NEXUS BETWEEN ACCOUNTING CONSERVATISM AND BOARD ATTRIBUTES: MODERATING ROLE OF INSTITUTIONAL OWNERSHIP

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ABSTRACT

Accounting conservatism is a principle for preparing financial statements to maintain accuracy and provide an accurate picture of the company's performance. This study examines the impact of board attributes on accounting conservatism with a moderating role of institutional ownership. Accounting conservatism is treated as a dependent variable, while board attributes (Board independence, Board size, Board diversity) are treated as independent variables in the current study. The current study uses the random effect model for the panel data from 2012-2021 to obtain the main objectives. The study's findings show that board size and independence are statistically significant and positively related to accounting conservatism. In contrast, board diversity is an insignificant factor in accounting conservatism. Moreover, the study also finds that institutional ownership has an influential role in tackling the issue of accounting conservatism. Institutional ownership with board size and independence has a significant positive association with accounting conservatism in non-financial firms. This study breaks new ground by exploring the scarcity of literature on board-specific attributes and institutional investors' role in addressing accounting conservatism, especially in poorly developed economies. This study significantly adds to the current literature by offering comprehensive insights and empowering investors with valuable information.

Keywords: Accounting conservatism, Board size, board independence, board diversity, Institutional ownership

INTRODUCTION

The transparency and timeliness of accounting information have greater importance in financial reporting in the current era of globalization. The imperfection and false manipulation within financial reporting resulted in the firm's collapse, like Enron, One Tel, World Call, etc. (Saeed, 2018). Therefore, companies must follow several accounting conventions to ensure accuracy while preparing financial statements.

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Conservatism is one of such accounting standards that requires accountants to choose a method that keeps the book values of net gains relatively low in situations of uncertainty. Accounting conservatism is a set of bookkeeping that needs a high degree of verification before a company makes a legal claim to any profit, while uncertain liabilities are to be recognized as soon as they are discovered (Basu, 1997; Sugiyanto, 2018). Particularly, investors need early loss recognition, which is helpful in decision-making (Kutubi & Shawagat, 2020; Boulhaga et al., 2023).

Undervaluing anticipated gains and overvaluing anticipated losses leads to reporting less net income and lower financial benefits expected in the future. This presents a miserable picture of a company's financial performance, which will encourage management to exercise greater care in its decisions. Accounting conservatism affects the quality of figures reported in financial statements (Kordlouie et al., 2014). Therefore, following conservatism, the unrecorded reserves created by the lower earnings give the flexibility to write more gains in the future. A company can inject more funds and increase investment, thereby reducing earnings. Conservatism, also known as the timely economic loss recognition process, is a determinant of earning quality as it increases the usefulness of financial statements in the minds of shareholders, debtors, regulators, and other potential investors (Kutubi, 2020). Accounting conservatism increases reporting transparency and regulates monitoring ability (Bushman et al., 2013), which are more prudent in managing lending risk, and such companies face fewer financial constraints (Bushman & Williams, 2015). Similarly, timely loss recognition increases the likelihood of quickly identifying bad debts, reducing lending-based corruption (Akins et al., 2017). Moreover, reducing agency problems, enhancing contractual agreements, reducing litigation costs, good decision-making, and reducing information asymmetry are the results of conservative reporting (Ahmed & Duellman, 2007; Affes & Sardouk, 2016).

In contrast, literature also witnessed the dark side of accounting conservatism (Ruch & Taylor, 2015), arguing that the conservatism approach is sometimes used for revenue shifting when a transaction does not meet the requirements to be reported. So, it must be written in the following period, which leads to the current period being understated and future periods being overstated. Accounting conservatism takes place in conditional and unconditional forms. Conditional refers to timely loss recognition (Basu, 1997), while in unconditional conservatism, values are reported independently to the economic event or news (Watts, 2003). It has been argued that company management has more information about company risk and expected losses than outsiders (Leventis et al., 2004). Therefore, due to the information asymmetry, an outsider can only rely on accounting information for decision-making and future predictions about the company. In such cases, accounting conservatism helps managers to decrease agency problems and easily attract outsiders for contracting by improving accounting information. Some factors can improve the effectiveness of an organization by enhancing conservatism and minimizing the risk associated with accounting conservatism, like ownership structure (Liu, 2019; Lin, 2016; Song, 2015) and good governance (Alim & Khan, 2016).

The board of directors (BOD) is one of the most crucial internal governance tools for keeping an eye on the entire operation to protect shareholders' interests and the company's strategic plans and enhance financial reporting (Sterling, 1967; Ahmed & Duellman, 2007). Instead of the board attributes' crucial role, it remains to be seen concerning accounting conservatism in developing countries, specifically in Pakistan. Moreover, in this current era of financial globalization, the increasing number of institutional shareholders interests the researchers to investigate whether they participate in effective monitoring. In the presence of institutional ownership, there is a greater need for quality reporting in financial statements, which forces managers to use accounting conservatism (Suleiman, 2014; Song, 2015).

Institutional shareholders may also process greater industry-specific knowledge than smaller owners who benefit from inexpensive and efficient monitoring (McConnell & Servaes, 1990; Jiang & Kim, 2000; Lin et al., 2014). Institutional shareholders focus more on performance and aim for more profits than domestic shareholders. Institutional shareholdings are predicted to increase business performance by effectively overseeing the firm's policies and strategies (Jansen & Meckling, 1976) and using tactics like the poison pills technique (Gine et al., 2017). Institutional investors enhance monitoring and strengthen the quality of financial reporting (Alkurdi et al., 2017) because fewer institutional investors offer management the opportunity to earn managing (Lin et al., 2014).

In contrast, it is also argued that larger institutional ownership positively relates to less conserved financial reporting and facilitates financial management (Lin, 2016). Such variation in institutional investor outcomes fulfills the basic rule for treating it as a moderator in the nexus between accounting conservatism and board attributes. Therefore, examining whether institutional ownership modifies the connection between common directors and the implication of accounting conservatism will be fascinating. This study gets support from agency theory (Jensen & Meckling, 1972) and resource dependency theory (Pfeffer & Salansick, 1978), which are used by (Cooper & Uzun, 2012 Affes & Sardouk, 2016; Francis et al., 2013; Watts, 2003; Majeed et al., 2017) highlighting that agency conflict enhances risk. On the other hand, supporting the resource dependence theory, (Elyasiani & Zhang, 2015; Van et al., 2010; Le et al., 2022; Mohammed, 2023) conclude that the board positively influences firms performance and reduces the risk because of their knowledge, information, and experience attributable to their extensive interactions with various sectors of the economy (reputation effect). Resource-dependent theory (RDT) proponents argue that resource-constrained firms gain access to external resources in multiple ways, comprising vertical integration, joint ventures, political action, and executive succession (Hillman et al., 2009).

Review of Literature and Proposed Hypotheses

Accounting conservatism mandates that before formally reporting any gains, accountants thoroughly investigate all transactions, identify any impartial, and provide a fair depiction of the firm's financial statements (Ali et al., 2021). Accounting conservatism restricts management prudence, helps resolve agency problems, and allows for effective negotiation where data asymmetry exists (Almashhadani et al., 2022; Ahmed & Duellman, 2007). To ensure a robust risk management system, the firm board of directors has a crucial role through regular meetings, maintains control over the company, and has a clearly defined rule (Kamardin et al., 2014).

Board Size and Accounting Conservatism

Board size is a double-edged sword as it reduces agency conflict (Jensen & Meckling, 1976) through accounting conservatism (Ahmed & Duellman, 2007). A larger board size shares more expertise and knowledge, which benefits firms in preparing financial statements. This provides good signals to the market, attracts investors, and increases firm performance (Mubeen et al., 2022). On the other hand, a giant board is less efficient because it is challenging to align a large commission on a single policy. Due to diverse opinions, larger panels cause inefficiency, decreasing accounting conservatism (Abdul-Manaf et al., 2014; Boussaid et al., 2015; Nasr & Ntim, 2017; Almashhadani et al., 2022). This study argues and assumes that a larger board will promote accounting conservatism, so benefits more than the costs (Coles et al., 2008).

Previous literature witnessed that prominent board members would lower the probability of firm insolvency (Platt & Platt, 2012; Darrat et al., 2016; Ahmed & Duellman, 2007). Literature also disclosed that board size favors conservative accounting practices in the context of conservatism (Mohd et al., 2020; Muttakin et al., 2019). Based on the above discussion, the current study's proposed hypothesis for the relationship between board size and accounting conservatism is

H1: Board size hurts accounting conservatism.

Board Independence and Accounting Conservatism

Board independence is considered the central pillar for reducing agency costs. Board independence enhances monitoring and compels management to follow basic rules, including accounting conservatism for preparing financial statements (Beekes et al., 2004; Fariha et al., 2022). It is intended that improved conservatism regarding accounting in reporting financial information will result from the independence features within the board (Aburisheh et al., 2022; Zadeh et al., 2023). A more impartial board of directors can provide better supervision and make choices that benefit the business and its stakeholders. An independent board assists in developing confidence and credibility with investors and other stakeholders, preventing conflicts of interest and guaranteeing that the firm is run ethically (Ahmed & Duellman, 2007).

H2: Board independence hurts accounting conservatism.

Board Diversity and Accounting Conservatism

The third most important aspect of a Board is gender diversity, which means male and female members within a board. The existence of male and female members has a dual impact on the entire firm's performance (Adam et al., 2010). By nature, females are risk aversive while males are risk takers, so increasing gender diversity may protect the company from any risky decision or loss. Still, on the other hand, such an increase in gender diversity may decline the firm's performance. The company may miss fruitful opportunities for fear of risk (Srinidhi et al., 2011; Virtanen, 2012; Pandey et al., 2022). Moreover, gender diversity also increases conflict because the monitoring role of females is less influential than males. Poor monitoring encourages the rest of the management to avoid illegal practices like accounting conservatism and expropriation (Alim et al., 2020). Governments and corporations worldwide have been making substantial efforts in recent decades to enhance the representation of women. Greater gender equality in the workplace is now more critical than ever, although some contend that appointing female directors benefits the company, as confirmed by previous findings (Wang L, 2016).

H3: Board diversity has a positive impact on accounting conservatism

Institutional Ownership in Moderating Role with Board Attributes

Institutional ownership limits a manager's behavior and can influence, control, and lessen the information gap among stakeholders (Song, 2015; Cao et al., 2016; El-Habashy, 2019). High monitoring due to institutional ownership may help improve the quality of financial reporting and impact accounting practices (Jiang & Kim, 2004; Lin et al., 2014). Institutional investors are more crucial in influencing management to embrace more conservative accounting practices, which benefits the company (Ahmed & Duellman, 2007).

Institutional investors are encouraged to participate in company governance actively (Lin et al., 2014; Cullinan et al., 2012). Institutional shareholders often possess more vital skills to decrease opportunistic management behavior and earnings management potential (Farooq & El Jai, 2012; Amahalu et al., 2023). Institutional investors and board attributes may be more influential because of excessive monitoring of the firms' operations.

METHODOLOGY

Accounting conservatism is a dependent variable in the current study, which can be measured through the firm-specific proxy following Givoly and Hayn (2000).

$$\text{Accruals} = \text{EBEXT it} + \text{DEP it} - \text{OCF}\frac{\text{it}}{\text{TA}} - - - -(1)$$
$$\text{CONACC} = (\text{Accruals})\text{x}(-1) - - - - - - -(2)$$

From equation 1, EBEXT represents income before tax and extraordinary items, DEP is the depreciation charge for the year, OCF is operating cash flow, and TA is total assets. From equation 1, the current study calculates accrual, which is further used for measuring accounting conservatism in equation 2.

Description of Variables

Name	Notation	Variable	Measurement
Accounting Conservatism	ACC	Dependent	Accrual based measurement
Board size	BS	Independent	Log of total number of directors
Board independence	BI	Independent	A ratio of non-executive directors
Board diversity	BD	Independent	Percentage of women on board
Institutional ownership	IO	Moderating	Institutional investor shares / total outstanding shares
Firm size	FS	Control	Log of total assets
Financial leverage	FL	Control	Total Assets/ total liabilities
Market to book value	MTB	Control	Market value/ book value

$$\text{ACC}_{i\text{t}} = \alpha_{i\text{t}} + \beta^1\text{BS}_{i\text{t}} + \beta^2\text{BI}_{i\text{t}} + \beta^3\text{BD}_{i\text{t}} + \beta^4\text{IO}_{i\text{t}} + \beta^5\text{BS}*\text{IO}_{i\text{t}} + \beta^6\text{BI}*\text{IO}_{i\text{t}} + \beta^7\text{BD}*\text{IO}_{i\text{t}} + \beta^8\text{FS}_{i\text{t}}$$
$$+ \beta^9\text{FL}_{i\text{t}} + \beta^{10}\text{MTB}_{i\text{t}} + \varepsilon_{i\text{t}} - - - - - -(4)$$

Equation 4 highlights the econometric model for the relationship between accounting conservatism and board attributes with a moderating role of institutional ownership. From the equation, ACC is the accounting conservatism, α is the intercept coefficient, β is the slope coefficient, ε is the error term (supposed to be white noise), and $_I$ represent cross sections and the selected period (2012-2021).

The Data

The current study is quantitative and relies on secondary data. Panel data for the current study is collected through various sources such as the firm's annual reports, yahoo finance, and the company's official websites from 2012 to 2021.

Testing For Multicollinearity

The presence of multicollinearity leads to biased results upon which one cannot rely. Therefore, Data must be devoid of multicollinearity problems, which is one of the fundamental presumptions of the conventional linear regression model.

Testing for Heteroscedasticity

One of the basic assumptions of the classical linear regression model (CLRM) is the existence of homoscedasticity in the data. This means that the error term remains constant across the observations.

$$Var(\mu t) = \sigma^2 - - - - - - - - - - - - (5)$$

Heteroskedasticity, which refers to the variance or error term being variable and distributed, violates this assumption. Heteroskedasticity will trigger the equation to change in a certain way.

$$Var(\mu t) = \sigma t^2 - - - - - - - - - - - (6)$$

The distinction between equations 5 and 6 is the letter "t," which denotes the possibility that the variance of the explanatory Variable may vary for each distinct observation of the study's sample.

Hausman Test

The Hausman test determines the appropriate model between fixed and random effects models. When faced with panel data, researchers often confront the choice between these two models to account for unobserved heterogeneity.

$$H = (\beta^{FE} - \beta^{RE}) [Var(\beta^{FE}) - Var(\beta^{RE})]^{-1} (\beta^{FE} - \beta^{RE}) \sim x^2 - - - - - ()$$

In the equation above, β^{FE} represents the beta for the fixed effect model, while β^{RE} represents the beta for the random effect model.

Random Effect Model

The random effect model assumes that the individual-specific effects are uncorrelated with the explanatory variables, capturing the average impact across entities while allowing for individual deviations from this average. By incorporating both time-invariant heterogeneity and within-unit variability, the random effects model efficiently estimates the impact of variables on the outcome of unobserved individual-specific characteristics.

RESULT and DISCUSSION

Table 1: Descriptive Statistics

Variable	Obs	Mean	Std-Dev	Min	Max
ACC	1000	-13.001	2.0511	-18.579	-5.8112
BS	1000	8.121	1.4807	5	17
BI	1000	0.1822	0.1226	0.01	1.12
BD	1000	0.1033	0.1286	-0.0061	0.5714
IO	1000	14.345	2.7792	5.9107	20.766
BS*IO	1000	117.10	34.491	41.375	267.84
BI*IO	1000	2.5714	1.7822	0.1132	16.055
BD*IO	1000	1.5128	1.9259	-0.0998	8.6343
FS	1000	15.242	1.9445	6.3969	18.919
FLEV	1000	0.6625	0.5224	-0.0072	4.3818
MTBV	1000	101.13	668.67	-232.58	11745.48

Table 1 presents a statistical summary of the number of observations and the minimum, maximum, and standard deviation of all variables used in the current study.

Table 2: Correlation Matrix

I	ACC	BI	BS	BD	IO	BS*IO	BI*IO	BD*IO	MTB	FL	FS
ACC	1.0000										
BI	-0.0304	1.0000									
BS	-0.2616	-0.0796	1.0000								
BD	0.0250	0.0242	-0.1344	1.0000							
IO	-0.2205	-0.0800	0.1478	0.0834	1.0000						
BS*IO	-0.3195	-0.0823	0.7492	-0.0356	0.7533	1.0000					
BI*IO	-0.1226	0.8808	-0.0100	0.0414	0.2297	0.1667	1.0000				
BD*IO	0.0051	0.0121	-0.1183	0.9819	0.1957	0.0478	0.0684	1.0000			
MTB	0.0650	-0.0350	-0.0475	0.0927	-0.0145	-0.0439	-0.0332	0.0904	1.000		

FL	0.2250	0.0097	-0.0514	0.0394	0.0376	-0.0046	0.0071	0.0472	0.011	1.000
FS	-0.7964	0.0307	0.2376	0.0015	0.1812	0.2768	0.1057	0.0174	-0.036	-0.26	1.0

*ACC: Accounting Conservatism, BI: Board Independence, BS: Board Size, BD; Board Diversity, IO: Institutional Investor, BS*OI: Board Size with Institutional Investor, BI*IO: Board Independence with Institutional Investor, BD*IO: Board Diversity with Institutional Investor, MTB: Market to Book Value, FL: Financial Leverage, FS: Firm's Size*

Table 2, confirming the absence of perfect correlation among variables used in the current study.

Table 3: Heteroskedasticity Table

Chi²	*P Value*
8.06	0.2306

Table 3 shows the result of the Breuch Pagan test, which shows that the probability value is more than the statistically significant value (0.05), confirming the presence of homoskedasticity in the data.

Table 4: Hausman Test

chi2	*3.18*
Prob	0.9569

Table 4 presents the findings of the Hausman Test. The p-value of the Hausman test is 0.9569, which is greater than the significant value of (0.05), so the null hypothesis that the random effect model is more appropriate should be accepted.

Table 5: Random Effect Model

ACC	Coef	Std. Err	t-statistic	Prob
BS	0.3283	0.0425	7.72	0.000***
BI	1.0835	0.5039	2.15	0.032**
BD	0.1707	0.4848	0.35	0.725
IO	0.1413	0.0225	6.27	0.000***
BS*IO	0.0183	0.0018	10.16	0.000***
BI*IO	0.0838	0.0350	2.39	0.017***
BD*IO	0.0264	0.0319	0.83	0.408
FS	-0.8346	0.0210	-39.73	0.000
FL	0.0541	0.0779	0.69	0.488
MTB	0.0001	0.0000	1.95	0.051**
_con	**-10.6773**	0.2267	-47.09	0.000

*Significant at 10 percent, **significant at 5 percent, ***significant at 1 percent, Prob>F =0.0000, Adjusted R-Squared = 0.2251*

The study's findings highlight that board size is statistically significant (0.000) and relates positively (0.3283) to accounting conservatism. Increased board size enhances monitoring and reduces conflict of interest because of different opinions and diverse expertise. This leaves less space for the firm's management to violate basic rules for preparing financial statements. Such finding is in line with the previous studies of (Goshi et al., 2002; Ahmed & Duellman, 2007; Nasr & Natim, 2017; Mohammed et al., 2017; Ahmed & Henry, 2012; Lafond & Roychowdhury, 2018 Lim, 2011) and opposed (Elshindady & Hassanein, 2015; Chi et al., 2009). Similarly, board independence is statistically significant (0.032) and relates positively (1.0835) to accounting conservatism. This means that an increase in board independence results in increase in accounting conservatism. Independent directors on the board have no conflict of interest, therefore looking more effectively at preparing financial statements. Independent directors also enhance monitoring over the firms and decisions, so remains an obstacle for the management if they think of financial fraud, such findings get support (Beekes et al., 2004; Ahmed & Duellman, 2007; Nasr & Natim, 2017; Mohammed et al., 2017; Lim, 2011; Abdullah, 2004) and oppose (Beasley & Salterio, 2001; Rehman & Ali, 2006). Board diversity was found to be an insignificant factor (0.725) in accounting conservatism. Females are usually risk averse and try to follow the planned characteristics of the firms, hence remaining less influential on the firm's board. The study supports (Srinidhi et al., 2011; Hilman Dalziel, 2003; Cohen et al., 2005) and opposes (Boussaid et al., 2015; Krishnan & Visvanathan, 2008).

Moreover, the findings of the study also uncovered that board size and board independence with institutional ownership as a moderating variable were found statistically significant (0.000), (0.017) and positively (0.0183), (0.0838) related to accounting conservatism. Institutional investors strengthen the corporate governance frameworks of the organization, which improves corporate performance through proactive oversight, management know-how, and financial resources. Monitoring and reviewing the company's financial reporting methods should be done more often.

The study support (El-habashy, 2019; Ramalingegowda & Yu, 2012; Firth et al., 2016; Song, 2015; Ahmed & Duellman, 2007; Farizal et al., 2017; Lin et al., 2014; Mohammed et al., 2017; Nasr & Ntim, 2018; Kukah et al., 2016) and oppose (Jiang & Kim, 2000; Alkurdi et al., 2017; Majeed et al., 2017; Hwang et al., 2022; Cullinan et al., 2012). The current study also finds that board diversity still needs to be more significant with the moderating role of institutional ownership.

CONCLUSION
The current study delved into the intricate relationship between board attributes and accounting conservatism, exploring the moderating influence of institutional ownership. The findings revealed compelling evidence supporting the significant and positive impact of board size and board independence on accounting conservatism. Moreover, the study highlighted the crucial moderating role of institutional ownership in strengthening this relationship. However, despite its relevance in contemporary discourse, board diversity emerged as an insignificant factor influencing accounting conservatism in this context. These outcomes contribute to our nuanced understanding of the interplay between board characteristics, institutional ownership, and accounting practices, offering valuable insights into corporate governance frameworks and decision-making processes. The findings of this study might offer suggestions to companies looking to enhance the excellence value of their financial recording. Managers employ accounting procedures that represent the accurate economic content rather than their preferences due to the board's independence and the company's audit quality. At the same time, the institutions and the most prominent investors within the firm or an organization's ownership construction promote the excessive preparation of remuneration

with the management by the minor degree of prudent concept. A measure of accounting conservatism and the value of accounting evidence exists that is not necessarily dependent on the board size or the managerial owners. Companies must be compelled to follow transparency regulations by policymakers. To further the research, larger samples, more extended periods, and consideration of other governance quality standards will be used.

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