

## **Measuring Accounting Conservatism for Listed Companies in Amman Stock Exchange (ASE) During the Period 2001 – 2010**

**Tareq Z. Mashoka**\*

### **Abstract**

This paper aimed to measure accounting conservatism for listed companies in the Amman stock Exchange (ASE) from the period 2001 to 2010. The sample of the study includes listed firms from three main sectors: manufacturing, banking and service. The paper applied a model developed by Basu (1997) to measure conservatism based on several events and circumstances. Results show that listed companies report their financial reports using a certain degree of conservatism. Results also show that companies reporting a loss or reversing their losses use less conservative practices in order to report profits. The paper also provides evidence that the level of conservatism changes according to the companies' industry classification. Moreover, the results show that companies became less conservative in their financial reporting after the financial crisis.

Key words: accounting conservatism, stock returns, financial reporting.

---

\* Department of Accounting, Mutah University, Jordan.

**Received: 1/ 10 /2013**

**Accepted: 2 /10/2014.**

© 2015 Mu'tah University. All right reserved.

2010-2001

(1997) Basu . . . . .2010 - 2001 :  
.  
.  
.  
.  
.  
.  
.  
.  
.  
.  
.  
.

## **Introduction**

Accounting practices and methods have always been viewed upon as pessimistic. The general rule is that losses, even when in doubt, are immediately recorded and recognized. Whereas profits, even when guaranteed, are not recorded unless they become realized. Based on that, all figures reported in the financial statements and especially net income is characterized of being prudent and conservative.

The rationale of following this approach in accounting is to present the financial position of the company of being more realistic and more pessimistic. In other words, producing an earnings figure that reflects the worst scenario for the company; this is achieved by anticipating any possible losses that might occur in the future.

This paper aims to measure accounting conservatism for listed companies in the Amman Stock Exchange (ASE). The paper applies the Basu Model (1997), which captures the recognition of future losses embedded in the earnings (net income) figure. The Basu Model has been used almost exclusively in literature to measure conservatism.

The sample for this study consists of all companies, with available data from 2001 to 2010, from three main sectors; banking, manufacturing and services. The Basu Model is applied on the sample in order to measure conservatism. The model is also applied on subgroups taken from the sample to compare conservatism under different conditions and circumstances.

Generally, the paper aims to answer the following questions:

- 1- Does the Basu Model measure accounting conservatism for listed companies on the ASE?
- 2- Do listed companies on the ASE that reported losses in a previous year use less conservative accounting choices in order to reverse losses and report higher earnings?
- 3- Did the financial crisis have any effect on the level of conservatism for listed companies in the ASE?

Literature review

---

Accounting conservatism is generally defined through anticipating losses but not profits. In other words, accounting numbers reflect bad news (losses) more often than reflecting good news (profits). Thus, accountants are bounded by “rules-of-thumb” such as lower of cost or market to reflect a prudent perspective. Additionally, when ever two estimates are equally predicted, accountants choose the least optimistic estimate. (Kothari et al. 2010; Francis et al. 2004; Ahmed et al. 2002)

However, throughout the years a number of events have influenced standard setters to demand stricter accounting methods to reflect more conservative numbers. Presumably, more prudent and conservative accounting numbers provide different stakeholders with much more useful information (Lafond & Watts, 2008; Chen et al. 2007; Watts, 2003).

Early research on conservatism focused on examining variation in the accounting methods in order to measure conservatism (Watts & Zimmerman, 1990; Christie, 1990). Subsequent studies have used the Basu Model almost exclusively to measure accounting conservatism. The model focuses on examining and measuring the reflection of bad news (losses) versus good news (profits) in stock prices (Basu, 1997).

Furthermore, studies examined conservatism relationship to firm’s characteristics. For example, firms that exhibit an increase in cost of equity and increase in accruals quality also exhibit an increase in conservatism. Additionally, conservatism can be characterized in terms of book value and earnings/book rate of return. Companies that show growth in earnings and in value also show changes in the level of conservatism in accounting data. Generally, there is a strong influence of conservatism on the cost and value of equity, and therefore the firm’s financial position (Francis et al. 2004; Zhang, 2000).

Conservatism also relates to the length of the operating cycle. Accounting conservatism is measured more efficiently in firms with longer operating cycles. The main reason for poor measurement of conservatism over short periods is the affect of accruals on the quality of earnings (Roychowdhury& Watts, 2007).

Moreover, the firm’s relationship with different stakeholders influences the level of conservatism. When a firm’s suppliers or customers hold bargaining advantages, the firm recognizes losses more quickly. As the bargaining power of different stakeholders increase, the demand of more

realistic data about the firm's financial position increases as well (Hui et al. 2012). This influence is also related to the ownership structure; firms with higher institutional ownership apply higher conservative accounting practices in their financial reporting. This is also true for firms with more growth options (Ramalingegowda & Yu, 2012; Sen, 2005).

Accounting conservatism is examined according to the auditor's characteristics in a number of studies. For example, Krishnan (2005) finds that in a sample of firms characterized with either a big auditor or high auditor experience show higher conservatism in their reporting. The reason is attributed to the accounting scandals and failure of high profile companies and the failure of their auditors to detect irregularities in the accounting practices and reporting. As a result, the demand for more experienced auditors is required by different stakeholders. Additionally, auditors' independence also influences the level of conservatism. It is assumed that the non-audit services may impair auditor's independence and as a result less bad news recognition. However, auditors who provide non-audit services still demand higher conservatism in their clients reporting (Ruddock et al. 2006). Thus, many studies find that as the auditor's size, experience and independence increase, the level of conservatism increase as well.

Bond holders that require strict dividends policy demand an increase accounting conservatism (Ahmed et al. 2002). Lenders generally ask for higher conservatism, especially in firms with low credit rating (Beatty et al. 2008). As conservatism increase, cash holdings are invested and utilized more efficiently; this suggests that conservatism provides direct benefits to the shareholders by mitigating agency costs related to incentive conflicts between managers and shareholders as well as between managers and lenders (Louis et al. 2012). Management characteristics are associated with the level of conservatism. Overconfident managers tend to delay loss recognition and use less conservatism accounting methods. This is mainly due to the managers' ego and reputation in their effort to increase the value of the firm (Ahmed & Duellman, 2013). Moreover, conservatism is affected by the composition of the board of directors. Companies with outsider members in the board of directors show higher levels of accounting conservatism (Beekes et al. 2004).

Several studies examined accounting conservatism and the timeliness of income recognition for firms that operate under different sets of accounting standards. For example, Pope and Walker (1999) measured and assessed differences in conservatism between the US and the UK, and provided evidence of differences in timeliness of loss and profit recognition in the two regimes in which firms operate under different set of standards. Furthermore, UK companies that cross listed in the US show higher conservatism than other companies that are listed only in the UK, especially during the early years of their cross-listing (Huijen & Lubberink, 2005). This indicates that US firms report their financial position with higher conservatism, which might explain the existence of stricter accounting standards and securities law.

Moreover, when comparing firms according to code law countries versus common law countries, the latter have more timeliness income recognition. In other words, firms operating in common law countries (e.g. US and UK) apply higher conservative practices compared to firms operating in code law countries (e.g. Germany and France) where less timeliness of income recognition is shown (Ball et al. 2000). However, European countries with different legal traditions and different securities laws show significant differences in conservatism among them (Bushman & Poitroski, 2006; Giner & Rees, 2001).

Based on that, other studies show that European firms are becoming more conservative. The reason is because these firms are operating in international markets and listing their shares in different stock exchanges (i.e. economic convergence); as a result, these firms are showing more sensitivity to loss recognition (Grambovas et al. 2006; Raonic et al. 2004).

In the above conservatism literature, the model developed by Basu (1997) is used almost exclusively to measure timely recognition of losses. Although some papers have examined the model's power and reliability to measure conservatism from an econometric perspective, they did not offer a more powerful alternative model. However, they did raise certain issues that challenge the inferences drawn by studies which applied the Basu model. Based on that, some of these papers argue the need for a different or a modified measure for conservatism (Ettredge et al. 2012; Kothari et al. 2010; Givoly et al. 2007)

In this study, conservatism is examined for firms listed in the Amman Stock Exchange (ASE). Accounting conservatism and timeliness of loss recognition is examined based on identified conditions and events using the measure developed by Basu (1997). The identified conditions and events are used as the foundation for the hypotheses development and testing.

**Sample and data:**

The sample includes all listed companies in Amman Stock Exchange. Companies are included based on the availability of data from 2001 to 2010. This provides a sample with 1080 firm-year observations. Any company with missing observations was dropped from the sample to insure consistency across all firms within the sample. From this sample, sub-samples are constructed in order to test conservatism in specific conditions, as stated in the hypothesis of the study. Table 1 shows main classification of the sample.

Table 1 Sector classification of firms included in sample			
	Banks	Manufacturing	Service
No. of firms	15	58	35
Firm-year observations (after removing missing data)	150	579	346

Variables are arranged in a cross sectional format. Stock Returns is measured as the difference between stock prices in two periods at the end of March to ensure that all disclosed accounting information is reflected in stock prices. Net income is measured as earnings after taxes. Additionally, loss firms are defined as firms that report a loss in the two consecutive periods. Profit firms are firms that report profits in at least two consecutive periods. Loss reversal firms are firms that report losses in the previous period and profits in current period.

**Measurement of conservatism:**

Basu (1997) measured earnings conservatism by showing the strength of the association between returns and earnings when future bad news (i.e. losses) is anticipated. If earnings, through accruals, incorporate information about future losses, then the association with returns becomes stronger because stock returns incorporates information about future losses as well. However, earnings only reflect future losses and not future profits because of the conservatism principle. In accounting practices, any anticipated loss in the following period is recorded even if not realized yet. For example, future bad debts are estimated and recorded even before bad debts occur or becomes realized. On the other hand, any anticipated profits or gains in future periods are not recorded unless they occur or become realized. Sales revenue is only recorded when the goods are delivered to the buyer; therefore any anticipated growth in sales is not reflected in the earnings figure.

Hence, accounting earnings reflect the impact of current performance and the bad news (anticipated losses) of future performance. Stock returns reflect anticipations about both future losses and future profits. Thus, returns captures the impact of current performance and future performance, whether bad (losses) or good (profits). Based on that, the association between earnings and returns becomes stronger when there is significant bad news (losses) in the future, and becomes weaker when there is significant good news (profits) in the future.

Based on the above argument, Basu (1997) measured conservatism using the following regression model:

$$NI_{it} = \alpha + \beta_1 NEG_{it} + \beta_2 RET_{it} + \beta_3 (NEG * RET)_{it} + \varepsilon_{it}$$

Where,

$NI_{it}$ : net income after taxes for firm  $i$  in period  $t$ .

$NEG_{it}$ : an indicator variable that equals 1 if stock returns in previous period are negative and 0 if returns are positive in previous period.

$RET_{it}$ : stock returns over a period of 12 months ending at March for firm  $i$  in period  $t$ .

All variables are scaled with total assets at the end of period to reduce heteroskedasticity.



In the above model,  $\beta_3$  is the measure of conservatism. If stock returns are reflecting future losses, then the association with net income becomes stronger, thus  $\beta_3$  becomes significantly positive. In other words, if returns are negative it means they are reflecting future losses (bad news) and the association with net income strengthens to extent to which bad news is captured by accounting earnings. Therefore,  $\beta_3$  is used as the measure for conservatism to test all the hypotheses of this study.

**Table (2) Descriptive statistics for variables**

	Net income <sup>*</sup>	Stock returns	Negative stock returns <sup>**</sup>
Mean	0.0386	0.19	-0.106
St. deviation	0.109	0.855	0.165
Min.	-0.426	-0.905	-0.905
Max.	1.59	12.1	-0.005

\* net income after taxes, scaled with total assets in period t-1

\*\* Firms that have negative stock returns.

### Hypotheses

The Basu model is applied on a sample of listed companies in Amman Stock Exchange (ASE) in order to measure accounting conservatism. Based on the model, the resulting  $\beta_3$  will be examined in different situations to measure conservatism. In this paper,  $\beta_3$  will be used to test the following hypotheses:

**H<sub>1</sub>: Accounting earnings for listed firms in the ASE are not conservative.**

This is to generally measure conservatism for all listed firms in the ASE. The measurement of conservatism is for all companies regardless the sector classification or any other conditions. Thus, the Basu model is applied on the sample as a whole without specifying any preconditions. Hence, the Basu model is applied on the whole sample in order to test the validity of conservatism measurement.

---

**H<sub>2</sub>: Conservatism in loss firms is higher than in profit firms.**

This hypothesis tests the differences between firms based on their financial performance. The argument is firms reporting losses will have higher conservatism than firms that report profits.

**H<sub>3</sub>: Conservatism increase/decrease according to sector classification.**

Accounting practices and accordingly conservatism is changed according to the sector or the industry classification. Conservatism will be tested for firms in three main sector classifications: banking, manufacturing and service sectors.

**H<sub>4</sub>: Conservatism is lower in loss reversal firms.**

Firms that report a loss will move away from conservatism in order to report a profit. Thus, conservatism is expected to be less in firms that report a profit after a period of reporting losses.

**H<sub>5</sub>: Conservatism is higher in listed firms in the ASE after the financial crises.**

The financial crisis had an impact on financial markets and accordingly on financial reports. The crisis placed pressure on firms to report their financial activities and performance with more prudence or conservatism. Thus, it is assumed that conservatism is higher after the financial crisis.

**Results and Hypotheses testing**

The Basu model is applied on different subsamples in order to test accounting conservatism in different situation according to the hypothesis statement. In all of the following tests, the conservatism measure is referred to as ( $\beta_3$ ), which captures and measures conservatism according to the Basu model.

**Test of H<sub>1</sub>: measuring ( $\beta_3$ ) for all listed companies in the ASE**

The Basu model is applied on the whole sample in order to measure conservatism in listed companies in the ASE. The reason for this test is to examine the model's validity for measuring conservatism. The results show that beta is significant; this means that the model is measuring conservatism for listed companies. ( $\beta_3$ ) measures bad news and is highly correlated with earnings which by default reflects bad news and ignores any good news. Moreover, ( $\beta_2$ ) which is measuring only good news is also significant; this

indicates that stock prices reflect any good news related to firms. Based on that, companies listed in the ASE report their financial performance at a specific level of conservatism. Thus, the null hypothesis is rejected. The importance of this result indicates that the Basu model is applicable on the entire ASE sample and the consequent coefficient ( $\beta_3$ ) measures conservatism in financial reports.

**Table 3 Results for H1**

Measuring conservatism on whole sample			
$NI_{it} = \alpha + \beta_1 NEG_{it} + \beta_2 RET_{it} + \beta_3 (NEG * RET)_{it} + \varepsilon_{it}$			
Coefficient	Coefficient measure	Std. error	t-value
$\alpha$	0.0355	0.004	8.75 **
$\beta_1$	0.0088	0.0077	1.15
$\beta_2$	0.0081	0.0038	2.10 **
$\beta_3$	0.1432	0.022	6.34 **
	R <sup>2</sup>	adj-R <sup>2</sup>	F-value
	7%	6.9%	27.68

$\beta_1$ ,  $\beta_2$  and  $\beta_3$  are the response coefficients for  $NEG_{it}$ ,  $RET_{it}$  and  $(NEG*RET)_{it}$  respectively.

Where;

$NEG_{it}$ : is the indicator variable that equals 1 if returns in period t-1 is negative (losses), 0 otherwise.

$RET_{it}$ : is stock returns for a period of 12 months ending on March for firm i in period t,

thus,  $\beta_2$  is measure for good news only.

$(NEG*RET)_{it}$ : is returns for firms that report losses, thus  $\beta_3$  is the measure of conservatism for firm i in period t.

$A_{t-1}$ : is total assets for firm i at period (t-1), to scale variables to reduce heteroskedasticity

\*\* t values at 1% significance level. Test of  $H_2$ : comparing ( $\beta_3$ ) between loss and profit firms

In order to examine conservatism in detail, it is applied on a subsample of companies that only reported losses in the previous year and compared to a subsample of companies that reported profits in the previous year. The expectation is that the ( $\beta_3$ ) should be higher for loss firms compared to firms that only reported profits in the previous year. The results in table (4) show that ( $\beta_3$ ) for loss firms are higher than profit firms. This indicates that the Basu model measures conservatism and that returns have a stronger relation with net income for firms that report losses. Negative earnings are a product of reflecting all bad news and the stock prices are also reflecting that information. Additionally, the returns coefficient ( $\beta_2$ ) is not significant for loss firms; this is further evidence that the model captures bad news for companies reporting a loss. On the other hand, the profit firms ( $\beta_3$ ) is lower and the returns coefficient ( $\beta_2$ ) is significant, this indicates that stock prices reflect good and bad news for companies that report profits.

**Table (4) Results for H2**

Comparing conservatism between loss and profit firms				
$NI_{it} = \alpha + \beta_1 NEG_{it} + \beta_2 RET_{it} + \beta_3 (NEG * RET)_{it} + \varepsilon_{it}$				
Coefficient	Loss firms		Profit firms	
	Coefficient measure	t-value	Coefficient measure	t-value
$\alpha$	-0.0122	-4.82 **	0.0477	17.94 **
$\beta_1$	0.0072	1.49	0.0017	0.34
$\beta_2$	0.0021	0.88	0.0059	2.37*
$\beta_3$	0.0942	6.68 **	0.0490	3.31 **
	adj-R <sup>2</sup>	F-value	adj-R <sup>2</sup>	F-value
	6.39%	24.35	2.97%	11.98

Loss firms are firms that reported a loss in previous period.

Profit firms are firms that reported profits in previous period.

$\beta_1$ ,  $\beta_2$  and  $\beta_3$  are the response coefficients for  $NEG_{it}$ ,  $RET_{it}$  and  $(NEG*RET)_{it}$  respectively.

Where;

$NEG_{it}$ : is the indicator variable that equals 1 if returns in period t-1 is negative (losses), 0 otherwise.

$RET_{it}$ : is stock returns for a period of 12 months ending on March for firm  $i$  in period  $t$ ,

thus,  $\beta_2$  is measure for good news only.

$(NEG*RET)_{it}$ : is returns for firms that report losses, thus  $\beta_3$  is the measure of conservatism for firm  $i$  in period  $t$ .

$A_{t-1}$ : is total assets for firm  $i$  at period  $(t-1)$ , to scale variables to reduce heteroskedasticity

\*\* t values at 1% significance level.

\*t values at 5% significance level.

### **Test of H<sub>3</sub>: measuring ( $\beta_3$ ) based on sector classification**

Companies in the ASE are classified according to their sector and industry classification. This gives three subsamples; the banking sector, the manufacturing sector and the service sector. The Basu model is applied on the three sectors. Results show that for the banking sector ( $\beta_3$ ) is not significant indicating that banks are not conservative in their reporting. A possible explanation is the bank's stock prices are considered an important indication for the Jordanian economy. Therefore, banks move away from conservative practices in financial reporting in order to show higher profits and reflect a good image of the state of the economy.

**Table (5) Results for H3**

Measuring conservatism according to sector classification			
	Banks	Manufacturing	Service
$\beta_3$	0.0082	0.211	0.065
t-value	1.01	6.28 **	1.49
Std. error	0.008	0.034	0.043
Adj-R <sup>2</sup>	1.09%	11.12%	4.08%

$\beta_3$  is the response coefficient for the variable  $(NEG*RET)_{it}$ , which is the measure of conservatism.

The ASE classifies the market into three main sectors: Banking, manufacturing and services other than financial services.

\*\* t values at 1% significance level.

The Basu Model is applied on each sector independently and resulting ( $\beta_3$ ) is obtained and compared.

When the model is applied on the manufacturing sector, ( $\beta_3$ ) becomes significant and with a large value. This indicates that conservatism is used more extensively in this sector. A possible explanation for this result is that manufacturing firms usually finance their operating and investing activities through acquiring loans. Therefore, lenders and debt providers place restraints on these companies in order for them to report their financial position with higher conservatism.

Another explanation is the use of accruals. As the level of accruals increase, the level of conservatism becomes higher. This is because accrual accounting is a method of using conservatism in financial reporting. Manufacturing firms rely heavily on accrual accounting compared to service firms; as a result, conservatism is higher in the manufacturing sector. This result is shown when the model is applied on the service sector; ( $\beta_3$ ), the measure of conservatism, is not significant.

#### **Test of H<sub>4</sub>: ( $\beta_3$ ) is smaller in loss reversal firms**

Loss reversal firms are companies that report profits directly after reporting a loss in the previous year. The results show that loss reversal firms move away from conservatism in order to report profits. The ( $\beta_3$ ) is not significant for firms reversing losses. This indicates that once firms report a loss, they undergo tremendous efforts in order to report profits in the following year in order to show that the previous year loss has no effect on the financial position of the company and as a result regain investors trust rapidly.

**Table (6) Results for H4**

Measuring conservatism in loss reversal firms			
$NI_{it} = \alpha + \beta_1 NEG_{it} + \beta_2 RET_{it} + \beta_3 (NEG * RET)_{it} + \varepsilon_{it}$			
Coefficient	Coefficient measure	Std. error	t-value
$\alpha$	0.0012	0.0006	1.89
$\beta_1$	0.0005	0.0012	0.45
$\beta_2$	0.0062	0.00059	10.44 **
$\beta_3$	-0.0036	0.0035	-1.05
	R <sup>2</sup>	adj-R <sup>2</sup>	F-value
	10.33%	10.08%	41.14

Loss reversal firms are firms that report a loss in period t-1 and a profit in period t.

$\beta_1$ ,  $\beta_2$  and  $\beta_3$  are the response coefficients for  $NEG_{it}$ ,  $RET_{it}$  and  $(NEG*RET)_{it}$  respectively.

Where;

$NEG_{it}$ : is the indicator variable that equals 1 if returns in period t-1 is negative (losses), 0 otherwise.

$RET_{it}$ : is stock returns for a period of 12 months ending on March for firm i in period t,

thus,  $\beta_2$  is measure for good news only.

$(NEG*RET)_{it}$ : is returns for firms that report losses, thus  $\beta_3$  is the measure of conservatism for firm i in period t.

$A_{t-1}$ : is total assets for firm i at period (t-1), to scale variables to reduce heteroskedasticity

\*\* t values at 1% significance level.

**Test of H<sub>5</sub>: Measuring effect of financial crisis on conservatism**

The financial crisis (identified as the credit crisis) occurred between 2007 and 2008; there is no agreed upon starting point for the crisis. However, this study uses the year 2007 as a starting time period of the crisis based on anecdotal evidence. Its influence is still affecting many economies and financial markets to this date. In order to measure the effect of the financial crisis on accounting practices and financial reporting in terms of conservatism, the sample is divided into two subgroups based on time period. The first group is the period from 2001 to 2006, and the second group is the period from 2007 to 2010. The model is applied on each period-group and the resulting ( $\beta_3$ ) is compared. Results are shown in Table (7).

**Table (7) Results for H5**

Measuring effect of financial crisis on conservatism		
Coefficient	Pre 2007	Post 2007
$\beta_3$	0.1759	0.1012
t-value	6.01 **	2.85 **
Std. error	0.0292	0.0065
adj-R <sup>2</sup>	7.76%	6.31%
F-value	19.15	10.57

$\beta_3$  is the response coefficient for the variable  $(NEG*RET)_{it}$ , which is the measure of conservatism.

The cut-off period is the year 2007.

\*\* t values at 1% significance level.

The results indicate that accounting conservatism in financial reporting is lower after the impact of the financial crisis. This is against expectations; the assumption is that after the financial crisis companies will become more prudent in reporting their financial position. Managers did not comprehend yet the full extent of the crisis and its affect the state of the economy; therefore, they will apply more conservative accounting practices. For example, many companies rely more on the LIFO method during inflation periods. However, results show that companies were more conservative before the financial crisis as compared to after the crisis.



The results show that pre 2007, the measure of conservatism from the Basu Model ( $\beta_3$ ) is (0.1759). The measure decreased after post 2007 to (0.1012). A possible explanation is that managers wanted to show that the financial crisis has no effect on the financial position of their companies and reassure investors and lenders that their financial position is not threatened. Hence, they use less conservative accounting practices in order to show more optimistic financial results.

### **Conclusion**

This paper aimed to measure accounting conservatism in different scenarios and circumstances for listed companies in the Amman Stock Exchange (ASE). The paper applied the model developed by Basu (1997) that captures and measures accounting conservatism within the net income figure.

In order to measure the model overall validity, it was applied on the sample as a whole without specifying any conditions. The results show that the Basu model does actually measure conservatism for the listed companies in the ASE. After that, the model was applied on the sample after specifying certain conditions and circumstances in order to measure conservatism between these conditions. The model was applied on two subsamples; loss firms and profit firms. The results show that conservatism is higher for firms reporting losses compared to firms that report profits. This result shows that the level of conservatism changes according to firms' profitability.

Accounting conservatism is measured across industry classification. According to the ASE, companies are classified into three main sectors; banking, manufacturing and services sectors. Results show that manufacturing companies are conservative in their financial reporting while the other two sectors show no evidence of using conservative practices. A strong explanation for this result is that manufacturing firms rely on accruals more than other types of companies. Results also show that service firms are not conservative in their reporting. Hamdan (2011) provides evidence that manufacturing firms show less conservatism in their reporting. The differing results could be attributed to the size of the sample and the time period included in the sample. Moreover, his study did not take into account the circumstances and conditions that could affect the level of conservatism in manufacturing firms. Additionally, The Basu model does not measure

conservatism for banks. This result is also inconsistent with other studies conducted on Jordanian firms (e.g. Hamdan, 2012; Yaseen, 2008). The results in both studies show that banks listed in the ASE are more conservatism than any other types of companies.

Furthermore, the results show that loss reversal firms show less use of conservative accounting practices. This can be explained by the effort of these firms in order to report profits directly after a loss year. Therefore, they move away from conservative accounting practices and show an optimistic position of their financial results and regaining the trust of the market rapidly.

Conservatism was also measured before and after the financial crisis. Results show that companies show more conservative practices before the crisis. Companies want to show that the crisis has little or even no effect on their financial position. Therefore, they use less conservative (more optimistic) accounting practices and issue financial reports with stronger and better financial standings.

The implication of this study is highlighting how companies manipulate the level of conservatism depending on the circumstances. Managers choose the desired accounting methods in order to increase or decrease conservatism and as a result increase (decrease) reported earnings. Based on that, investors and analysts should take into consideration the economic surroundings of a company, whether on the macro or micro levels, when assessing the quality of reported earnings.

Moreover, accounting conservatism in Jordan is under-researched. There is an imperative need to emphasis on the accounting practices applied in firms and how they affect the level of conservatism. Future research should focus on measuring conservatism over the years for listed companies in the Amman Stock Exchange. This will give a better understanding on whether companies are becoming more/less conservative through a span of time. Moreover, it will give significant insight on the evolution of accounting practices and techniques used by listed companies. Additionally, future research should assess the effect of conservatism on the quality of financial reporting and its relation to earnings management.

### References

- Ahmed, A. & Duellman, S. 2013, "Managerial overconfidence and accounting conservatism", *Journal of Accounting Research*, vol. 51, no. 1, pp. 1-30.
- Ahmed, A., Billings, B., Morton, R. & Stanford-Harris, M., 2002, "The role of accounting conservatism in mitigating bondholder-shareholder conflicts over dividend policy and reducing debt costs", *The Accounting Review*, vol. 77, no. 4, pp. 867-890.
- Ball, R., Kothari, S. & Robin, A, 2000, "The effect of international institutional factors on properties of accounting earnings", *Journal of Accounting and Economics*, vol. 29, pp. 1-51.
- Basu, S., 1997, "The conservatism principle and the asymmetric timeliness of earnings", *Journal of Accounting and Economics*, vol. 24, pp.3-37.
- Beatty, A., Weber, J. & Yu, J., 2008, "Conservatism and debt", *Journal of Accounting and Economics*, vol. 45, pp. 154-174.
- Beekes, W., Pope, P., & Young, S., 2004, "The link between earnings, timeliness, earnings conservatism and board composition: evidence from the UK", *Corporate Governance: an International Review*, vol. 12, no. 1, pp. 47-59.
- Bushman, R. & Piotroski, J., 2006, "Financial reporting incentives for conservative accounting: the influence of legal and political institutions", *Journal of Accounting & Economics*, vol. 42, pp. 107-148.
- Chen, Q., Hemmer, T. & Zhang, Y., 2007, "On the relation between conservatism in accounting standards and incentives for earnings management", *Journal of Accounting Research*, vol. 45, no. 3, pp. 541-565
- Christie, A., 1990, "Aggregation of test statistics: an evaluation of the evidence of contracting and size hypotheses" *Journal of Accounting and Economics*, vol. 12, pp. 15-36.

- Ettredge, M., Huang, Y. & Zhang, W., 2012, "Earnings restatements and differential timeliness of accounting conservatism", *Journal of Accounting and Economics*, vol. 53, pp. 489-503.
- Francis, J., Lafond, R., Olsson, P & Schipper, K., 2004, "Costs of Equity and Earnings Attributes", *The Accounting Review*, vol. 79, no. 4, pp. 967-1010.
- Giner, B. & Rees, W., 2001, "On the asymmetric recognition of good and bad news in France, Germany and the United Kingdom", *Journal of Business Finance & Accounting*, vol. 28, no. 9-10, pp. 1285-1331.
- Givoly, D., Hayn, C. & Natarajan, A., 2007, "Measuring Reporting Conservatism", *The Accounting Review*, vol. 82, no. 1, pp. 65-106.
- Grambovas, C., Giner, B. & Christodoulou, D., 2006, "Earnings conservatism: panel data evidence from the European Union and the United States", *ABACUS*, vol. 42, no. 3/4, pp. 354-378.
- Hui, K., Klasa, S. & Yeung, P. 2012, "Corporate suppliers and customers and accounting conservatism", *Journal of Accounting and Economics*, vol. 53, pp. 115-135.
- Huijgen, C. & Lubberink, M., 2005, "Earnings conservatism, litigation and contracting: the case of cross-listed firms", *Journal of Business Finance & Accounting*, vol. 32, no. 7/8, pp. 1275-1309.
- Kothari, S., Ramanna, L. & Skinner, D., 2010, "Implications for GAAP from an analysis of positive research in accounting", *Journal of Accounting and Economics*, vol. 50, pp. 246-286.
- Krishnan, Gopal, 2005, "The association between big 6 auditor industry expertise and the asymmetric timeliness of earnings", *Journal of Accounting, Auditing & Finance*, vol. 20, no. 3, pp. 209-228.
- LaFond, R. & Watts, R., 2008, "The Information Role of Conservatism", *The Accounting Review*, vol. 83, no. 2, pp. 447-478.
- Louis, H., Sun, A. & Ucran, O., 2012, "Value of cash holdings and accounting conservatism", *Contemporary Accounting Research*, vol. 29, no. 4, pp. 125-144.

- Pope, P. & Walker, M. 1999, "International differences in the timeliness, conservatism and classification of earnings" *Journal of Accounting Research*, Supplement pp.53-98.
- Ramalingegowda, S. & Yu, Y., 2012, "Institutional ownership and conservatism" *Journal of Accounting and Economics*, vol. 53, pp. 98–114
- Raonic, I., Mcleay, S. & Asimakopoulos, I., 2004, "The timeliness of income recognition by European companies: an analysis of institutional and market complexity", *Journal of Business Finance & Accounting*, vol. 31, no. 1&2, pp. 115-148.
- Roychowdhury, S. & Watts, R., 2007, "Asymmetric timeliness of earnings, market to book and conservatism in financial reporting", *Journal of Accounting and Economics*, vol. 44, pp. 2-31.
- Ruddock, C., Taylor, S. & Taylor, S., 2006, "Non-audit services and earnings conservatism: is auditor independence impaired", *Contemporary Accounting Research*, vol. 23, no. 3, pp. 701-746.
- Sen, P. 2005. "Reported earnings quality under conservative accounting and auditing", *Journal of Accounting, Auditing & Finance*, vol. 20, no. 3, pp. 229-256.
- Watts, R. & Zimmerman, J., 1990, "Positive accounting theory: a ten year perspective", *The Accounting Review*, vol. 66, pp. 131-156.
- Watts, R., 2003, "Conservatism in accounting part I: explanations and implications", *Accounting Horizons*, vol. 17, no. 3, pp. 207-221.
- Watts, R., 2003, "Conservatism in accounting part II: evidence and research opportunities", *Accounting Horizons*, vol. 17, no. 4, pp. 287-301.
- Zhang, Xiao-Jun, 2000, "Conservatism accounting and equity valuation", *Journal of Accounting and Economics*, vol. 29, pp. 125-144.

: " 2012  
.41-22 1 8 "

: " 2011  
"  
.433-415 2 38  
" 2008  
"