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The Relationship between Conditional and Unconditional Conservatism and Bankruptcy Risk: An Analysis of Companies in Tehran Stock Exchange

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K E Y W O R D S: conditional conservatism, unconditional conservatism, bankruptcy risk

ABSTRACT: Theoretical and empirical evidence regarding the informational role of accounting conservatism and its positive effects on preserving the interests of capital providers in stock companies abounds. The main aim of the present study is to investigate the relationship between conditional unconditional conservatism and bankruptcy risk in the companies listed in Tehran Stock Exchange. The sample of the study includes 157 companies from the companies listed in Tehran Stock Exchange and the data spans from 2005 to 2011. The results show that bankruptcy risk has no significant impact on conditional conservatism. However, contrary to the theoretical assumptions of the research, bankruptcy risk decreases unconditional conservatism among the sample companies. Furthermore, the results show that unconditional conservatism decreases bankruptcy risk. The latter finding is consistent with the theoretical assumptions of the research which indicates the advantages of accounting conservatism for protecting the interests of the owners in companies facing bankruptcy.

Introduction

Conservatism has been defined as the degree of caution and a deeper level of pessimism for identifying profit over loss. This helps to precipitate the process of identifying loss versus profit which in turn decreases the net asset value. The existence of conservatism procedures in financial reporting is a way of responding to the demand for such information to solve agency issues (Watts, 2003). Basu (1997) defines conservatism as "the differential verifiability required for recognition of profits versus losses, underestimating the gains and assets."

The above definition defines conditional conservatism. In recent studies, conservatism has been divided into two types: first, unconditional conservatism (pre-event) which is independent of news. Pre-event conservatism is based on those accounting standards which consider profit independent of the current economic news. For example, immediate identification of advertisement, research and development expenditure, even if the future cash flow is expected to be positive, is a first type conservatism (Ball, 2004). The second type of conservatism is post-event, which is also called news-dependent conservatism, conditional conservatism, and asymmetric timely earning. Post-event conservatism means a timely recognition of bad news over good news related to profit. For example, the principle of minimum cost or market value, removal of ownership after carrying out the test of value reduction, and asymmetrical identification of possible loss versus possible profit, is a second type conservatism (ibid.). The existing evidence shows that accounting conservatism, increases available cash by increasing the cash inflow and decreasing cash outflow (Biddle et al., 2011). Ahmed and Duellman (2002), Lara et al. (2101), and Li (2010) have forcefully argued that conservatism decreases capital costs by limiting radical investing and increasing operational cash flow, which leads to facilitate the inter-organization financing and expedites access to financial cash resources.

Lara et al. (2010) states that conservatism increases management incentives to avoid investing in projects with current negative net value and abandon non-beneficial projects. Bushman et al. (2010) found out that identifying loss at an early stage helps the manager to recognize and abandon non-beneficial projects at the right time. Therefore, conservatism in increasing cash flow level, decreases bankruptcy risk because according to theoretical and financial evidence, bankruptcy refers to a situation where the amount of saved cash does not meet the necessary needs. In other words, financial cash resources is needed to pay the debs and meet the obligations, which in the case of insufficient resources, leads the company to bankruptcy (Biddle et al. 2011).

Based on the above theoretical and empirical evidence, it can be expected that accounting conservatism – conditional or unconditional – affects bankruptcy risk in three ways: (1) the role of accounting conservatism in raising the amount of saved cash (e.g., discretionary reserves) helps the company to have access to adequate resources and face a lower bankruptcy risk; (2) due to on one hand underestimating of gains and assets and therefore limiting the payment to capital providers, and on the other, facilitating external financing, conservatism is able to decrease or postpone the bankruptcy of companies in crisis; (3) conservative approaches leads to a faster identification of bad news and non-beneficial projects and therefore helps stop them and reduce the possibility of bankruptcy (Biddle at al., 2011).

If accounting conservatism – conditional or unconditional – has an effect on bankruptcy risk, it may be possible that bankruptcy risk is a factor to be considered for applying conservatism approaches in financial reporting. In other words, it is expected that in companies with more likelihood of bankruptcy in the future, a higher degree of conservatism be applied, which is due to the demands and monitoring done by capital providers on the reporting environment. In the present study, in order to determine the efficacy of accounting conservatism for companies with bankruptcy signs and to consider the capital providers' tendency to implement more conservatism, the relationship between conditional and unconditional conservatism and bankruptcy risk is analyzed.

The informational role of conservatism

Managers potentially tend to overestimate the condition of the company, which given their managerial power in presenting financial reports, have the opportunity to do so. Thus, monitoring and controlling mechanisms are necessary for protecting the interests of the shareholders (Givoly and Hayn, 2000). The existing evidence suggests that conditional and unconditional conservatism reduces asymmetries and unreliabilities in information. This latter function of conservatism is due to the pessimistic view for unrealized revenues and immediate and on time identification of bad news (Watts, 2003; Li, 2010). Most of the previous studies have proven the positive effect of accounting conservatism on financial reporting environment for protecting the interests of shareholders and credit grantors (e.g., Bushman and et al., 2010; Lara, 2010).

The role of conservatism in companies facing bankruptcy

Managers are able to hide bad news about the company and it seems that negative information will be stored inside the company. However, there is a limitation in terms of the amount of bad news that managers can collect and successfully hide. This is so because if within a specific time period the collected bad news reaches a certain limit, hiding it further is either too costly or generally impossible. When collecting bad news reaches its apogee (the tipping point), the whole amount of information will be disclosed suddenly and will cause the immediate bankruptcy of the company (Jin and Myers, 2006; Hutton et al., 2009).

Given the above considerations, it seems that conservatism procedures in financial reporting for companies facing bankruptcy are of paramount importance because firstly, in these companies the amount of bad news prevails the amount of good news, and therefore, managers try more in hiding them. Secondly, the necessity of protecting the financial resources of the company through underestimating gains and assets is felt more urgently. Furthermore, conservatism decreases cash withdrawal by avoiding unnecessary costs, delaying the paying of realized costs, and decreasing the costs of agencies for storing cash. In this regard, by a late identification of profits and increasing the assets, conservatism decreases cash withdrawal as bonus, tax, or shared profit (Biddle et al., 1980; Watts, 2003; Callen, 2010).

Literature review

Jin and Myers (2006) have developed a model in which unclear information constitutes a series of individual factors that are homogenous, and creates the opportunity to hide the bad news. When later the collected bad news is disclosed, the negative consequences of stock return or the sudden plummeting of prices, shows itself. By using national data and the data from companies, Jin and Myers (2006) and Hutton et al. (2009), have respectively presented evidence for higher levels of prediction.

Kothari et al. (2009) have presented evidence suggesting that managers tend to postpone the release of bad news for foreign investors. Managerial tendency to hide bad news from foreign investors creates the danger of fall or in fact negative return skewness. This is due to the fact that asymmetrical disclosure thought of managers leads to intra-company storing of unknown information and its transferring to the foreign investors (Kothari et al. 2009).

Srivastava and Tse (2009) have found out that early diagnosis of loss increases the possibility of companies being able to abort non-beneficial projects at a better time. Similarly, Francis and Martin (2010) have suggested that conservative companies act much more timely than other companies in stopping non-beneficial projects.

Beatty, Weber, and Yu (2008) have studied conservative clauses included in debt contracts, stating that these clauses are used more when debt agency costs are higher. However, the evidence put forward by them indicates that the contractual terms alone do not satisfy the demands of credit providers for conservatism, and thus, using accounting conservatism is needed to decrease the debt agency costs.

Hui et al. (2009) have found out that conservatism enables the company to draw up a better contract with the raw material salesperson, which enhances the operating cash flow. In general, both conditional and unconditional conservatism decreases the risk of operating cash flow reduction.

Krischenheiter and Ramakrishan (2010) assert that conservative decision-makers, tend to apply accounting conservatism in order to decrease the risk of future cash inflow. This enables them to make easier decisions about cautionary cash savings and increase the cash storage levels (Biddle et al., 2011).

Biddle et al. in *Accounting Conservatism and Bankruptcy Risk* (2011) have found out that conditional and unconditional conservatism help to decrease the bankruptcy risk by increasing cash reserves and information transparency. They suggest that when the bankruptcy risk increases; capital providers and auditors make more demands for applying a higher degree of conservatism in financial reporting.

Rezazadeh and Azad (2008) have expounded the relationship between information asymmetry among investors and the degree of conservatism in financial reporting. They have used the price range difference in stock exchange to measure information asymmetry, and Basu's criterion to measure conservatism. Their findings indicate a positive and significant relationship between information asymmetry among investors and the level of applied conservatism to financial inventories. Furthermore, their findings show that modifying information asymmetry among investors modifies the level of conservatism.

Theoretical framework and the formulation of hypotheses

In general, in companies facing financial crisis, monitoring mechanisms by the capital providers and auditing processes are carried out more intensely and with greater care and sensitivity. Therefore, it seems that managers have to apply unconditional conservatism because not doing so leads to disciplinary costs for the managers such as losing their job or status. However, opportunistic motivations among managers to misreport and hide bad news in companies facing bankruptcy are more than other companies (Kothari et al., 2010). It seems that under financial crisis and intensified monitoring, managers tend to adopt conditional conservatism. Therefore, it is expected that both conditional and unconditional conservatism be used more in companies with higher bankruptcy risk. Accordingly, the first and second hypotheses of the present study can be formulated as follows:

First hypothesis

Bankruptcy risk increases conditional conservatism.

Second hypothesis

Bankruptcy risk increases unconditional conservatism.

Based on the introduction and literature review, it can be assumed that accounting conservatism – conditional or unconditional – can play an effective role in decreasing bankruptcy risk. Therefore, the third and fourth hypotheses will be as follows:

Third hypothesis

Conditional conservatism decreases bankruptcy risk.

Fourth hypothesis

Unconditional conservatism decreases bankruptcy risk.

Research Methodology

The present study is descriptive and correlational in its aims and methods. The study divides the variables into independent and dependent, and then analyzes the relationship between them by using regression tests. From this perspective, the present study can be considered a post-event one because historical data is used to test the hypotheses. The data collection is descriptive and the data from sample companies have been bibliographically collected.

Research sample

The research sample includes all the companies listed in Tehran Exchange Market except investment companies, insurance companies, and banks. The listed companies considered for research sample in the present study have had the following characteristics:

Have been present during 2005-2011 fiscal years

Their end of fiscal year has been Esfand (March), and during the above period have made no change in their fiscal year

The company's trading symbol has been active and has not stopped for more than 4 month per year

The research period has been seven years, spanning from 2005 to 2011. Sampling has been done by systematic elimination, and given the above considerations, 157 companies were chosen as the final sample.

Research variables and calculation method

The main variables of the present study are conditional conservatism, unconditional conservatism, and bankruptcy risk. The calculation method for each is as follows.

Bankruptcy risk estimation

The present study has used Altman's model (1968) to measure bankruptcy risk. Through multiple-diagnosis analysis, Altman (1968) has proposed 5 combined ratios out of 22 financial ratios as the best predictors of bankruptcy. Altman's model is used because it is one which has repeatedly proven very effective as a powerful predictor in Iran's economic context (e.g., Ghodrati and Ma'navimoghaddam, 2010; Soleymani, 2011). Altman's model is as follows (Soleymani, 2011):

$Z = 0/999X_1 + 0/6X_2 + 3/3X_3 + 1/4X_4 + 1/2X_5$

Predicting variables (X_{1-5}) are respectively: sale to total assets; shareholders equity value to sum of debt book value; pre-interest profit and tax to total assets; accumulated interest to total assets; capital flow to total assets. Having tested its calculating power, Altman has found out that the success of his model is 95% (ibid.). In the above model, Z indicates Altman's bankruptcy index, and is calculated separately for each year. The bigger the size of Z, the lesser the bankruptcy risk of the company. Since bankruptcy risk is included in the hypothesis testing of the present study, the obtained value for Z is multiplied by (-١). The bankruptcy risk in the hypothesis testing model is shown by BR.

Measuring unconditional conservatism

Unconditional conservatism is a type of conservatism which is affected by accounting standards and legal requirements. To measure this variable, the ratio of total accruals to total assets is calculated. More negative accrual items indicate a higher level of unconditional conservatism since the result of unconditional conservatism is the underestimation of profit, and consequently, the reported profit is lesser than the company's cash flow (Givoly and Hayn, 2000; Ahmed and Duellman, 2007).

$UC\text{-}ACC_{i,t}=\frac{TACC_{i,t}}{TA_{i,t}}(-1)$

TACC: total accruals

TA: total asset

The total accruals are calculated as follows:

Total $accruals_{it}$ = net income before extraordinary $items_{it}$ – operational cash $flow_{it}$

Measuring conditional conservatism

Conditional conservatism is caused by management reporting procedures and their asymmetrical reaction to identifying unrealized loss and profit (Basu, 1997). To measure conditional conservatism non-operational accruals are used because according to Jang (2008) the bad news of the company is accumulated and reflected in non-operational accrual items. This variable is calculated as follows:

$CC\text{-}ACM_{i,t}=\frac{NACC_{i,t}}{TA_{i,t}}(-1)$

NACC: non-operational accruals

TA: total assets

Non-operational accrual items are calculated as follows:

Nonoperating accruals = Total accruals - Δaccounts eceivable
-Δinventories-Δprepaid expenses+Δaccounts payable
+Δtaxes payable

Hypothesis test

To test the hypotheses of the present study the following models have been fitted. These regression models have been presented and tested by Biddle et al. (2011).

Model (1)

$$CC\_ACM_t = \beta_0 + \beta_1 BR_t + \beta_2 BR_{t-1} + \beta_3 UC\_ACC_{t-1} + \beta_4 CC\_ACM_{t-1} + \beta_5 Leverage_t + \beta_6 BM_t + \beta_7 ROA_t + \beta_8 LnMV_t + \beta_9 Size_t + \varepsilon_t$$

Model (2)

$$UC\text{-}ACC_t = \beta_0 + \beta_1 BR_t + \beta_2 BR_{t-1} + \beta_3 UC\_ACC_{t-1} + \beta_4 CC\_ACM_{t-1} + \beta_5 Leverage_t + \beta_6 BM_t + \beta_7 ROA_t + \beta_8 LnMV_t + \beta_9 Size_t + \varepsilon_t$$

Model (3)

$$BR_t = \beta_0 + \beta_1 CC\_ACM_t + \beta_2 BR_{t-1} + \beta_3 UC\_ACC_{t-1} + \beta_4 CC\_ACM_{t-1} + \beta_5 Leveraget + \beta_6 LnMV_t + \beta_7 Size_t$$

$+ \beta_8 ROA_t + \beta_9 Casht + \beta_{10} \Delta Casht + \varepsilon_t$

Model (4)

$BR_t = \beta_0 + \beta_1 UC\_ACC_t + \beta_2 BR_{t-1} + \beta_3 UC\_ACC_{t-1}$
$+ \beta_4 CC\_ACM_{t-1} + \beta_5 Leveraget + \beta_6 LnMV_t + \beta_7 Size_t$
$+ \beta_8 ROA_t + \beta_9 Casht + \beta_{10} \Delta Casht + \varepsilon_t$

In the above models, UC_ACC_t: uncontional conservatism; CC_ACM: conditional conservatism; BR: bankruptcy; Leverage: company's tool as a controlling variable (the ratio of total debts to total assets); ROA: return of assets as controlling variable (the ratio of net asset to total asset); LnMV: logarithm of market value of company's stock as a controlling variable; Size: the size of company as a controlling variable (the natural logarithm of company's assets).

The results of first hypothesis test

The first hypothesis is about the effect of bankruptcy risk on the level of conditional conservatism in which a direct relationship between these two variables is suggested. To test this hypothesis, a regression model, where accounting conditional conservatism is dependent on bankruptcy risk and other controlling variables, is used. To fit the hypothesis testing regression model, a stepwise method has been used. Stepwise method in regression refers to the method in which a statistics software adds independent variable one after another to the model and in each step, those variables which are statistically invalid are eliminated from the model. In the end, the most significant variables are presented in a valid regression model which becomes the basis for decision-making with regard to the relationship between dependent and independent variables and the hypotheses. The results of fitting this regression model are shown in Table 1.

Table 1: The results of statistical analysis of first hypothesis

R^2 Modified	Durbin-Watson statistic	F statistic	Significance level of F
0/052	2/06	13/73	0/000

Variable	β Standardized	t statistic	Significance level
UC_ACC_{t-1}	0/186	4/117	0/000
CC_ACM_{t-1}	-0/138	-3/096	0/002
BM	-0/116	-3/642	0/000
ROA	-0/12	-3/69	0/000

After model fitting, it was found out that the above four variables are statistically significant and valid and thus were kept in the stepwise regression. The other variables were eliminated either for lack of significance or lack of validity. Based on the results, the estimated determination coefficient of the first sub-hypothesis testing regression model was 0/052 which indicates that this model has explained only 5/2% of changes in conditional conservatism by changing dependent and controlling variables. Durbin-Watson statistic is an index for analyzing the lack of self-correlation among regression model residues. The desired Durbin-Watson statistic is between 1/5 and 2/5. As the results show, the lack of self-correlation among the residues is considered as one of the initial hypothesis of regression in both models. One of the basic analysis of regression, is the study of total significance of the model. This analysis is necessary because it shows the existence or lack of significant relationship between dependent and independent variables of regression model. The criterion in this case is F statistic. The statistical hypotheses with regard to regression model are as follows:

H0: $\beta i=0$ regression model is insignificant.

H1: $\beta i\neq 0$ regression model is significant.

The significance level of F statistic is less than test error (α=۰/۰۵), and therefore, the H0 hypothesis is rejected. It can be concluded that at least one of the β coefficients, in the fitted model, is significant. The second part of Table 1, shows the results of statistical analysis for dependent variable coefficients in the regression models. The results show the severity and significance of the relationship of each independent variable inserted into the regression model with dependent variables. The results show that the bankruptcy risk variable, which is the basis of decision-making in this case, has been eliminated from the model because of lack of validity, and the obtained coefficients are for the controlling variables. The estimated coefficient for the variable of UC_ACC_{t-1} is positive and significant, and negative and insignificant for CC_ACM_{t-1}. This indicates that the current conditional conservatism has a direct relationship with the previous unconditional conservatism, and inverse relationship with the previous conditional conservatism. Furthermore, the estimated coefficient for the variable of the ratio of book value to market value and asset returns, is negative and significant. Thus, it can be concluded that companies with higher book value and more asset returns apply lesser degree of conservative procedures in their financial reporting. Based on the

above evidence, the claim in the first hypothesis of the present research regarding the effect of bankruptcy on conditional conservatism is rejected, and therefore, the first hypothesis is rejected.

The results of second hypothesis test

In the second hypothesis of the present study it has been predicted that bankruptcy risk increases unconditional conservatism. In Table 2, the results of fitting this regression model are shown.

Table 2: The results of statistical analysis of second hypothesis

R^2 Modified	Durbin-Watson statistic	F statistic	Significance level of F
0/17	2/014	48/833	0/000

Variable	β Standardized	statistic t	Significance level
BR	-0/154	-3/059	0/002
UC_ACC_{t-1}	0/097	3/196	0/001
BM	-0/109	-3/613	0/000
ROA	-0/476	-9/429	0/000

Based on the results, the estimated determination coefficient of regression model is 0/17, and this model has explained 17% of the changes in unconditional conservatism by changing the dependent and controlling variables. Durbin-Watson statistic indicates that there is no self-correlation among the residues of the model. The significance level of F statistic is less than test error (α=۰/۰۵). It can be concluded that at least one of the coefficients of β, in the fitted model, is significant. The results show that the estimated coefficient for the variable of bankruptcy risk is -۰/۱۵۴ and the level of significance is 0/002. This indicates that there is a significant inverse relationship between bankruptcy risk and unconditional conservatism. In other words, companies which having been exposed to higher (lower) risk of bankruptcy have applied lesser (higher) degree of conservative procedures in financial reporting. This latter finding is not consistent with the theoretical assumptions and the claim in the second hypothesis because it was expected that bankruptcy risk increase the motivation of sample companies to apply conservative procedures in financial reporting. Accordingly, the ratio of book value to market value and asset returns has a significant inverse relationship with unconditional conservatism, and there is a significant direct relationship between previous unconditional conservatism and the current unconditional conservatism. In general, based on the above evidence, the claim in the second hypothesis concerning the fact that bankruptcy risk increases unconditional conservatism is rejected.

The results of third hypothesis test

In the third hypothesis of the present research it has been predicted that conditional conservatism decreases bankruptcy risk. Similar to the previous hypotheses, the fitting of regression model for testing this hypothesis was done stepwise. In Table 3, the results of regression model fitting has been presented.

Table 3: The results of statistical analysis of third hypothesis

R^2 Modified	Durbin-Watson statistic	statistic F	Significance level of F
0/77	1/679	450/517	0/000

Variable	β Standardized	statistic t	Significance level
CC_ACM_{t-1}	0/05	2/262	0/024
UC_ACC_{t-1}	-0/092	-4/123	0/000
BR_{t-1}	0/269	11/656	0/000
BM	0/186	9/531	0/000
ROA	-0/406	-16/86	0/000
Lev	0/347	13/188	0/000
Cash	-0/036	-0/269	0/023

After model fitting, it was found out that the above variables are statistically significant and valid, and therefore have been kept in the stepwise regression. The other variables have been eliminated because of either insignificance or lack of validity. Based on the results, the estimated determination coefficient of regression model is 0/77, and this model has explained 77% of the changes in bankruptcy risk by the changes in dependent and controlling variables. The Durbin-Watson statistic is between 1/5 and 2/5 which indicates that there is no self-correlation among the model's residues. The significance level of F statistic is less than test error (α=۰/۰۵), and it can be concluded that at least one of the coefficients of β is significant in the fitting model.

The results show that the variable of CC_ACM_t has been eliminated from the model because of lack of validity. However, the estimated coefficient for the variable CC_ACM_{t-1} is 0/05 with a significance level of 0/024, which indicates that previous conditional conservatism has increased the bankruptcy of the current period. This latter finding is not inconsistent with the claim in the third hypothesis. The obtained coefficient for the variable UC_ACC_{t-1} is negative and significant which shows the fact that there is an inverse relationship between unconditional conservatism the previous period and the bankruptcy risk. The estimated coefficients for the controlling variables show that there is a significant inverse relationship between bankruptcy risk and asset returns and cash reserve. In other words, companies with a better efficiency and a higher cash reserves are less likely to face bankruptcy. Furthermore, based on the findings in Table 3, there is a significant direct relationship between bankruptcy risk with leverage and the ratio of book value to market value, which indicates that companies whose capital structure relies more strongly on inter-company financing, and companies with lesser market value, are more likely to face bankruptcy. Given the fact that conditional conservatism, as the basis for decision-making in the third hypothesis, has been eliminated from the regression model, the claim in this hypothesis is not acceptable and therefore the hypothesis is rejected.

The results of fourth hypothesis test

In the fourth hypothesis of the present research, it has been predicted that unconditional conservatism decreases bankruptcy risk. The fitting of regression model for testing this hypothesis has also been done stepwise. In Table 4, the results of regression model fitting has been presented.

Table 4: The results of statistical analysis of fourth hypothesis

R^2 Modified	Durbin-Watson statistic	statistic F	Significance level of F
0/767	1/667	516/283	0/000

Variable	β Standardized	statistic t	Significance level
UC_ACC_t	-0/034	-1/981	0/048
BR_{t-1}	0/254	10/997	0/000
BM	0/189	9/564	0/000
ROA	-0/414	-16/313	0/000
Lev	0/348	13/118	0/000
Cash	-0/036	-2/228	0/022

The estimated coefficient for the variable of UC_ACC_t is -0/034, and significance level is 0/048. This finding indicates that there is a significant inverse relationship between bankruptcy risk and unconditional conservatism which is consistent with the claim in the fourth hypothesis of the research. The obtained results for the coefficients of controlling variables are similar to the results in the third hypothesis test which shows bankruptcy risk has an inverse relationship with cash residues and asset returns, and a direct relationship with the company's leverage.

Based on the above evidence, it can be assumed that with the increase (decrease) of unconditional conservatism in the sample companies, their bankruptcy risk, decreases (increases). Thus, the claim in the fourth hypothesis is accepted with a 95% certainty.

Discussion and Conclusion

The present research has studied the relationship between conditional and unconditional conservatism and bankruptcy risk. The statistical analysis show that bankruptcy risk does not have a significant effect on conditional conservatism. However, contrary to the theoretical assumptions of the research, bankruptcy risk decreases unconditional conservatism among the sample companies. Since conservatism causes an underestimation of net profit and asset values, it seems that managers of companies facing bankruptcy, by restricting conservative procedures, try to represent the company's status as satisfactory and thus hide the bad news. This finding shows that the monitoring duties of owners and share-holders have not been effectively

carried out in Iran's exchange market companies; they have not been able to resist the opportunistic interests of managers in financial reporting of bankrupting companies. Furthermore, the results show that unconditional conservatism decreases bankruptcy risk. This latter finding is consistent with the theoretical assumptions of the research, and indicates the advantageous of accounting conservatism for preserving the interests of owners in companies facing bankruptcy. In general, the above findings lead to some key concepts with regard to the informational and monitory role of accounting conservatism. First, bankruptcy signs may not be a cause for the capital providers of the company to demand more conservative procedures. Second, the above findings are consistent with the previous theoretical and empirical evidence on the positive role of conservatism in financial reporting systems (e.g., Jang 2008; Hui et al., 2009), which indicates that accounting conservatism may contribute to financial transparency and the preserving of the capital providers' interests. Finally, the asymmetric effect of conditional and unconditional conservatism on bankruptcy risk might imply that the managers of the sample companies may not tend to implement conservative procedures in financial reporting, and only a degree of unconditional conservatism which is not in the managerial jurisdiction, has been implemented in the financial reporting of these companies.

Research Suggestions

Based on the findings from the hypotheses testing, the present research recommends the following: (1) It is recommended that the capital providers of stock companies enhance their monitoring tools for curbing the opportunistic motivations of the managers, especially in companies facing bankruptcy, and demand stronger conservative procedures in financial reporting. (2) It is recommended that accounting standard boards and company's disclosure rule makers pay special attention to supporting the interests of investors in designing financial reporting systems. (3) It is suggested that managers in companies with higher risk of bankruptcy help to preserve the interests of the company and the owners by applying a more amount of conservatism in financial reporting.

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