

# The Level of Accounting Conservatism and Firm Life Cycle

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**Abstract:** The aim of the research was to investigate the level of accounting conservatism in firm life cycle. The research method was descriptive-survey. 80 listed companies on Tehran Stock Exchange in 2009-2013 were selected as a sample. Using panel data model the results showed that firms in their growth and decline stage are less conservative in comparison to maturity stage.

**Keywords:** accounting conservatism, firm life cycle, Tehran Stock Exchange.

## Introduction

A company spends various stages including introduction, growth, maturity, and decline over its life. Among this stage, maturity stage is of considerable importance. In the growth, the company is developed. It consumes cash to buy productive capital assets in investments in working. On the other hand, it also includes high return on investment. The companies that spend their adult stage and create cash flow from their existing assets and they have balance returns. According to well-informed and unaware of the relationship between the environment and economic activity has also been adjusted (Rahmani et al., 2011).

Conditional conservatism is one of features for measurement system of accounting. To determine the extent in this system is of great importance. One of criteria for its measurement is time asymmetry for profit of Basu (1997). Basu (1997) stated in this case that gains identified bad news (losses) faster than good news and this asymmetric behavior of the gain was attributed to accounting conservatism (Rezazadeh & Heidarian, 2010). With regard to economic aspects information, financial reporting and accounting system play a vital role in the capital market. The main objective of financial reporting is to provide the information needs of investors. Investors and users by using accounting information predict future performance of the company and they use it for valuation of the company (Dastgiri & Khodadadi, 2007).

A number of researchers studied the effect of conservatism on the value of the company. The researchers only observed the effect of conservatism on the value of the company and other factors such as economic characteristics were not examined (Karami and Emrani, 2010). One of these economic characteristics is the company life cycle.

According to life cycle theory, the companies at different stages of the lifecycle financially and economically include special indicators and behaviors; this means that company financial and economic characteristics are affected the life cycle which the company is there, indicate that reaction and response of capital markets to accounting information at different stages of the life cycle are significantly different. Therefore, the aim of the research was to investigate the level of conservatism in companies life cycle.

### Materials and Methods

The research method was descriptive-survey. The research population included all companies listed on Tehran Stock Exchange in 2009-2013 that according to Morgan and randomly, 80 companies were selected as a sample. Companies that met the following conditions were chosen as examples.

1. They have not fiscal years during the study period.
2. They are not a part of investment companies, financial intermediaries, holding, leasing and bank.
3. Company financial statements are available.
4. They are in stocks from 2009 to 2013.
5. Their fiscal year lead to the end of March.

To achieve research objectives, the model like the Table1 was used.

**Table 1.** Variables definition.

$C\text{-SCORE}_{it} = \beta_0 + \beta_1 D_{\text{MATURTY}_{it}} + \beta_2 D_{\text{DECLINE}_{it}} + \beta_3 D_{\text{GROWTH}_{it}} + \beta_4 \text{AGE}_{it} + \beta_5 \text{SG}_{it} + \beta_6 \text{DP}_{it} + \beta_7 \text{CEV}_{it}$			
Symbol	Type of Variable	Name of Variable	Calculation method
C-SCORE	Dependent	Conservatism	$C\_Score = \beta_4 = \lambda_1 + \lambda_2 \text{Size}_{it} + \lambda_3 \text{M/B}_{it} - \lambda_4 \text{Lev}_{it}$ $\text{SIZE} = \text{Logarithm of the market value of equity}$ $\text{M/B} = \text{Book value / market value}$ $\text{Lev} = \text{Total assets / total debt}$
MATURY	Independent	MATURY	If the sum of compound, average of growth of sales, dividends and capital expenditures in Table equal 6, the company will be in a growth phase.
DECLINE	Independent	DECLINE	If the sum of compound, average of growth of sales, dividends and capital expenditures in Table equal 5, the company will be in a growth phase.
Growth	Independent	Growth	If the sum of compound, average of growth of sales, dividends and capital expenditures in Table equal 7, the company will be in a growth phase.
AGE	Independent	AGE	Year of company = fiscal year – age of company
SG	Independent	SG	percent of sales growth = sales of current year - sales last year - sales of last year during year T
DP	Independent	DP	Annual dividends as a percentage of revenue of year T = common stock dividend for the year T/ income of the company before extraordinary items
CEV	Independent	CEV	Capital expenditure as a percentage of the total value of the company at the year T = book value of long-term debt at the end of year T + equity value of shareholders/ change of fixed assets of T and T1

For data analysis, regression, Fisher F-test, t significance test and Hausman test were used. Also, to choose between panel data and data compilation methods, F Limer test for the test of non-correlation, Durbin-Watson test for test of heterogeneity, variances for White test and also Fisher test were used for stationary test of variables. Moreover, we drop maturity stage from the regression to avoid dummy trap and compare the other results with it.

In other words, mature firms are more conservative than growth firms

### Results

According to the probability F statistic calculated (0.000), it can be argued that the fitted regression model is significant. According to determine the coefficient of the fitted model, it can be claimed that about 78 percent of the variations in the dependent variable (conservatism) is explained by the independent variables. The estimated coefficient of  $D_{\text{GROWTH}}$  independent variable in the table 2 reflects negative and significant relationship between growth stage and conservatism at the level 0.01 because the p-value calculated for the

independent variable coefficient of less than 0.01 is obtained. Therefore, we can say in comparison with maturity stage, firms in the growth stage are less conservative. In other words, mature firms are more conservatism than growth firms. The estimated coefficient of  $D_{\text{DECLINE}}$  independent variable in the table shows negative and significant relationship between DECLINE and conservatism at the level of 0.01 because the p-value calculated for the independent variable coefficient of less than 0.01 is obtained. Therefore, in comparison with maturity stage, firms in the decline stage are less conservative. In other words, mature firms are more conservatism than decline firms.

**Table 2.** The summary of statistics results of the first model.

Variable	Coefficients	Standard deviation	t-statistics	Significance level
C	2.6745	5.1776	0.5165	0.6058
Growth stage ( $D_{\text{GROWTH}}$ )	-0.0881	0.0248	-3.5509	0.0004
Decline ( $D_{\text{DECLINE}}$ )	-0.0678	0.0253	-2.6804	0.0077
Age of the company ( $AGE$ )	-0.0823	0.1570	-0.5243	0.6004
Sale growth ( $SGT$ )	0.0009	0.0002	4.3264	0.0000
Dividend ( $DPT$ )	0.0803	0.0245	3.2723	0.0012
Capital cost ( $CEV$ )	0.0001	0.0000	2.3333	0.0203
(F Fisher statistic (significant (0.0000)	12.7221	Durbin Watson statistics		2.1612
Coefficient of determination	0.7750	Adjusted coefficient of determination		0.7141

### Discussion and Conclusion

The aim of the research was to investigate the level of conservatism in companies' life cycle. The results are consistent with the results of Feroz and Ud-Din (2011) but they are not consistent with the results of Asna Atqa Abdulla1, N.M.-S. (2014) on that when the companies spend decline stage, according to their circumstances and the need to continue, they predict a higher level of verification to identify good news compared to identification of bad news.

According to Chen and Huang (2007), accounting conservatism of companies in the early stages and growth, more than ever are to unconditional conservatism actions, more conservative measures unconditionally and less attention is discussed on conditional conservatism. This can lead to forecasting symmetrical earnings. With approaching the to the stage of ejaculation, conditional conservatism by preventing deviations which there are in growth and efflorescence, can become more stronger due to unconditional conservatism in future periods. The results are also consistent with the results of Asna Atena Abdollahi (2014) that higher growth company will bring a greater volume of revenue for the company. Overall, conservatism shows the asymmetry in requirements for verification gains and necessities of lifecycle of the companies with U. Karami and Emrani (2009) performed a study on the impact of the company life cycle and conservatism on the value of the company which in this research, the stages of company life cycle is divided into three categories: growth, maturity and decline. They concluded that investors care more about Net Operating Assets and abnormal operating profit of the companies in the growth stage to companies of mature and declining stages of the day. Feroz and Ud-Din (2011) discussed on investigating the relationship between conservatism and a number of enterprise features. They showed that the correlation coefficient between conservatism and variable of life was negative and significant and for variables of the investment life cycle and special uncertainty of the company was positive and significant.

### Conflict of Interest

The authors declare no conflict of interest.

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