analysts can also use this study to know that whether corporate governance supports conservatism in the firms, how they should evaluate them, what is the extent of this influence and how the true picture of the accounting estimates can be seen. The investors are always concerned about the efficient working of firms as well as their accounting information. The findings also help them unveil the role played by the governance stature in reporting conservative estimates. The creditors can also take advantage of this investigation by understanding that how they should evaluate the firms before extending capital to them. The findings of this study also help managers to understand that how the governance procedures could compel them to exercise conservatism. Last but not the least are the executives. This study is beneficial for the executives in many ways. Frist, it helps them understand conservatism. Secondly, it helps them understand the influence of governance mechanisms on conservatism. Third, this study helps them better understand that if the managers are employing conservatism or not.

2. LITERATURE REVIEW

Empirical studies on accounting conservatism and corporate governance show that internal corporate governance mechanisms are important factors in determining the

NICE Research Journal

ISSN: 2219-4282

level of conservatism employed by a firm. The first milestone on the road to understanding conservatism is set forth by Beneish and Press (1993). They report that creditors favor conservatism especially in case of debt contracts. Ahmed et al. (2002) also argue that conservatism is important because the firms using conservative accounting are ranked higher whenever it comes to debt ratings. The importance of conservatism is also evident from a survey by Graham, Cannice, and Sayre (2002). One of the outcomes of that survey is that whenever the conservative accounting is employed, the financial reports look better because of the use of such a phenomenon that renders somewhat clean accounting estimates thus making the statements look better. The significance of conservatism is also evidence from its discussion as a governance tool, especially in case of debt and managerial compensation contracts (Watts, 2003). Beekes et al. (2004) demonstrate that board composition and managerial ownership are significantly related to the level of conservatism. Lin (2006) shows that conservatism is an effective tool in revealing important information whenever a project undertaken by the firm is evaluated. This study argues that in case of a good project the manager employs conservatism with the intention of earning more compensation whenever the project earns positive cash flows. Chen et al. (2007) are also of the viewpoint that the use of conservatism mitigates the managers' power to manipulate earnings. According to them, the managers indulge themselves in earnings manipulation in order to meet the investor's expectations as well as to reduce the adverse effects on the share price of the firm. Zain and Subramaniam (2007) set forth their argument that the internal auditors consider independent directors as more knowledgeable and always look to them for the council. This thinking compels the auditors to put too much trust in independent directors as these directors can indicate any problem in the financial reporting process.

Another viewpoint regarding the relevance of conservatism in debt contracts is of Zhang (2008). He shows that the use of conservatism offer benefits to the lender as debt contract violations can be early recognized. There are no two opinions over the matter that the tenure of managers is limited therefore they sometimes consider themselves to be less accountable and go for making weak decisions thus jeopardizing the goal of maximizing the wealth of stakeholders (LaFond & Roychowdhury, 2008). Most of the

ISSN: 2219-4282

empirical studies suggest that audit committee independence enhances the quality of financial reports. One of the implications discussed by that study is that the presence of independent auditor on the committee is a symbol of more reliable accounting reporting process (Rose and Rose, 2008). Lara et al. (2009) prove that the wealth of stakeholders is at stake if the opportunistic behavior of its managers is not mitigated in due time. They set forth this argument by examining the behavior of bankrupt firm in the United Kingdom and state that the firms employ less conservative and more aggressive earning management strategies before filing for bankruptcy. Iyengar and Zampelli (2010) prove that use of conservatism is tied to producing more accurate and reliable financial reports. A very interesting fact is shared by Francis and Martin (2010). They find that if the firm has indulged herself in more profitable investment projects, the financial statements are more conservative in nature. They prove that the indulgence of a firm in the good project is evidenced by the returns as well as the performance of the firm. Shuto and Takada (2010) followed by Kung, Cheng, and James (2010) are those researchers who also analyzed the impacts of various governance mechanism on the level of conservatism employed by firms. However, they concentrated their efforts on the investigation of effects of ownership structure only. Sun and Liu (2011) report that firms employ more conservative mechanisms when they are being closely monitored by financial analysts and are audited by bug auditors. The role of board members' independence in paving the way for conservatism in those firms that are listed on FTSE is examined by Elshandidy and Hassanein (2014) who report a significant effect of this governance mechanism on conditional accounting conservatism.

On the basis of the discussion above it can be argued that greater the size of the board less is the efficiency of the board. Though it is sometimes argued that larger boards have a pool of expertise and knowledge but the problems like delayed decision making, the existence of free riders etc. reduces the efficiency of large boards. Such a type of board is less likely to look into the decision-making process carried out by top managers hence does not demand conservatism (Beekes et al., 2004). The following hypothesis is thus formulated:

H₁: *There is a negative relationship between board size and accounting conservatism.*

It is also been found that greater the number of independent directors on the board greater is the efficiency of the board. This increased efficiency may be because of the fact that these directors are more experienced and possess understanding as well as knowledge to judge the decisions of the board from various dimensions. It is less likely a chance that these directors would be unaware of the benefits offered by conservatism. Hence they will demand more conservatism while reporting accounting estimates (Garcı'a Lara et al., 2007). The following hypothesis is thus formulated:

H₂: There is a significant positive relationship between board independence and accounting conservatism.

Moreover, more active the board is, greater is the efficiency of the board. This increased efficiency may be because of the fact that the directors if present at the board meetings will review the affairs of the firm periodically hence increasing the efficiency of the board (Garcı'a Lara et al., 2007). Hence the demand for conservatism will be more, thus paving the way for the following hypothesis:

H₃: *There is a significant positive relationship between board activity and accounting conservatism.*

It has also been reported that greater the presence of a female on the board greater is the efficiency and monitoring performance of the board as García-Sánchez, Martínez-Ferrero, and García-Meca, (2017) analyze the effect of gender diversity on board and financial expertise on audit committee on accounting conservatism in the banking sector. The reason for more efficiency is that the empirical literature states that the female is more risk-averse, less prone to overconfidence bias as compared to males, are independent thinkers especially in case of decision making and focus on trust building leadership style thus improves the efficiency and monitoring capabilities of the board. The more efficient the board is greater is the demand for conservatism. So, the following hypothesis is formulated:

H₄: *There is a significant positive relationship between gender diversity on board and accounting conservatism.*

Furthermore, there are no two opinions over the matter that a departing and coming CEO will have different preferences over the matter of conservatism that should

be practiced. However one can agree on the fact that if CEO Turnover is more, the more will be conservatism. The justification of such thinking is simple. The CEOs are not changed very frequently meaning that the CEO who has departed will most likely to have been working for some time with the firm hence on the basis of his skills and expertise will be aware of the benefits of conservatism and will be inclined towards it.

H₅: There is a significant positive relationship between CEO Turnover and accounting conservatism.

If the CEO also holds the position of the chairman of the board less conservatism will be demanded. The reason is obvious. Holding the two positions means more power in the hands of a single person. The board will lose its effectiveness so as the benefits attached thus demanding less conservatism (Krishnan and Visvanathan, 2008). Another viewpoint is that the Chairman of the Board will close his eyes on the matter of manipulating accounting estimates in a positive or upward direction to gain the benefit of increased compensation as CEO (Hoseini, 2014). Thus, the following statement is hypothesized:

H₆: *There is a negative relationship between CEO Duality and accounting conservatism.*

It is also interesting to note that greater the number of shares held by institutions greater is the demand for quality in financial reporting. This demand compels the managers to go for conservative accounting estimates (Suleiman, 2014). On the basis of this argument, this study develops the following hypothesis:

H₇: *There is a significant positive relationship between Institutional ownership and accounting conservatism.*

Moreover, greater the number of shares held by the managers in a firm lower is the demand for conservatism. The reason is simple. The managers are more informed about the resources as well as the position of the firm. They can use this information to gain personal benefits through inefficient allocation of scarce resources available to the firms. Hence they will demand less conservatism. Another viewpoint that is discussed in the literature is that in case of more managerial ownership the agency conflict will be less thus there will be not much need of using conservatism (Suleiman, 2014). Hence paying the way for the following hypothesis:

H₈: *There is a negative relationship between Managerial Ownership and accounting conservatism.*

It is also been found that greater the number of independent members on the audit committee, greater is the demand for conservatism. The reason is very simple. Independent audit committee will be more effective in monitoring the managers as well as concerned about the quality of financial reporting process hence demand more conservatism (Rosilda, 2009). The following hypothesis is thus formulated:

H₉: *There is a significant positive relationship between Audit Committee Independence and accounting conservatism.*

The existence of the Big Four auditor demands more conservatism. This link can be explained by a simple argument. The auditors are motivated to employ conservatism to mitigate litigation costs. On the basis of this argument, a large number of researchers have empirically proved that there exists a positive relationship between Big Four auditor as the external auditor and Accounting Conservatism. The following hypothesis is thus formulated:

H₁₀: There is a significant positive relationship between the existence of Big Four Auditor and accounting conservatism

3. RESEARCH METHODOLOGY

This study is an attempt to investigate the extent of relationship therefore Multivariate Regression analysis is employed. However, the nature of the data supports the use of panel data regression analyses as the method for estimating the existence of relationship understudy. A few researchers who have also employed multivariate panel data regression for a similar type of investigations are Ahmed, Duellman and Watt (2007), Ming, Gee, and Leng (2008) and Youns (2012). A sample of 100 non-financial listed firms is taken from the listed firms in Pakistan for the period from 2009 to 2015. The reason for collecting data from the non-financial sector is that there is a significant difference between the structures and accounting practices of financial and non-financial companies (Wei, 2007). Only those firms are made the part of the sample whose market capitalization is high and whose data is available for the period under study. Secondary

ISSN: 2219-4282

data is employed for the purpose of estimation and is collected from the annual reports of the individual firms. Most of the data for control variables is extracted from balance sheet analysis of state bank of Pakistan. However, some missing dataset is also collected from company's websites and other published reports. The econometric modeling for this investigation is presented in the following equation:

 $AC_{it} = \beta_0 + \beta_1 BS_{it} + \beta_2 BA_{it} + \beta_3 BI_{it} + \beta_4 GDB_{it} + \beta_5 CEOD_{it} + \beta_6 INSO_{it} + \beta_7 MANO_{it} + \beta_8 ACI_{it} + \beta_9 TAUD_{it} + \beta_{10} CEOT_{it} + \beta_{11} FS_{it} + \beta_{12} LEV_{it} + \beta_{13} PROF_{it}$ (1)

Where ACit is accounting conservatism and is measured by five distinct measures. The first measure is adapted from Zhang (2008) who measured accounting conservatism by dividing the sensitivity in earnings because of bad news by the sensitivity in earnings because of good news. This measure is calculated first by running an earnings-return regression where the independent variables include the dummy that takes the value of "1" if the return is negative and "0" otherwise, twelve months return of the firm and an interaction term created by multiplying dummy for negative return with the return of the firm. The earnings are also deflated by beginning share price before being used as dependent variable. The coefficient of earnings return is a measure of sensitivity in earnings because of good news and the coefficient of interaction term shows the sensitivity in earnings because of bad news. Deflating the former coefficient by the later yields sensitivity based measure of accounting conservatism i.e. ACsen. The second measure employed in this study is adopted form Basu (1997). Like the Zhnag's (2008) measure it is also calculated by estimating an earnings-returns regression but it includes a change in earnings rather than earnings deflated by beginning share price as the dependent variable. The independent variables include a dummy variable that takes the value of "1" if a change in earnings is negative and "0" otherwise, a lagged value of the change in earnings and an interaction term created by multiplying dummy for a negative change in earnings with a lagged value of the change in earnings for a firm. A rolling regression is run to estimate the coefficient of the interaction term for each year that measures the level of conservatism employed by the firm i.e. ACche. Unlike the above two measures that are based on earnings, the third measure is accruals based and is adopted form Ball and Shivakumar (2005). A firm specific regression is run for each firm

on a rolling basis of 10 years and this measure i.e. ACacc is measured. Accruals are used as dependent variable and the independent variables include cash flow from operations, a dummy that takes the value of "1" if cash flow from operations is negative and "0" otherwise and an interaction term that is created by multiplying dummy variable and cash flow from operations. Another measure employed in this study is adopted form Beatty et al. (2008) and is a statistical measure that deflates the skewness of earnings by skewness of cash flows i.e. ACske. At least three annual observations were required to estimate this measure for each firm in our sample set. The last measure is a composite measure of Accounting Conservatism (ALLCON). This composite measure is developed by calculating the weighted average of all the measures. The weights are being assigned through principal component analysis as ALLCON = Σ (w1ACsen + w2ACche + w3ACacc + w4ACske). A high value of all these measures depicts more conservatism.

Board Size (BS) is captured as the number of members on the board of the firm. The Board Independence (BI) is captured by calculating a ratio of Independent directors to total directors on the board. The Board activity (BA) is calculated by the ratio of a number of meetings attended by at least 80 percent of board members to a total number of meetings held. The gender diversity (GDB) is calculated by using a ratio of a number of female members on the board to total board members. CEO turnover (CEOT) is represented by a dummy variable that takes the value of 1 if the turnover takes place and 0 otherwise. A dummy variable is used to capture CEO Duality (CEOD). This dummy takes the value of, "1" if CEO and Chairman are same and, "0" otherwise. The institutional ownership (INSO) is the ratio of a number of shares held by the institutions to the total number of shares of a firm. The managerial ownership (MANO) is captured by using a ratio. This ratio is estimated by dividing the number of shares held by directors on the board to a total number of firm's shares. The audit committee independence (ACI) is also captured by calculating a ratio of a number of independent directors on the audit committee to a total number of audit committee members and audit quality (TAUD) is measured by a dummy variable that takes the value of 1 if the auditor is a big four otherwise 0.

Three control variables are employed in this study. The firm size (FS) is

ISSN: 2219-4282

calculated by taking the natural logarithm of total assets. The leverage (LEV) is calculated by dividing total debt by total equity of the firm. The profitability (ROA) is measured by calculating Return on Assets of the firm.

4. RESULTS AND DISCUSSION

		Table 1:	Descriptive sta	atistics*	
	Mean	Median	Max	Min	Std. Dev.
ACACC	-0.800	-0.593	0.956	-4.003	0.680
ACCHE	-0.392	-0.311	1.315	-3.897	0.652
ACSKE	0.006	0.016	0.759	-0.919	0.121
ACSEN	1.257	1.381	1.982	-0.424	0.718
ALLCON	0.000	0.279	2.813	-4.943	1.186
BA	0.605	0.595	1.000	0.265	0.122
BS	8.357	8.000	14.000	5.000	1.673
ACI	0.261	0.042	1.000	0.005	0.317
BI	0.667	0.714	0.929	0.125	0.185
CEOD	0.236	0.000	1.000	0.000	0.425
CEOT	0.076	0.000	1.000	0.000	0.265
GDB	0.051	0.000	0.670	0.000	0.116
INSO	0.184	0.043	0.820	0.000	0.255
MANO	0.065	0.034	0.156	0.000	0.060
TAU	0.496	0.000	1.000	0.000	0.500
FS	17.010	16.551	21.574	14.188	2.340
LEV	0.263	0.200	0.970	0.010	0.214
PROF	0.065	0.057	0.214	-0.046	0.081

Table 1 presents the descriptive statistics of all the variables. the

*All values are rounded to three decimal places

It is evident from this table that the mean ACACC is -0.800 which is far less than the values reported by Ahmed and Duellam (2007), Krishnan and Visvanathan (2008), Yunos (2011) and Yun Ren (2014). Ahmed and Dellman (2007) and Krishnan and Visvanathan (2008) report a mean value of 0.010 for US market whereas Yunos (2011) and Yun Ren (2014) present the mean values of accrual-based conservatism measures of -0.006 and -0.014 for Malaysian and Chinese markets respectively. It may be inferred that the firms listed in Pakistan employ less conservatism as compared to the firms listed in the US, Malaysia, and China. The mean values of ACCHE, ACSEK, ACSEN, and ALLCON are -0.3916, 0.006, 1.2568 and 0.0000 respectively. Again by looking at the mean value of ALLCON (a composite measure of conservatism) the less level of conservatism employed by non-financial firms listed in Pakistan is evident. The mean board activity is 0.6050 meaning that 60% of the meetings are attended by at least 80% of the board members. The average board size found is eight. This number is in line with many studies conducted in developing markets for example by Rahman and Ali (2006) and Haniffa and Hudaib (2006). The mean value of 0.66 represents that 66% of the board on average is comprised of independent directors. This value is very much alike as reported by Haron (2005) and Yunos (2011) while examining the Malaysian economy. The mean of ACI is 0.26 which shows that only 26% of the audit committee is constituted of independent directors. It is found that approximately 24% of the board are those where the responsibilities of CEO and the office of the chairman are held by the same person. This number is also fairly high than 4.8% as reported by Yunos (2011) for Malaysian firms. The average of CEOT is 0.07 and of GDB is 0.50. The later shows that on average only 5% of the board is comprised of female directors. The institutional ownership and managerial ownership on average is 18% and 6.5% respectively. This shareholding patter implies that the ownership is dispersed as stated by Claessens, Djankov, Fan, and Lang (1999) and later on by Cheah (2006) that the shareholding below 20% can be regarded as a symbol of dispersed ownership as is the case in Pakistan. About 49.5% of the sample is found to be audited by big four auditors. This number is less than that is reported by Yatim et al. (2006), Yunos (2011) and Yunren (2014) for Malaysian and Chinese firms. The mean of the composite measure for firm governance is 1.09. The following Table 2 presents the correlation matrix

	BA	BI	BS	CEOD	CEOT	FS	GD	INSTO	LE V	MAN O	PRO F	TAU D
BA	1.00											
BI	0.10	1.00										
BS	0.06	0.13	1.00									
CEOD	- 0.02	- 0.29	- 0.15	1.00								
CEOT	- 0.01	- 0.08	0.06	-0.02	1.00							
FS	- 0.17	0.02	0.04	0.12	0.03	1.00						

GD	- 0.03	- 0.08	0.14	-0.05	-0.01	0.08	1.00					
INSO	- 0.09	0.13	0.03	-0.18	0.00	0.20	0.10	1.00				
LEV	- 0.07	- 0.13	- 0.09	0.14	-0.02	0.07	- 0.19	-0.04	1.00			
MAN O	0.01	0.07	0.00	-0.07	-0.01	-0.04	0.09	-0.03	- 0.07	1.00		
PROF	- 0.03	0.02	- 0.03	0.01	-0.02	0.26	0.12	0.27	- 0.03	-0.12	1.00	
TAUD	0.05	- 0.03	0.02	0.02	0.00	0.02	0.03	0.03	0.03	0.02	0.04	1.00

* Values rounded to two decimal places

It is also evident from the above table that there does not exist any problem of multicollinearity between the explanatory variables.

Table 3A and 3B present the results of fixed effect model for equation 1. The selection of fixed effect model is done on the basis of Hausman test. It is evident from the above table that all the models have appropriate explanatory power and are good fits. The results of the first models where the conservatism is measured by ACSEN i.e. sensitivity of earnings, only FS, INSO, and PROF are significant at 1% level of significance. CEOD and BI are also significant but at 5% and 10% levels of significance respectively. All other variables are insignificant. The second column reports the results for that model in which the dependent variable is measured by ACACC. The results show that PROF and BS significant at 1% level of significance whereas CEOD, GDB and MANO are also significant at 10% level of significance. The third column represents the results of that equation in which the conservatism measure is ACCHE. Here INSO and BS are significant at 5% and 10% levels of significance respectively. The fourth equation is that in which the dependent variable is skewness based measure. The results show that PROF and INSO are significant at 1% level of significance whereas the BS is significant 10% level of significance. The last equation involves the composite measure of accounting conservatism and its results report that FS, INSO, and PROF are significant at 1% level of significance, BS and CEOD are significant at 5% whereas the MANO is significant at 10% level of significance.

Table 3(A): Multivariate Regression Analysis*										
		ACs	sen	ACacc						
Variables	Predicted Sign	Coefficients	t- statistic	Coefficients	t- statistic					
Constant		-0.335	-0.792	-0.258	-0.642					
ACI	+	0.035	0.456	-0.008	-0.104					
BA	+	-0.044	-0.16	-0.358	-1.388					
BI	+	-0.317	-1.841***	-0.04	-0.246					
BS	-	-0.006	-0.308	-0.054	-2.796*					
CEOD	-	-0.209	-2.556**	-0.147	-1.894***					
CEOT	+	-0.061	-0.811	0.044	0.611					
FS	-	0.088	4.983*	0.004	0.264					
GD	+	0.518	1.336	-0.636	-1.730***					
INSO	+	0.407	2.974*	0.24	1.851***					
MANO	-	-0.365	-0.974	-0.618	-1.734***					
PROF	+	5.193	10.594*	2.346	5.041*					
TAUD	+	0.054	0.803	-0.018	-0.285					
LEV	+	0.049	0.336	-0.058	-0.42					
Adj R ²			0.537		0.5351					
F-statistic			8.253*		8.183*					
N			700		700					

*All values are rounded to three decimal places

Table 3(B): Multivariate Regression Analysis*										
		ACc	he	ACs	ke	ALLCON				
Variables	Predicted Sign	Coefficients t- statistic		Coefficients	t- statistic	Coefficients	t- statistic			
Constant		-0.661	-1.666	-0.068	-0.765	-0.847	-1.21			
ACI	+	0.149	2.035**	0.032	1.933***	-0.028	-0.216			
BA	+	-0.41	-1.606	-0.052	-0.922	-0.301	-0.668			
BI	+	-0.054	-0.336	0.014	0.396	-0.352	-1.238			
BS	-	0.036	1.895***	0.008	1.958***	-0.076	2.259**			

CEOD	-	-0.089	-1.163	-0.006	-0.354	-0.334	- 2.468**
CEOT	+	-0.012	-0.168	-0.022	-1.382	0.011	0.084
FS	-	0.013	0.768	0.001	0.291	0.086	2.941*
GD	+	0.205	0.564	0.072	0.886	-0.27	-0.42
INSO	+	-0.256	-1.994**	0.092	3.201*	0.588	2.595*
MANO	-	0.276	0.783	0.047	0.597	-1.082	- 1.74***
PROF	+	0.221	0.48	-0.462	-4.498*	7.853	9.674*
TAUD	+	0.034	0.539	0.007	0.487	0.021	0.187
LEV	+	0.083	0.604	0.036	1.171	-0.062	-0.256
Adj R2			0.506		0.282		0.610
F-statistic			7.381*		3.448*		8.182*
N			700		700		700

*All values are rounded to three decimal places

The results of the three models involving earnings based, accrual-based and skewness based measures and the model involving a composite measure of accounting conservatism show that board size has a significant impact on the level of conservatism employed by the firms listed in Pakistan. The sign is also relevant to that was hypothesis i.e. the board size has a negative significant effect. It can hence be stated that our H1 is accepted meaning that larger the size of the board less will be the conservatism employed. One can argue that if the board is small the consequence will be a more conservative firm. These results are consistent with that of Rahman and Ali (2006) reported the negative relationship while considering earnings-based measures of conservatism. This result is also contrary to that of Bonn et al. (2004) and Yunos (2012) who reported the absence of any such relationship. Yun Ren (2014) reports a positive significant relationship between the size of the board and level of conservatism employed by the firms in China. One of the reasons for the existence of such a connection would be the conventional wisdom inherent in large boards having more expertise and skills thus enhancing effectiveness and reducing the phenomenon like conservatism.

Again, the results of four out of five models show that the relationship between board independence and accounting conservatism is insignificant. A slight significance can be seen in case of one of the two measures that are based on earnings. On the basis of these results, this study can reject H_2 that addresses the existence of a significant positive relationship between board independence and accounting conservatism. The results are fully in line with that of Beekes et al. (2004), Duellman (2006) and Ahmed and Duellman, (2007) who while examining the two developed markets i.e. US and UK presented the same results. These results involved the earnings-based measures of conservatism. While analyzing the accruals based measures of conservatism Peasnell et al. (2005) and Cornett et al. (2009) report a significant connection between independence of the board and accounting conservatism.

 H_3 adhering to the connection between board activity and conservatism is also rejected. The results are in disagreement with that of Xie et al. (2003) and Tang and Xu (2007) who argued that if the frequency of board meetings is more along with good attendance of board members, the earnings management will be reduced thus reducing the appointment of conservatism. The results also pave the way for the rejection of H_4 involving the effect of gender diversity of board on accounting conservatism.

 H_5 that talks about the connection with CEO turnover are also rejected as all the five models report an insignificant relationship. The results are inconsistent to that of Pourciau (1993), Godfrey et al. (2003) and Lin (2011) who argue that whenever the new CEO of the top manager will take charge he or she will tend to adopt conservative accounting policies. As expected the CEO duality has a negative relationship with conservatism hence H6 is accepted because three out of the five models report a significant coefficient. The argument is simple as if the CEO and chairman of the board are same it will lead to recognition of good news into earnings at a reduced pace thus creating more conservatism. The results are consistent with Tian and Lau (2001), Klein (2002) and Peng et al. (2007), Krishnan and Visvanathan (2008) whereas the studies of Wang and Deng (2006) offer inconclusive results. H_7 and H_8 involve institutional and managerial ownership.

The results show that both H_7 and H_8 are accepted. It is interesting to note that all the five equations report a significant coefficient of institutional ownership. The sign is also in line with the theory as reported by four models. The results are in line with that of Haniffa and Hudaib (2006) and Adbullah (2006) who argue that if the institutional ownership is more the firms tend to employ less conservatism. Both of the two remaining hypotheses i.e. H_9 and H_{10} are also rejected in case of Pakistan. The results are inconsistent with that of Subramaniam (2007) and Pomery and Thornton (2008) who stated that if there are more independent members on the audit committee, the conservatism will be reduced. The rejection of hypothesis involving the big four auditors is also inconsistent with that of Dickins et al. (2009) and Rahman et al. (2009) who argued that if the auditor is among the big auditor the firms tend to reduce the level of conservatism. Two of the control variables i.e. Leverage and Firm size are insignificant. Only profitability is significant. The positive and significant relationship of profitability is also correct as the more profitable firms tend to earn more benefits by giving away more good news thus employing conservatism.

5. CONCLUSION AND RECOMMENDATIONS

From the results, it can be concluded that in case of Pakistan size of the board, the duality of CEO, managerial ownership, and institutional ownership affect accounting conservatism. Two new attributes of corporate governance i.e. CEO turnover and gender diversity on board that was specifically investigated in this study are not found to be acting as an influential factor with respect to conservatism. Other conventional governance variables like board independence, audit committee independence, board activity, type of the auditor are found to be fully unrelated to conservatism in case of nonfinancial listed firms in Pakistan. The influencing factors thus discovered can be seen as the factors that could change the extent of conservatism employed by firms listed in Pakistan. The results clearly imply that the existence of various corporate governance theories is being tested and also empirically evidenced the examination of such a relationship in a developing country like Pakistan. Moreover, some of the new attributes of corporate governance are also being added to the literature. The researchers should now also consider these new attributes while analyzing the impact of corporate governance practices on strategic decisions of the firms. The regulatory bodies working in developing economies as well as the policymakers can now develop new yet effective policies by specifically targeting those factors that are found to be significant in reducing conservatism. Another important implication is for the academic and researchers who should use the methods employed in this study to gauge accounting conservatism as it is one of the methods that could offer a better numeric sense of the extent of conservatism. The results of this study could be helpful for the investors as well as fund managers as they could now better evaluate a firm with respect to the level of conservatism employed by that firm before investing a significant amount of funds into the firm.

This study is limited to non-financial companies as well as those firms whose data was available for the time period under study. One can also replicate this study by taking into account the financial sector of Pakistan or specifically the banking industry. A study can also be carried out that could evaluate the impact of corporate governance as a whole i.e. a composite measure of firm governance can be employed and then its effect on conservatism could be discussed. Moreover, some new attributes of corporate governance could be examined. This study, however, has set forth a conclusive evidence that size of the board, the duality of CEO and shareholding of institutions affect the level of accounting conservatism employed by firms in Pakistan.

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