

THE EFFECT OF INFORMATION INCONFIDENCE AND MANAGERIAL EFFICIENCY ON CONDITIONED CONSERVATISM IN BIG AND SMALL COMPANIES

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ABSTRACT

Conservatism as one of qualitative characteristics of accounting information can be affected by many factors. Competitive pressures and the type of board composition in business units are among these factors. The present research has dealt with information inconfidence and managerial efficiency on conditioned conservatism in big and small companies. To do this research we have chosen a sample of 105 firms from among those enlisted in Tehran Stock Exchange for the time period between 2007 and 2012. On the whole, 315 observations related to big companies and 315 observations related to small companies were carried out for this research. To measure conservatism we have used income perspective used in Basu' model and market value to book value ratio using balance sheet perspective. The statistical method used in this research was multiple variable regression method. Results of this research showed that information inconfidence and managerial efficiency affected conditioned conservatism in big and small companies meaningfully.

Keywords: *Information Inconfidence, Managerial Efficiency, Conditioned Conservatism, Big and Small Companies*

INTRODUCTION

Basu (1997) defined conservatism as the tendency of accountants to adopt a higher level of being affected to recognize good news in earnings compared with bad news. Basu mentioned conservatism regarding income statement and mentioned asymmetrical behavior of earnings as conservatism towards good news instead of bad ones. He used this definition to achieve a criterion to measure conservatism and considered positive and negative returns of stocks as good and bad news in order to operationalize and formulate the criterion. Therefore, this definition of conservatism considered earnings-return relationship.

From long ago firm's performance assessment has been a major part in accounting, management, and economic discussions. Performance assessment of a firm without considering business characteristics and conditions dominating goods and services (measurement and data control, outputs, production process) and on the contrary to the position of the assessed firm in the set of system and economic structure of the country and it would not be so outstanding (Ghanbari, 2007).

Financial performance assessment is the base of many decisions such as managers' reward, stock price, stock risk, decision making related to investment, and other similar cases. Decision making is one of the most fundamental and most important duties of managers and they should decide and administer programming, organizing, and administration. These decision making should be carried out based on results of assessments carried out (regarding performance return) appropriating job processes of an organization.

The permanent assessment of performance will result in emergence of documentary information and in time and valuable ones for decision making by managers. This is done due to promoting the organization and improves its working activities regarding different issues (Moghaddam and Barzideh, 2003).

Thus, the goal of this study is to find out whether there is a meaningful relationship between information inconfidence and managerial efficiency and conditioned conservatism in big and small companies.

Theoretical Foundations and Research Literature

Say (2012) studied the relationship between firm management efficiency and conditioned conservatism in firms in a research about the role of management and conservatism. He used a new method to measure

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management efficiency called Dupont ratio. Results of this research showed existence of a direct relationship between firm efficiency and conditioned conservatism.

Amir, *et al.*, (2010) found out that operational earning ratio has more prevalent role in market reaction. In next stage, the ratio of operational earning has been divided into two elements which included gross earnings and other earnings' ratio. Results showed that non-interactive consistence of gross earnings was more than other earnings' ratio, but there was not NY difference found between interactive consistencies of these two elements.

Solomon (2008) first studied the efficiency and accuracy of results in previous studies in his research and showed that based on previous studies the isolation of changes in net return of operating assets and the changes in its constituents has a role in analyses and reactions of those who are active in the market. From among elements mentioned by Dupont, changes in net flow of operating assets have a better capability to forecast future profitability changes. The novel perspective of his research was to investigate about reaction and the amount of its use and its elements in order to modify (change) short-term and long-term decisions.

Bahatacharia *et al.*, (2008) studied the relationship between earnings quality and information asymmetry. They concluded due to their findings that low quality of earnings results in increasing information asymmetry in financial markets.

Ball and Shivakumar (2005) posed another method by using accruals to measure conservatism. There would be greater direct correlation between cash flows and accruals during those periods that operating cash flows are very low or negative because during these periods economic losses (such as negative return on stocks) will be represented concurrently within cash flows and not realized accruals while during those periods through which cash flows are positive, conservative accounting causes economic losses (bad news) in accruals reflected and this correlation would be less and even reversed.

Moradifar (2012) stated in a paper entitled: 'studying the relationship between return on assets, information asymmetry, leverage, operating cash flows, ownership concentration, market value of stocks, and surplus dividends in firms enlisted in Tehran Stock Exchange' that the main goal in every investment is to achieve profit. Results of testing hypotheses showed that surplus dividends has had a meaningful relationship with return on assets, leverage, operating cash flows, market value of stocks, and the effect of controlling size variable.

Namdar (2011) studied the relationship between information asymmetry and ownership concentration and earnings management in firms enlisted in Tehran Stock Exchange. Results of his research showed that there has been a direct and meaningful relationship between this variable and information asymmetry level. Also the results showed that there has been a meaningful relationship between earnings management and ownership concentration.

Hypotheses

3-1- Information asymmetry affects conditioned conservatism in big companies.

3-2- Information asymmetry affects conditioned conservatism in small companies.

3-3- There is a meaningful difference between effects of information asymmetry on conditioned conservatism in big and small companies.

3-4- Managerial efficiency affects conditioned conservatism in big companies.

3-5- Managerial efficiency affects conditioned conservatism in small companies.

3-6- There is a meaningful difference between effects of managerial efficiency on conditioned conservatism in big and small companies.

The Proposed Model and Research Variables

Hypotheses 1, 2, and 3 test model

The regression model used to test hypotheses 1, 2, and 3 was as follows: (Yoshi Sayto, 2012)

$$BTM_{it} = b_0 + b_1 FE_{it} + b_2 RV_{it} + b_3 FD_{it} + b_4 LCCOMP_{it} + b_5 FL_{it} + \varepsilon_{it}$$

Hypotheses 4, 5, and 6 test model

The regression model used to test hypotheses 4, 5, and 6 was as follows: (Yoshi Sayto, 2012)

$$BTM_{it} = b_0 + b_1 PERM_{it} + b_2 LCCOMP_{it} + b_3 FL_{it} + \varepsilon_{it}$$

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Where,

BTM = conditioned conservatism (it can be calculated by using model 5.)

FE= forecast error of earnings per share

RV= standard deviation of annual returns during previous 3 years

FD= standard deviation of earnings per share predicted in budget and adjustments during previous 3 years

LCCOMP= salary and rewards paid for board members

FL= firm's leverage

PERM_{it}= managerial efficiency or Dupont's ratio growth

Independent Variables

Information Inconfidence

Lack of confidence towards information has been calculated as follows by using 3 criteria for forecasting error per share, return variability, earning prediction discrepancy per share of any business unit:

Earnings per share forecast error: the difference between primary earnings per share forecast and real earnings per share during year t:

$$FE = \frac{|YEPS_{t-1} - FORE_{t-1}|}{P_{t-1}}$$

Where,

t-1 = the fiscal year before stock earnings is announced

YEPS_{t-1} = real earnings for the year t-1

FORE_{t-1} = forecast for average revenue accessible during the last month of fiscal year t-1

P_{t-1} = stock price at the last day of fiscal year t-1

Return variability (RV): standard deviation of annual returns during previous 3 years

Forecast dispersion of earnings per share (FD): standard deviation of earnings per share predicted in budget and adjustments applied during previous 3 years

Managerial Efficiency

PERM_{it} = managerial efficiency or Dupont's ratio growth (the same as ROA: of management's performance using the method described in models 3 and 4)

Control Variables

CCOMP = salary and rewards paid to board members

FL = firm's leverage

$$\text{leverage} = \frac{\text{totaldebts}}{\text{totalassets}}$$

Before YushiSayto calculated Dupont's ratio in 2011 in a new way, and before it was introduced for financial science world, it was calculated simply through dividing the average assets into net profit before taxes. But in this research we have utilized YushiSayto's method in calculating Dupont's ratio. (Yoshi Sayto, 2012)

$$(1) \quad ROA_{it} = \frac{INCOME_{it}}{ASSET_{it-1}} = \frac{INCOME_{it}}{SALE_{it}} \frac{SALE_{it}}{ASSET_{it-1}}$$

Formula (1) is the method to calculate Dupont's ratio using Dupont's calculation method.

Dupont's ratio is comprised of the two ratios of assets' flow and operating earnings. But in a new method we can calculate Dupont's ratio as follows: (Yoshi, 2012)

$$(2) ROA_{it} = \left(1 - \frac{EXP_{it}}{SALE_{it}}\right) \frac{SALE_{it}}{ASSET_{it-1}}$$

The equation above is a combination of revenues and expenses.

EXP = all firm expenses

By expanding the equation above, we will have the following equation for our calculation:

$$(3) ROA_{it} = \frac{SALE_{it}}{ASSET_{it-1}} - \frac{EXP_{it}}{ASSET_{it-1}}$$

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This equation shows Dupont's ratio in summary regarding the data extracted from financial statements. In this research, Dupont's ratio will be used in calculation methods 2 and 3, and then in next stage of growth of Dupont's ratio, which is the same as management's performance measured as follows: (Yoshi, 2012)

$$(4) \text{PERM}_{it} = \frac{\text{ROA}_{it>0}}{\text{ROA}_{it=0}}$$

When the amount is equal to (1), the company is in the best state for management's performance (ROA growth) and when it is equal to 0, the company is in the worst state for management's performance (ROA growth). Also when this amount is between 0 and 1, the company is in a desirable state (ROA growth).

One of the greatest factors that can affect this ratio is accounting conditioned conservatism.

Dependent Variable

Conditioned Conservatism

Finally we used the following model to investigate about accounting conditioned conservatism: (Yoshi, 2012)

$$(5) \text{BTM}_{it} = \alpha_i + \alpha_t + \sum_{j=0}^{j=3} \beta_j R_{t-j,i} + e_{it}$$

BTM = the ratio of book value to market value of firm's assets

R = lag, return of firm during 3 previous years

Adjusting Variable

Firm Size (Big or Small)

To determine firm size we have used the following formula:

Size = log (net sale)

To divide the firms under investigation into two groups of big and small, first we used the formula above to calculate firm size and then calculated the median of sizes calculated. Firms higher than median were considered as big and those lower than that was categorized as small ones.

MATERIALS AND METHODS

Research Methodology

This research is of correlation type and is based on regression equations. Accordingly, a number of firms enlisted in Tehran Stock Exchange were selected and their data were collected during the years between 2006 and 2012. Sampling was carried out using deletion method and the sample was consisted of 105 firms.

RESULTS AND DISCUSSION

Research Findings

Based on the first main hypothesis, information inconfidence affects conditioned conservatism in big firms.

According to table 1, Pearson's correlation coefficient between the two variables of information inconfidence and conditioned conservatism in big companies was equal to 0.695.

This amount showed a meaningful relationship between the two variables of information inconfidence and conditioned conservatism in big companies in error level of % 5.

Regarding the outputs of SPSS software, the tables showed that since Sig was less than % 5, correlation between these two variables is approved. Also the calculated adjusted identification coefficient showed the number 0.475 and this was a good amount and presents a suitable balance of changes in the variable conditioned conservatism in big companies using information inconfidence. One of the presuppositions was independence of errors. If error independence presupposition was rejected and errors did have correlation between themselves, there would not be a possibility of using regression. Durbin-Watson statistic was used to study error independence and if Durbin-Watson statistic was within 1.5 and 2.5, the hypothesis of correlation between errors is rejected and we can use regression.

The amount of Durbin-Watson statistic was 1.771 based on the table and it showed that errors were independent and there has not been self-correlation between errors and error correlation hypothesis was rejected and we could use regression.

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Table 1: Correlation coefficient, identification coefficient and Durbin-Watson test regarding information inconfidence with conditioned conservatism in big firms

Model	coefficient correlation	Identification coefficient	Adjusted identification coefficient	Gaurantee criterion error	Durbin-Watson statistic
1	0.695	0.483	0.475	0.21942	1.771

Table 2 shows variance analysis between the variable of conditioned conservatism in big firms as the dependent variable and information inconfidence as the independent variable. Based on these outcomes, the overall model meaningfulness of regression was tested using ANOVA test and regarding that sig was less than %5, the linearity hypothesis of the relationship between these two variables was approved.

Table 2: Variance analysis of the regression for information inconfidence and conditioned conservatism in big companies

Model		Total squares	Degree of freedom	Average squares	F statistic	Meaningfulness
1	Regression	13.907	5	2.781	57.769	.000a
	Residual	14.877	309	.048		
	Total	28.784	314			

Regarding t statistic gained in table 3, the presence of a relationship between the two variables of information inconfidence and conditioned conservatism in big firms, we can say that information inconfidence affects conditioned conservatism in big firms.

Table 3: Coefficients of regression equation for independent and control variables:

Model	Symbol	Not standardized coefficients		standardized coefficients Beta	statistic t	Meaningfulness level	Collinearity Statistics	
		B	B criterion error				Tolerance	Variance factor
1	(Constant)	2.485	.046		54.590	.000		
	FE	-.519	.061	-.421	-8.517	.000	.988	1.012
	RV	-.179	.011	-.675	-16.336	.000	.979	1.021
	FD	-.217	.081	-.111	-2.684	.008	.981	1.020
	CCOMP	5.212E-7	.000	.025	.612	.541	.995	1.005
	FL	.013	.064	.008	.198	.843	.988	1.012

Testing Second Hypothesis

Information inconfidence affects conditioned conservatism in small firms.

According to table 4, Pearson's correlation coefficient between the two variables of information inconfidence and conditioned conservatism in small companies was equal to 0.614. This amount showed a meaningful relationship between the two variables of information inconfidence and conditioned conservatism in small companies in error level of %5. Regarding the outputs of SPSS software, the tables showed that since Sig was less than %5, correlation between these two variables is approved. Also the calculated adjusted identification coefficient showed the number 0.367 and this was a good amount and presents a suitable balance of changes in the variable conditioned conservatism in small companies using

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servatism in small firms information inconfidence.

Table 6: Coefficients of regression equation for independent and control variables:

Mode l	Symbol	Not standardized coefficients		standardized coefficients Beta	statistic	Meaningfulne ss level	Collinearity Statistics	
		B	B criterio n error				Toleranc e	Varianc e amass factor
1	(Constan t)	2.485	.034		72.304	.000		
	FE	-.432	.059	-.415	-7.331	.000	.955	1.047
	RV	-.139	.010	-.619	-13.305	.000	.931	1.074
	FD	-.350	.051	-.391	-6.867	.000	.963	1.038
	CCOMP	-	.000	-.013	-.292	.771	.970	1.031
	FL	6.681E-7 -.008	.050	-.007	-.154	.877	.946	1.057

Durbin-Watson statistic was 1.679, based on the table, and it showed that errors were independent and there has not been self-correlation between errors and error correlation hypothesis was rejected and we could use regression.

Table 4: Correlation coefficient, identification coefficient and Durbin-Watson test regarding information inconfidence with conditioned conservatism in small firms

Model	coefficient correlation	Identification coefficient	Adjusted identification coefficient	Gaurantee criterion error	Durbin-Watson statistic
1	0.614a	0.377	0.367	0.17443	1.679

Table 5: Variance analysis of the regression for information inconfidence and conditioned conservatism in small companies

Model		Total squares	Degree of freedom	Average squares	F statistic	Meaningfulness
1	Regression	5.683	5	1.137	37.352	.000a
	Residual	9.402	309	.030		
	Total	15.085	314			

Table 5 shows variance analysis between the variable of conditioned conservatism in small firms as the dependent variable and information inconfidence as the independent variable.

Based on these outcomes, the overall model meaningfulness of regression was tested using ANOVA test and regarding that sig was less than %5, the linearity hypothesis of the relationship between these two variables was approved.

In table 6 and in column B, the fixed amount and independent variable coefficient were entered into regression equation and this equation changed into the following:

$$BTM_{it} = 2.485 - .432 * FE_{it} - .139 * RV_{it} - .350 * FD_{it}$$

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Regarding t statistic gained in table 6, the presence of a relationship between the two variables of information inconfidence and conditioned conservatism in small firms, we can say that information inconfidence affects conditioned con

Studying Third Hypothesis

There is a meaningful difference between effects of information asymmetry on conditioned conservatism in big and small companies.

As it can be seen in table 7, the amount of correlation coefficient and identification coefficient in big companies is more than small companies and thus we can conclude that information asymmetry on conditioned conservatism in big companies has had greater effects than small companies and therefore, there is a meaningful difference between effects of information asymmetry on conditioned conservatism in big and small companies.

Table 7: Comparing correlation coefficient, identification coefficient of information inconfidence on conditioned conservatism in big and small companies

Hypothesis	Correlation coefficient	Identification coefficient
First	0.695	0.483
Second	0.614	0.377

Testing Fourth Hypothesis

Managerial efficiency affects conditioned conservatism in big firms.

According to table 8, Pearson's correlation coefficient between the two variables of managerial efficiency and conditioned conservatism in big companies was equal to 0.637. This amount showed a meaningful relationship between the two variables of managerial efficiency and conditioned conservatism in big companies in error level of %5. Regarding the outputs of SPSS software, the tables showed that since Sig was less than %5, correlation between these two variables is approved. Also the calculated adjusted identification coefficient showed the number 0.459 and this was a good amount and presents a suitable balance of changes in the variable conditioned conservatism in big companies using managerial efficiency. Durbin-Watson statistic was 1.861, based on the table, and it showed that errors were independent and there has not been self-correlation between errors and error correlation hypothesis was rejected and we could use regression.

Table 8: Correlation coefficient, identification coefficient and Durbin-Watson test regarding managerial efficiency with conditioned conservatism in big firms

Model	coefficient correlation	Identification coefficient	Adjusted identification coefficient	Gaurantee criterion error	Durbin-Watson statistic
1	0.637a	0.519	0.459	0.30135	1.861

Table 9 shows variance analysis between the variable of conditioned conservatism in big firms as the dependent variable and managerial efficiency as the independent variable. Based on these outcomes, the overall model meaningfulness of regression was tested using ANOVA test and regarding that sig was less than %5, the linearity hypothesis of the relationship between these two variables was approved.

Table 9: Variance analysis of the regression for managerial efficiency and conditioned conservatism in big companies

Model		Total squares	Degree of freedom	Average squares	F statistic	Meaningfulness
1	Regression	.541	3	1.180	12.967	.000
	Residual	28.242	311	.091		
	Total	28.784	314			

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In table 10 and in column B, the fixed amount and independent variable coefficient were entered into regression equation and this equation changed into the following:

$$BTM_{it} = 2.385 - .930 * PERM_{it}$$

Regarding t statistic gained in table 6, the presence of a relationship between the two variables of managerial efficiency and conditioned conservatism in big firms, we can say that managerial efficiency affects conditioned conservatism in big firms.

Table 10: Coefficients of regression equation for independent and control variables:

Model	Symbol	Not standardized coefficients		standardized coefficients		Meaningfulness level	Collinearity Statistics	
		B	B criterion error	Beta	t		Tolerance	Variance factor
1	(Constant)	2.385	.078		30.427	.000		
	PERM	-.930	.163	-.517	-5.706	.001	.672	1.489
	CCOMP	1.264E-6	.000	.061	1.081	.280	.997	1.003
	FL	.023	.106	.015	.218	.828	.673	1.485

Testing Fifth Hypothesis

Managerial efficiency affects conditioned conservatism in small firms.

According to table 11, Pearson's correlation coefficient between the two variables of managerial efficiency and conditioned conservatism in small companies was equal to 0.641.

This amount showed a meaningful relationship between the two variables of managerial efficiency and conditioned conservatism in small companies in error level of %5.

Regarding the outputs of SPSS software, the tables showed that since Sig was less than %5, correlation between these two variables is approved.

Also the calculated adjusted identification coefficient showed the number 0.521 and this was a good amount and presents a suitable balance of changes in the variable conditioned conservatism in small companies using managerial efficiency.

Durbin-Watson statistic was 1.676, based on the table, and it showed that errors were independent and there has not been self-correlation between errors and error correlation hypothesis was rejected and we could use regression.

Table 11: Correlation coefficient, identification coefficient and Durbin-Watson test regarding managerial efficiency with conditioned conservatism in small firms

Model	coefficient correlation	Identification coefficient	Adjusted identification coefficient	Gaurantee criterion error	Durbin-Watson statistic
1	0.641a	0.521	0.476	0.21805	1.676

Table 12 shows variance analysis between the variable of conditioned conservatism in small firms as the dependent variable and managerial efficiency as the independent variable. Based on these outcomes, the

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overall model meaningfulness of regression was tested using ANOVA test and regarding that sig was less than %5, the linearity hypothesis of the relationship between these two variables was approved.

Table 12: Variance analysis of the regression for managerial efficiency and conditioned conservatism in small companies

Model		Total squares	Degree of freedom	Average squares	F statistic	Meaningfulness
1	Regression	.298	3	.299	6.229	.000
	Residual	14.787	311	.048		
	Total	15.085	314			

In table 13 and in column B, the fixed amount and independent variable coefficient were entered into regression equation and this equation changed into the following:

$$BTM_{it} = 2.436 - .757 * PERM_{it}$$

Regarding t statistic gained, the presence of a relationship between the two variables of managerial efficiency and conditioned conservatism in small firms, we can say that managerial efficiency affects conditioned conservatism in small firms.

Table 13: Coefficients of regression equation for independent and control variables:

Model	Symbol	Not standardized coefficients		standardized coefficients Beta	statistic t	Meaningfulness s level	Collinearity Statistics	
		B	B criterion error				Tolerance	Variance inflation factor
1	(Constant)	2.436	.048		51.093	.000		
	PERM	-.757	.081	-.589	-9.353	.000	.736	1.359
	CCOMP	-	.000	-.099	-1.759	.080	.991	1.009
	FL	4.983E-6	.070	.004	.069	.945	.738	1.354

Studying Sixth Hypothesis

There is a meaningful difference between effects of managerial efficiency on conditioned conservatism in big and small companies.

Table 14: Comparing correlation coefficient, identification coefficient of managerial efficiency on conditioned conservatism in big and small companies

Hypothesis	Correlation coefficient	Identification coefficient
Third	0.637	0.519
Fourth	0.641	0.521

As it can be seen in table 14, the amount of correlation coefficient and identification coefficient in small companies is more than big companies and thus we can conclude that managerial efficiency on conditioned conservatism in small companies has had greater effects than big companies and therefore, there is a meaningful difference between effects of managerial efficiency on conditioned conservatism in big and small companies.

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Conclusion

Conservatism in accounting means the difference in policies chosen and accepted regarding good and bad news. By good news we mean positive return of stocks or events that result in increasing earnings. By bad news we mean 0 return or negative return on stocks that results in a reduction of earnings. Also conservatism has been defined as earning reduction approach and showing assets less than reality responding bad news and increasing earnings to show assets more responding good news, on the other hand (Basu, 1997).

Regarding the importance of accounting conservatism concept, the goal of this research was to study the effects of information inconfidence and managerial efficiency on conditioned conservatism in big and small companies.

Regarding the results, there has been a reverse relationship between information inconfidence and conditioned conservatism in big companies enlisted in Tehran Stock Exchange. This means that by increasing information inconfidence, conditioned conservatism reduced in big companies and vice versa. Results of the second hypothesis test showed that there has been a reverse relationship between information inconfidence and conditioned conservatism in small companies enlisted in Tehran Stock Exchange. This means that by increasing information inconfidence, conditioned conservatism reduced in small companies and vice versa.

Also by comparing correlation coefficient and identification coefficient in big and small companies we concluded that information inconfidence has had a greater effect on big companies than small ones and thus, there is a meaningful difference between effects of information asymmetry on conditioned conservatism in big and small companies.

The result of testing fourth hypothesis showed that there has been a reverse relationship between managerial efficiency and conditioned conservatism in big companies enlisted in Tehran Stock Exchange. Also result of testing fifth hypothesis showed that there has been a reverse relationship between managerial efficiency and conditioned conservatism in big companies enlisted in Tehran Stock Exchange. Results of hypotheses 4 and 5 accord with results of a research carried out by Yushi (2012) dealing with the relationship between managerial efficiency and conditioned conservatism in companies. Also by comparing correlation coefficient and identification coefficient in big and small companies we concluded that managerial efficiency has had a greater effect on small companies than big ones and thus, there is a meaningful difference between effects of managerial efficiency on conditioned conservatism in big and small companies.

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