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Corporate Governance and Accounting Conservatism: The Moderating Role of Family Ownership

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Abstract

This study objective is to investigate the influence of board characteristics and audit committee characteristics on accounting conservatism with respect to the influence of family ownership in Turkey. The findings explained that clients' demand for accounting conservatism improved because of board characteristics (e.g. board size, independence & women on board) and the audit committee characteristics (e.g. audit committee independence and audit committee expertise). Hence, the family ownership undermines the impact of board characteristics and the audit committee characteristics to demand accounting conservatism, which will be unfavorable outcome for the minority shareholders. Thus, this study suggests that regulators should increase law enforcement to improve corporate governance in Turkey to accommodate the unique characteristics of family ownership and offer a protected environment for minority shareholders.

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INTRODUCTION

Accounting conservatism represents one of the significant features of the quality of financial information. Conservatism is subjective in nature, and it is involved in most of accounting conceptual frameworks. Numerous studies have examined accounting conservatism in different financial and economic environments (Basu, 1997). In general, these studies focus on viewing conservatism as a practice of asymmetric recognition in which emphases on accounting norms with highest liabilities/expenses of lowest assets/revenues. Conservatism accounting could be affected by features of each environment such as the set of accounting standards adopted in the country. For instance, Ball, Robin and Wu (2003) revealed that accounting results of firms in countries with code law systems are less conservative than those of firms in common law legal systems. Recently, although some studies have argued that family ownership is associated with higher earnings quality and firm performance (Ali, Chen, & Radhakrishnan, 2007) accounting conservatism has become an important issue for family-controlled firms. Family firms certainly have less serious agency problems because of their reduced separation of ownership and management; however, they do have more serious agency problems between the controlling family and minority shareholders (type-II agency problem). Corporate governance mechanisms have received substantial scholarly attention as a way to enhance accounting conservatism. There are a considerable number of studies (Ahmed & Duellman, 2007) which document that the effectiveness of corporate governance mechanisms affect accounting conservatism practices of widely held public firms, however there are relatively less studies (Ren, 2014) which investigates whether the measures of corporate governance have the same effect on the level of accounting conservatism when ownership is not widely dispersed, and in particular when ownership is concentrated in the hands of families. This study contributes to the existing research by searching whether family ownership moderates the effectiveness of corporate governance mechanisms in enhancing the level of accounting conservatism practices on a sample of Turkish firms. Turkey has an ideal setting to handle issues related to accounting conservatism in family firms due to the presence of large number of family firms (Mustafa, Che-Ahmad, & Chandren, 2018).

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

According to the positive accounting theory accounting conservatism can be exercised to control earnings management and reduce agency conflicts (Watts & Zimmerman, 1986). Accounting conservatism is one of the corporate governance mechanisms. That is due to its role in restricting the opportunistic behaviours of managers (Basu, 1997). Due to the benefits of accounting conservatism, firms with strong corporate governance are more likely to adopt high levels of conservatism practices. Corporate governance is an interrelated system; in a particular arrangement some practises of corporate governance mechanisms are more effective, leading to various patterns of corporate governance. In this regards, this study applies a contingent approach to investigate how family-owned firms influence board strategic behaviours in terms of adopting the levels of accounting conservatism. According to agency theory, internal corporate governance mechanisms such as board of directors and audit committee (Ahmed & Duellman, 2007) represent significant corporate governance mechanisms to limit the agency conflicts through improving the quality of reported earnings. This study is concentrating on family-owned businesses not only influence board incentives to monitor management, but also on board's ability to demand accounting conservatism. The importance of clients' incentive is addressed by agency theory while, the importance of clients' ability to demand accounting conservatism is derived from resource dependency theory (Hillman & Dalziel, 2003). Based on the above arguments, these study hypotheses are:

H_1: There is a relationship between board size and accounting conservatism.
H_2: There is a relationship between board independence and accounting conservatism.
H_3: There is a relationship between women on board and accounting conservatism.
H_4: There is a relationship between audit committee independence and accounting conservatism.
H_5: There is a relationship between audit committee expertise and accounting conservatism.
H_6: There is a relationship between family ownership and accounting conservatism.
H_7: Family ownership moderates the relationship between board size and accounting conservatism.
H_8: Family ownership moderates the relationship between board independence and accounting conservatism.
H_9: Family ownership moderates the relationship between women on board and accounting conservatism.
H_{10}: Family ownership moderates the relationship between audit committee independence and accounting conservatism.
H_{11}: Family ownership moderates the relationship between audit committee expertise and accounting conservatism.

METHODS

Turkish firms have been used as a population of this study. Financial institutions are excluded from the sample because they apply different principles of corporate governance (Zulkarnain, 2009). This study covers the five-year period starting from 2011 to 2015. The empirical analysis based on data collected from firms' annual reports, complemented by DataStream.

MULTIVARIATE ANALYSIS

Table 5 shows that there is a negative relationship between BSIZE and ACCR at the rate of 0.081. Agency theory suggests that large corporate boards encourages directors' domination and leads to complicate the process of decision making (Jensen, 1993). Hence, hypothesis H1 is supported.

Table 5
Accounting Conservatism Regression Models

Items	Model1		Model2(IVs*FOWN)	
	Coefficient	t-value	Coefficient	t-value
BSIZE	-0.081	-2.39**	-0.061	-1.79*
BID	-0.098	1.13	0.157	1.84*
WOB	0.170	2.62**	0.185	2.95**
ACCI	-0.062	-0.61	-0.125	-1.27
ACCEX	0.297	4.55***	0.276	4.33***
SOTI	0.452	4.11***	0.416	3.79***
BSIZE*FOWN	-	-	-0.035	-0.53
BID*FOWN	-	-	0.009	0.12
WOB*FOWN	-	-	-0.223	-4.47***
ACCI*FOWN	-	-	0.028	0.42
ACCEX*FOWN	-	-	-0.169	-3.42**
FSIZE	-0.095	-3.37**	-0.088	-3.17**
LEVE	2.790	2.17**	1.720	1.36
FAGE	0.007	2.65**	0.007	2.84**
Wald Chi 2	105.88		173.05	
Prob>chi^2	0.000		0.000	

*Notes: * = significant at 10%, ** = significant at 5% and *** = significant at 1%.*

The influence of BID on ACCR is positive but not significant. Its effect is about 0.98%. The implication of this finding is that for every increase in BID by one unit, ACCR would rise by 0.98%. The finding consistent with that of (Ren, 2014). Family related directors as independent directors satisfy the definitions set by the regulators, but these families related who represent them are not truly independent. Hence, hypothesis H_2 is rejected. WOB has positive influence on ACCR to the tune of 17%. This implies that for every single increase in WOB, the influence on the ACCR increase by 17% this align with that of (Abdullah & Ku Ismail, 2013). A 62% medium relationship exists between ACCI and ACCR. This relationship which is also a direct relationship shows that the more independent the audit committee, the lower the chances of selecting a high ACCR even though this relationship is insignificant (-0.61). this study result align with the result of Krishnan and Visvanathan (2008). Thus, hypothesis H_4 is rejected. The finding displays that ACCEX have a 29% influence on ACCR. A study by Sultana and Mitchell (2015) show positive association between accounting and financial expertise of audit committee members and ACCR. Hence, hypothesis H_5 is accepted. Family ownership has a positive contribution to the accruals (t= 4.11). Family owners are less likely to evolve in earning manipulation and this align with the result of (Ball, Robin, & Wu, 2003). Therefore, hypothesis H_6 is accepted. The influence of BSIZE on ACCR turns insignificant with the introduction of the FOWN (t = -0.53). Consistently, Lipton and Lorsch (1992) argued that large board of directors complicates decision making process as a consequence of tasks coordination problems. Thus, hypothesis H_7 is rejected. Nevertheless, like the direct relationship that displays an insignificant negative relationship of about -0.98%, the moderated relationship gives a positive influence of about 0.09%. The insignificance of the moderating effect of BID is a concept deprived of its actual meaning. Firms nominate directors that fulfil the legal definition of independence but are close to the management and act in the interest of the controlling shareholders. The finding does not support Hypothesis H_8. WOB show a significant (t = -4.47) impact on ACCR with the introducing FOWN. The most interesting is that the moderating influence of FOWN on WOB leads to a negative relationship. The same opinion is reported by Wu et al. (2016). Hence, hypothesis H_9 is accepted. There is insignificant relationship between ACCI and ACCR in the presence of FOWN. However, the result is consistent with Krishnan and Visvsnsthsn (2008). The result doesn't support Hypothesis H_{10}. Expertise directors have an adverse influence on ACCR in the presence of FOWN (t = -3.42). Directors occupy a position in the audit committee might have low incentive to depend on ACCR in their monitoring role, because lawsuits against directors are much less common as a consequence of weak institutional setting such as Turkey compared to the United States (Fanto, 1998). The finding supports Hypothesis H_{11}.

CONCLUSION

This study finding align with that of previous evidences that board characteristics and audit committee characteristics mitigate Type II Agency Problem through adopting high accounting conservatism. This study validates that family ownership undermines boards demand for accounting conservatism, a result which will be unfavourable to minority shareholders. To sum up, this paper contributes to providing a general understanding about board behaviour in engaging in monitoring function using accounting conservatism. Based on the aforementioned, it is worth for more empirical studies on corporate governance, accounting conservatism and family-owned firms in Turkey.

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