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The Managerial Determinants of Accounting Conservatism during COVID-19 Era: Evidence from Saudi Arabia

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Abstract: The research investigates the adoption of accounting conservatism and its managerial determinants in Saudi Arabia during COVID-19 era. firstly, we analyzed the academic literature and developed the framework of accounting conservatism in terms of definition, advantages, motivations and scientific theories. Secondly to conduct our empirical study where we choose a sample consisted of 100 firm years' observations which represented the financial statements of the top 50 firms listed in the stock market in terms of size during two years. Going further, the accounting conservatism mean was 0.4315 during COVID-19 era. the research's results illustrated empirically a positive relation between accounting conservatism, managerial ownership, institutional ownership, board of directors' size and profitability among the sample. and a negative relation between accounting conservatism, board of directors' independence, board of directors' duality, firm size and leverage.

Keywords: Conservatism, Managerial Ownership, Institutional Ownership, CEO Duality.

1 Introduction

Earnings and related ratios are the most important information that can affect the decision-making by stakeholders. According to the importance of earnings' information in the financial reports, it makes managers under pressure to prepare financial statements that are acceptable from both internal and external parties' perspectives, and resulting in the appearance of information asymmetry issue between managers and stakeholders [1]. Where this problem is known in the literature as agency conflict [2]. Going further, accounting conservatism is a major practice to control earnings through the alternatives given by accounting standards. On the other hand, several studies [3,4,5,6] indicated that the phenomenon of the increasing accounting conservatism' degree in the financial reports after the global financial crisis is one of the most important controversial issues in contemporary accounting thought, which formed a focus of the academic accounting research interest. This is despite the severe criticism it is subjected to as a result of its conflict with some qualitative characteristics of the accounting information quality (i.e. Neutrality, Faithful Presentation and Relevance). Especially after the

emergence of the fair value concept [5] and the tendency of professional authorities to adopt the concept of fair value in preparing the new accounting standards. Moreover, with the beginning of the current century, the academic and professional interest in accounting conservatism increased after the failure of many big international companies, such as Enron in 2001, and TESCO in 2016. One of the reasons for the failure of these companies was the opportunistic behavior of these companies' managers and their lack of commitment to the accounting conservatism adoption. Which raised doubts about the quality of the disclosed accounting profits and the extent of the credibility of the financial report in the honest expression of business results and financial position. Thus, made accounting conservatism after these collapses of major international corporations an essential topic in accounting thought. In addition, since conservatism considers a measure of biased financial reporting which may not reflect high-quality earnings, the relationship between the board of directors, ownership patterns, organizational characteristics and accounting conservatism is cloudy [7].

From the above, the importance of this research is driven by the inconsistencies in the academic literature results and

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previous research gaps related to accounting conservatism. So, this research aims to identify the major managerial determinants of adopting accounting conservatism in Saudi firms during the COVID-19 period. It contributes to the accounting literature in the context of the Saudi business environment, especially that of Saudi non-financial firms listed in the Saudi shares market, where to the authors' knowledge, accounting conservatism doesn't examine during this period. Thus, the article continuous as follows: part two Academic literature reviews and hypotheses development, part three develops the research model, part four Results, and part five Conclusions.

2 Academic Literature Review and Hypotheses Development

2.1 Conservatism in the management and Accounting Thought

Accounting conservatism has been interpreted as capturing firms' tendency to adopt a higher verification degree for the recognition of good news than bad news in the financial reporting [8] and proved that earnings respond more quickly and completely too bad than good events or news, meaning "expect no profits but expect all losses". Then [9] have shown Accounting conservatism as the choice of available accounting methods and policies by accounting standards to report on the lower values of revenues and assets. Moreover, the higher values of expenses and liabilities, which results in a lower net book value of equity than the market value. On another side. It's a firm decision in response to bad news, due to the unwillingness of managers to take risks in cases of uncertainty [10]. So we can put forward the accounting conservatism's nature that no profits are expected (delaying profits' recognition) and the expectation of all possible losses (accelerating losses' recognition). In addition, we can argue that the essence of accounting conservatism's application is the difference between the market value of equity and disclosed book value.

Furthermore, the concept of Accounting conservatism in the academic literature is a bookkeeping guideline that needs a high degree of verification before a firm can disclose profit in the financial reports [7]. The major point is to expect the worst scenario in the future of the firm's financial performance [10]. Where, Uncertain liabilities are to be recognized as they appear. In contrast, revenues can only be recognized when they are achieved and fully realized. Thus, it is a way of accounting practice that provides guidance uncertainty cases [11]. Where the firm has the potential for bias, and it considers a rule when choosing between two financial reporting alternatives. So, Accounting conservatism can be considered as a control tool to firm's managers that prefer the results' recognition in the least opportunistic period. According to [12] accounting conservatism can help in solving many problems such as agency cost and information asymmetry [4]. On another side, accounting conservatism can be aggravated when firms present certain complex characteristics that limit the

information's transparency [13].

Going further, accounting conservatism has two types in the academic accounting literature [9,10]. The first type is conditional conservatism and It means that the conservatism is dependent on the occurrence of events, as the book values of assets are reduced in the unfavorable events, and ignoring the recognition of the increase in book values under good events unless there is evidence of its realization in the sense of the asymmetric timeliness of both good and bad news in accounting profit. The second type is unconditional conservatism and it means that the conservatism must be independent of the occurrence of events. In the sense that assets are recorded and measured from the beginning with book values less than their market values over their useful life in a way that leads to the emergence of unrecorded goodwill. On another side, the academic accounting literature addressed the importance of adopting accounting conservatism policies in financial reporting through four main interpretations [14]. First, Contracting Explanation as the application of conservative policies will lead to the reduction of agency-related problems resulting from the separation of ownership from management such as information. Second, Litigation Explanation as the application of conservative accounting policies will lead to a reduction in the costs of litigation and compensation. Third, Tax Explanation, as the application of conservative accounting policies will lead to a reduction in the value of taxes payable for the financial period for which the financial report is submitted and minimize the tax burden. Fourth, Political Explanation as the application of conservative accounting policies will lead to a reduction in the political costs arising from a firm's disclosure of a high-profit value. But we believe that the contractual interpretation represents the essence of accounting conservatism's importance, as it is the main reason for the adherence of the accounting thought - so far - to the application of accounting conservatism policies despite the numerous criticisms.

However, Advantages of Accounting Conservatism, overstating losses and understating profits means that firms will report lower financial future benefits. Painting a cloudy image of the firm's financials actually comes with many benefits. Most likely, it motivates firms to exercise greater concern in their decisions [15]. Moreover, there are more possibilities for good surprises, rather than bad surprises, which are big drivers of stock prices and these rules, should make it easier for stockholders to judge financial reports in any financial period [6]. On the other side, Disadvantages of Accounting Conservatism, the alternatives of accounting conservatism can arise arguments in interpretation, where, firms will find methods to manipulate them to their advantage [13]. Another issue is the possibility of revenue shifting, if a financial event doesn't meet the reporting requirements due to conservative policies, it must be included in the next financial period. This will result in the overstating of the future period and the understating of the current period, making it hard for stakeholders to track the firm events [16].

So, we can conclude the opinions which supported the application of accounting conservatism as follows: (a) it helps to ensure the firm's continuity through the cumulative effect of conservative accounting policies on profits and assets. (b) it serves as a mechanism to achieve a balance between managers and shareholders resulting from the agency [4]. (c) it reduces information asymmetry between stakeholders [11]. (d) it reduces the incentives and motives of management to practice earnings management [1]. (e) accounting conservatism perform as a protection tool against managers' opportunism behavior [7]. From another side, we can put forward conclude the opinions which against the application of accounting conservatism as follows: (a) it does not lead to express the reality of financial position or operational results [9]. and there is an absence of objective criteria governing its application. (b) it leads to conservative results in the first period will lead to un-conservative results in the following periods as a result of duplication in the revenues' recognition compared to expenses' recognition, and this has a negative impact on earnings quality. (c) The negative impact of accounting conservatism on the characteristics of accounting information, as accounting conservatism is a type of bias. (d) it helps to form hidden or secret reserves.

2.2 The Relation between Ownership Structure and Accounting Conservatism

2.2.1. Managerial Ownership: The concept of Managerial ownership in the academic accounting literature refers to the percentage of equity stocks owned by managers' and their families during the financial period, where, the agency theory prove that if managers have a high percentage of ownership, agency conflict will be minimized [11]. In the related literature, managerial ownership has two different arguments. managerial ownership can perform as a monitoring tool in the process of financial reporting that makes firms tend to be more conservative [17]. on another side. And [2] assumed that it can also be a factor for transferring minority stockholders' wealth, and that makes firms tend to avoid using conservatism policies. Based on agency theory, managerial ownership will minimize agency problems because the more stocks are owned by the managers, the stronger their desire to improve the firm value and its stocks price. Furthermore, Empirical literature shows a positive relation between Managerial Ownership and accounting conservatism [16]. where another part of the literature shows a negative relation [5,7]. But [18,19] proved that there is no relation, from above; the following hypothesis can be developed:

H.1 "Managerial Ownership has a positive relation with Accounting Conservatism".

2.2.2. Institutional Ownership: The concept of Institutional ownership in the academic accounting literature refers to the percentage of equity stocks owned by institutions such as investment firms, insurance companies, mutual or pension funds, endowments or other large companies that invest funds on behalf of others. Moreover,

institutional ownerships can influence stock prices through reputations because institutions are dealing patiently with their stocks and in case of they start to sell stocks, it can be considered as a judgment on the stock's value and decrease its price. From other side, Institutions may also maximize stock price once they own it. Furthermore, Empirical literature shows a positive relation between Institutional Ownership and accounting conservatism [20,21,22]. Where another part of the literature shows a negative relation [15]. But [2] proved that there is no relation, from above, the following hypothesis can be developed:

H.2 "Institutional Ownership has a positive relation with Accounting Conservatism".

2.3 The Relation between Board of Directors and Accounting Conservatism

2.3.1. BOD Size: the concept of BOD size in the academic accounting literature refers to the number of members in the firm's board, where BOD size may play an important role in controlling financial reporting through the mentality of each member. so at least a percentage of BOD will tend to adopt accounting conservatism. Furthermore, Empirical literature shows a positive relation between BOD Size and accounting conservatism [22,23,24]. Where another part of the literature shows a negative relation [25]. But [26,27] proved that there is no relation, from above, the following hypothesis can be developed:

H.3 "BOD Size has a positive relation with Accounting Conservatism".

2.3.2. BOD Independence: the concept of BOD independence in the academic accounting literature refers to corporate governance that needs a large percentage of board members to be independent of the firm, that happens when a board member has not been and is not employed by the firm and doesn't have a significant volume of interest in the firm's performance [2]. The Board of directors' independence was given legal definition and direction in 2002 in the Sarbanes-Oxley act. Furthermore, Empirical literature shows a positive relation between Board of Directors Independence and accounting conservatism [26]. Where another part of the literature shows a negative relation [22, 23]. But [27] proved that there is no relation, from above, the following hypothesis can be developed:

H.4 "BOD Independence has a negative relation with Accounting Conservatism".

2.3.3. CEO Duality: The concept of CEO duality in the academic accounting literature refers to a Board of directors' characteristic when one-person act as the chairman and Chief Executive Officer. Where [11] argued that it is a phenomenon worldwide, which decrease the information asymmetry, and can make up the conflict between CEO and stockholders, which is the main source for agency conflicts, Thus, CEO duality can decrease the agency problem. In adverse, in firms without CEO duality, executives have more chances, motivates and intention to manipulate financial results to achieve their own benefits, resulting in a lower accounting conservatism [1]. Furthermore, Empirical

literature shows a positive relation between CEO Duality and accounting conservatism [3,4]. Where another part of the literature shows a negative relation [29]. But [9] proved that there is no relation, from above, the following hypothesis can be developed:

H.5 “CEO Duality has a negative relation with Accounting Conservatism”.

2.4 The Impact of Organizational Characteristics on Accounting Conservatism

2.4.1. Firm Size: Firms tend to minimize the volume of disclosed earnings in the financial reports to minimize political costs, where political costs are measured by the firm size, so, the large-sized firms face greater political costs and taxation by the government. Thus, large-sized firms try to adopt accounting policies and alternatives that can decrease the volume of earnings to decrease the extent of political costs [26]. Furthermore, Empirical literature shows a positive relation between firm size and accounting conservatism [25]. Where another part of the literature shows a negative relation [27,28]. But [19] proved that there is no relation. From above, the following hypothesis can be developed:

H.6 “Firm Size has a negative relation with Accounting Conservatism”.

2.4.2. Leverage: Debt usage at a certain level will reduce the cost of capital due to the expected reduction of taxes, and increase profit, firm value and stock prices as a logical result, which immediately will benefit managers and investors [18]. Where the higher the leverage ratio, the more likely the firm will break the financing agreements, so the firm will attempt to disclose a higher volume of profit that can be achieved by minimizing expenses. And [26] argued that when the leverage ratios owned by the firm is large, the firm's ability to pay off obligations is low. This leads firms to be more likely to adopt accounting policies that maximize profits or tend to be not conservative. In other meaning, the higher the leverage ratio, the conflict between stockholders and managers will also m which can affect the using conservative policies. So, the higher leverage leads to higher conservative financial reporting. Furthermore, Empirical literature shows a positive relation between Leverage and accounting conservatism [28]. Where another part of the literature shows a negative relation [29]. But [30] proved that there is no relation. From above, the following hypothesis can be developed:

H.7 “Leverage has a negative relation with Accounting Conservatism”.

2.4.3. Profitability: the concept of profitability in the academic accounting literature refers to a set of financial performance ratios such as return on equity (ROE), earnings per share (EPS) and return on assets (ROA). Where most studies depended on ROE to measure profitability, Furthermore, Empirical literature shows a positive relation between Profitability and accounting conservatism [29]. Where another part of the literature shows a negative relation [31,32]. But [7] proved that there is no relation, from above,

the following hypothesis can be developed:

H.8 “Profitability has a positive relation with Accounting Conservatism”.

3 Research Model

We indicated the multiplicity of models for measuring accounting conservatism and the inconsistency of accounting studies about an optimal model to measure it. However, we noticed that the model [8] asymmetric timelines for the recognition of profits and the model Book to Market Value are the most common models in academic accounting studies to infer the degree of accounting conservatism in the financial reporting. So we follow the proxy of the book to market value (BTM) in our study to measure accounting conservatism, Thus, this section presents the regression model that we estimated to analyze the accounting conservatism's determinants by the following equation:

$$AC_{i,t} = \alpha + \beta_1 MO_{i,t} + \beta_2 IO_{i,t} + \beta_3 BODS_{i,t} + \beta_4 BODI_{i,t} + \beta_5 BODD_{i,t} + \beta_6 FS_{i,t} + \beta_7 LEV_{i,t} + \beta_8 ROE_{i,t} + \varepsilon_{i,t}$$

Where,

Accounting Conservatism (AC)	Book to market value (BTM)
Managerial Ownership (MO)	Percentage of stocks owned by managers
Institutional Ownership (IO)	Percentage of stocks owned by institutions
BOD Size (BODS)	Natural Logarithm of board members
BOD Independence (BODI)	Percentage of nonexecutive members
CEO Duality (BODD)	(1) if CEO and Chairman the same person, (0) other.
Firm Size (FS)	Natural Logarithm of total assets
Leverage (LEV)	total liabilities / Total shareholders' equity
Profitability (ROE)	Net profit / Total shareholders' equity

4 Results

4.1 Descriptive Statistics

We collected our data from the financial reports published by the Saudi shares market and we depended on 100 observations. On average, accounting conservatism' mean was 0.4315, median 0.39 and standard deviation 0.1837. Which shows that corporations in our sample tended to report a conservative report. from other side, managerial ownership's mean was 0.095, median 0.085 and standard deviation 0.072. Institutional Ownership's mean was 0.3573, median 0.31 and standard deviation 0.1291. BODS 's mean was 9.5, median 9 and standard deviation 1.6606. BODI 's mean was 0.494, median 0.5 and standard deviation 0.1445. BODD 's mean was 0.6, median 1.0 and standard deviation

0.4924. FS's mean was 1263.3, median 970.50 and standard deviation 985.42. LEV's mean was 0.4251, median 0.39 and standard deviation 0.16204. ROE's mean was 0.2274, median 0.25 and standard deviation 0.0684.

Table 1: Summary of statistics.

	A C	C	M O	I O	B O D S	B O D I	B O D D	FS	L E V	R O E
Me an	0. 43	1 .0	0. 09	0. 35	9. 5	0. 49	0. 6	126 3.3	0. 42 5	0. 2
Me dian	0. 39	1 .0	0. 08	0. 31	9. 0	0. 5	0	970 .50	0. 39	0. 2
Ma xim um	0. 95	1 .0	0. 29	0. 71	1 3. 0	0. 8	1. 0	549 2.0	0. 85	0. 3
Min imu m	0. 11	1 .0	0. 00	0. 12	7. 0	0. 2	0. 00	250 .00	0. 18	0. 05
Std. Dev .	0. 18	0 .0	0. 07	0. 12	1. 66	0. 14	0. 49	985 .42	0. 16 2	0. 06
Ske wne ss	0. 68	N A	0. 66	0. 69	0. 18	- 0. 28	- 0. 4	1.9 591	0. 72	- 0. 3
Kur tosi s	2. 78	N A	3. 0	2. 99	2. 19	2. 36	1. 16	8.1 279	2. 75	2. 3
Jarq ue- Ber a	8. 1	N A	7. 33	8. 05	3. 29	3. 01	1 6. 7	173 .53	8. 96	4. 0
Pro babi lity	0. 01 7	N A	0. 02	0. 01	0. 19	0. 22	0. 00 02	0.0 00	0. 01	0. 1
Su m	4 3. 1	1 0 0	9. 53	3 5. 7	9 50	4 9. 4	6 0. 00	126 332	4 2. 5	2 2
Sq. Dev .	3. 34	0 .0	0. 51	1. 64	2 73	2. 06	2 4. 00	961 339	2. 59	0. 4
Obs erv.	1 00	1 0 0	1 00	1 00	1 00	1 00	1 00	100	1 00	1 00

furthermore, Table 2 show the correlation coefficients. this matrix provide that all the explanatory variables are

correlated with the explained variable (risk of error below 1%). The positive correlation coefficient appears between accounting conservatism and (managerial ownership 0.147, institutional ownership 0.037, BODS 0.126, ROE 0.018), from other side, the negative correlation coefficient appears between accounting conservatism and (BODI -0.033, BODD -0.065, FS -0.034, LEV -0.149).

Table 2: Correlation matrix.

Correlations										
	A C	M O	IO	BO DS	BO DI	B O D D	FS	LE V	R O E	
AC	1	.14 7	.03 7	.12 6	- .03	- .06	- .03	- .14	.01	
M O	.1 4	1	- .16 3	- .14 8	- .00 8	.22 *	.07 2	- .04	.00 0	
IO	.0 37	- .16 3	1	.18 3	.04 5	- .02	- .16	.2* .	- .14 3	
BO DS	.1 2	- .14 8	.18 3	1	- .16 4	- .11 1	- .05	- .03	- .2* *	
BO DI	- .0 3	- .00 8	.04 5	- .16 4	1	- .2* .	.00 5	.15 6	.01 2	
BO D D	- .0 6	.22 7*	- .02	- .11 1	- .20 3*	1	- .07	.18 8	.16 4	
FS	- .0 3	.07 2	- .16	- .05 8	.00 5	- .07 7	1	- .11	.00 1	
LE V	- .1 4	- .04	.2* .	- .03 3	.15 6	.18 8	-.1	1	.03 6	
RO E	.0 18	.00 0	- .14	- .2* *	.01 2	.16 4	.00 1	.03 6	1	
**. Correlation is significant at the 0.01 level (2-tailed).										
*. Correlation is significant at the 0.05 level (2-tailed).										

4.2 Regression Results

Table 3 shows the results by three methods: OLS, fixed effects and random effects, the variables in the regression models: accounting conservatism, managerial ownership, institutional ownership, BODS, BODI, BODD, firm size, leverage and profitability (ROE). Our table shows that the coefficient managerial ownership is significantly positive using two methods (OLS and random effects). This result confirms the hypothesis H.1 following that managerial ownership can perform as a monitoring tool in the process of financial reporting that makes firms tend to be more conservative. This result is in line with the findings of [16]. moreover, the table shows that the coefficient institutional

ownership is significantly positive using all methods. This result confirms the hypothesis H.2. This result is in line with the findings of [21,22]. Where, the table shows that the coefficient BODS is significantly positive using all methods. This result confirms the hypothesis H.3. This result is in line with the findings of [22, 23,24]. Further, the table shows that the coefficient BODI is significantly negative using all methods. This result confirms the hypothesis H.4. This result is in line with the findings of [22,23]. Moreover, the table shows that the coefficient BODD is significantly negative using all methods. This result confirms the hypothesis H.5. This result is in line with the findings of [29]. Then, the table shows that the coefficient Firm size is significantly negative using two methods (OLS and random effects). this result confirms the hypothesis H.6. This result is in line with the findings of [27,28]. Moreover, the table shows that the coefficient leverage is significantly negative using all methods. this result confirms the hypothesis H.7. This result is in line with the findings of [29]. Finally, the table shows that the coefficient profitability (ROE) is significantly positive using two methods (OLS and random effects). This result confirms the hypothesis H.8. This result is in line with the findings of [29].

Table 3: Regression results

VARIABLE	OLS	FIXED EFFECTS	RANDOM EFFECTS
MO	0.500718***	-0.499757	0.470097*
IO	0.103432	0.059828*	0.070067*
BODS	0.015987	0.015175	0.014509
BODI	-0.010014	-0.051697	-0.038290
BODD	-0.031379	-0.053097	-0.046634
FS	-0.000009	0.000242	-0.000009
LEV	-0.159732	-0.031108	-0.125737
ROE	0.228502	- 0.35694**	0.098746
Constant	0.249***	0.1429	0.309**
Observation	100	100	100
R-squared	0.080465	0.849253	0.059391
F-Test	3.98 (0.05)*		
Hausman Test	2.075 (0.99)		
***The correlation is significant at the 0.01 level.			
**The correlation is significant at the 0.05 level.			
* The correlation is significant at the 0.1 level.			

5 Conclusions

This article investigated the managerial determinants of accounting conservatism in Saudi Arabia during COVID-19 era. At the beginning we reviewed the academic literature to develop the theoretical framework of accounting conservatism in terms of definition, motivations, advantages,

disadvantages of the application and academic theories. Then to conduct our empirical study, we depended on a sample consisted of top 50 corporations operating in the Saudi shares market to analyze 100 firm years' observations, going further, the accounting conservatism mean was 0.4315 during the study. the article's results illustrated empirically a positive relation between accounting conservatism, managerial ownership, institutional ownership, board of directors' size and profitability among the sample. and a negative relation between accounting conservatism, board of directors' independence, board of directors' duality, firm size and leverage. Finally, the article results will add to the academic literature and help stakeholders to understand the managerial determinants and motivates of adopting accounting conservatism based on scientific evidence.

Conflict of interest: The authors declare that there is no conflict regarding the publication of this paper.

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