“The Effect of Accounting Conservatism on Earnings Management & Bankruptcy Risk: The Case of Jordan”

أثر التحفظ المحاسبي على إدارة الأرباح وخطر الإفلاس: حالة الأردن

Thesis Submitted in Partial Fulfillment of the Requirements for the Degree of Master in Accounting at Yarmouk University

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Program: Accounting
2012
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DEDICATION

I begin this dedication in the name of the Almighty God who uplifted me until I completed this research study.

This study is dedicated to my Dad & Mom who provided a real example of tolerance and support. They kept me encouraged and helped me see the light at the end of the tunnel.

It is also dedicated to my wonderful sisters (Rania, Sana’a, Wafa’a) and brothers (Ayman & Mohammad). I appreciate their sincere support and encouragement. They were a big help, as always.

To the joy of our life, my nephews and nieces (Osama, Husam, Qusai, Hashem, Ahmad, Nour, Joudy and Abdallah).

To my other family members who assisted and encouraged me in various ways.

To my close friend for a life time, Bassamat.

To my close friends from school and university. To my friends, colleagues, and supervisors in optimum co. & Jordan securities commission. Your existence in my life mean a lot to me.

It is also dedicated to anyone and everyone this study might be in use.
ACKNOWLEDGMENT

Throughout the process of earning this degree, I benefited from the wisdom and helpful nature of several people who contributed in making this research project possible. In particular, my supervisor Prof. Mishiel Suwaidan, was a big help to me because of his sage advice, friendly disposition, timely encouragement, and thoughtfulness.

I would also like to thank the committee members, Dr. Iaad Al Sartawi and Dr. Radi Al Hamadin, for their helpful interaction throughout the defense session and for their valued comments.

I would also like to thank my teachers in bachelor & master degrees for everything they taught me. I specify Prof. Mishiel Suwaidan & Dr. Iaad AlSartawi, you were a true beacon of knowledge and a great inspiration.

Finally, I gratefully acknowledge all those who have participated in this study and all that helped me achieve my goal. I specify Dr. Suzan Abed, my dear friends Dr. Dana Alnajjar and Abdelaziz Ebdah.
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The Effect of Accounting Conservatism on Earnings Management & Bankruptcy Risk: The Case of Jordan

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ABSTRACT
This study examines the effect of accounting conservatism in the Jordanian companies by studying conservatism effect on two crucial variables; earnings management and bankruptcy risk. Study’s sample consists of (59) Jordanian manufacturing companies listed in the ASE for the period 2006-2010 with a total of (295) observations. This examination is expected to provide an opinion or a recommendation regarding the movement by standards setters toward less conservative financial reporting. Descriptive analysis and multiple linear regression was conducted to investigate this effect.

Non operating accruals was used for measuring conservatism using Givoly and Hayn (2000) model, while earnings management was measured by discretionary accruals using modified Jones’ model and bankruptcy risk was measured by Altman Z-Score
bankruptcy model. In addition, three controlled variables have been employed in this study: size of the company, financial leverage and performance.

The study revealed that there is a negative statistical significant relationship between accounting conservatism and earnings management for the companies incorporated in the study. Whereas the relationship between accounting conservatism and bankruptcy risk found insignificant.

The study recommends that accounting standard setters’ leadership (such as IASB and FASB) need to have full image of potential costs associated with their movement toward less accounting conservatism by conducting excessive studies in all countries including developing ones. On the other hand, regulatory bodies in Jordan need to be aware of this movement in order to control its effect. Bankruptcy risk matter needs more attention from researchers, banks and regulatory bodies in Jordan. General credit rating and bankruptcy predictions models need to be set, periodically calculated, reviewed and published to the public. Earnings management issue also needs to get more attention. Earnings management practices should be detected once they occur and proper penalties need to be enforced by regulatory bodies and laws.

**Keywords:** Accounting Conservatism, Earnings Management, Bankruptcy Risk.
Chapter One:

Introduction
1.1 Introduction

In a recent discussion paper on an improved conceptual framework (IASB, 2006a), the IASB and the FASB argue that prudence and conservatism are not desirable qualities of financial reporting information (IASB, 2006a, Basis for Conclusions (BC) 2.21). One interpretation of this proposal is that the consistent undervaluation of net assets (consistent conservatism) is not considered to be an adequate way of dealing with uncertainty. Instead, the changes in the business conditions of a firm should be, to a greater extent, reflected in the financial reporting via changes in future-oriented estimates and probabilities. In turn, this should increase the decision relevance to users. In other interpretation, preparers of financial statements should not at all be encouraged to be conservative when dealing with uncertainty since this could lead to a conservatism bias. Instead, preparers shall take a neutral standpoint when dealing with uncertainty (Hellman, 2008).

Considering the above illustration, this study attempts to examine the effect of accounting conservatism on two crucial variables; earning management and bankruptcy risk. This examination is expected to provide an opinion or a recommendation regarding the movement by standards setters toward less conservative financial reporting.