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Impact of Conservatism and Earnings Management on Earning Quality: Evidence from Pakistani Listed Firms

ABSTRACT

This study examines whether accounting conservatism (prudence) and earning management are related with improved quality of earnings. Using a sample of 70 non-financial Pakistani listed firms covering a 10 years period from 2008-2017 with 700 observations. Quality of earning is measured on the basis of Accrual quality measurement as proxy to earning quality indicator. Basu Reverse regression approach is used to measure conservatism (Prudence) and Modified Jones Model is used for Earning Management. The results of the research indicate a significant positive impact of conservatism and earning management on quality of earnings in context of Pakistan. This context will provide a source for shareholders, stakeholders, controlling bodies of firms, regulators and other concerned bodies to make decisions on the financial position of the firm's on available financial reports.

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1. INTRODUCTION

The general purpose of financial reporting is to make available the financial position about the reporting entity which will be helpful to the existing and potential investors, lenders and other concerned bodies to make decision on the provided resources. To predict the performance of firms by provided useful information for investors is primary objective of financial accounting. The earnings report provide help to the community of economy in several ways for instance a basis for tax calculation, a criteria, a determining amount of dividends, distribution of earnings, assessing the success of companies performance and managing the business unit and so on (Delkhosh & Sadeghi, 2017). Among financial statement's user the net income always one of the most important issue and its quality and management is also attention of investors and creditors (Beatty, Weber, & Yu, 2008). The emphasis of the study is to determine the impact of investment on the basis of conservatism (prudence) and earning management on earning quality of non-financial firms. For this research non-financial Pakistani listed firms are selected as sample. The major and most important variable is earning quality of firms which is affected by accounting conservatism and earning management. Huge studies reveal the relationship between the earning quality and investment but this research will focus to trace down the quality of earnings for investors, affected by conservatism and earning management.

In current research we try to examine the relationship of earning management and conservatism on quality of earnings of non-financial firms of Pakistan. This research will mainly focus on purpose of finding the impact of prudence and earning management on earning quality and as a result giving valuable and actual accounting information about earnings for investors, shareholders, speculators and other related clients such as banks, managers and artisans. Moreover, it is also evaluated that any accumulations made in earnings more than in a period must be balanced with the accruals in other period.

Moreover, the purpose behind the study is also by giving valuable and actual accounting information about financial reports for investors from manipulation of their investments as many accounting scandals hit the companies and investors. Such as a few accounting scandals of world's largest famous organizations like Enron, World.com etc. Such scandals had put the investors, speculators and other concerned persons in accepting the future financial viability of organizations because the aggressive accounting standards are not easy to interpret which are regulated by such firms. To be precise, this study will tend to provide answers to the question that what is the impact of earning management and conservatism simultaneously on the earning quality of non-financial firms. The basic idea behind the research is to provide evidence to the stock brokers, managers, planners, policy makers, investors and regulatory authorities that they actively share financial information about the firms which may be used for future decisions about stocks and investors in Pakistan. The results of the study will be helpful to explain the investor's behavior on financial statements and determine the improved predictions about current and future firm's performance. This study is also essential for filling the gap of earning management and accounting conservatism on earning quality of firms.

This study is further categorized in following sections. Section 2 will discuss the literature review and hypotheses development. In section 3, methodology of the study will be discussed in detail. Results and discussions are in section 4 while section 5 is about the conclusion and future recommendations.

2. LITERATURE REVIEW

Current section will describe the theoretical and empirical literature as a background for the study. This section is divided in two main parts. First part will explain the theoretical background base of the research, whereas, second part will explain the past empirical evidences which will focus on the influence of conservatism and earning management on earning quality.

2.1.   Conservatism

Prudence relatively known as "accounting conservatism" is a disputed area under discussion in academic circles and also in policy making matter. Concepts of prudence or "conservatism" in financial reporting have a prominent role and regularly incorporated into conceptual or theoretical framework (APB, 1970; Board, 1980a). Prudence (conservatism) has a prominent role in defining the quality of financial evidence also with respect to the company's performance (Shroff, Venkataraman, & Zhang, 2013). Conservatism has a vital effect on financial results as higher conservatism reflects lower firm's performance.

Conservatism is generally expressed as by the standard "anticipate no profits but anticipate all losses". Whereas, the concept of accounting conservatism comes under the front discussion among accountants and with the passage of time got a vital place in reporting the financial statements. Accountants interpret the conservatism "implies that preferably the lowest values of assets and revenues and the highest values of liabilities and expenses should be reported".

In early 1930's conservatism was came under debate for the first time by (Hunt, 1939). Gilman and MacNeal criticized the asset valuation method introduced to represent the assets in the monetary reports. Gilman criticized it by expressing his views as by disclosing the asset valuation by historical cost. On the other hand, MacNeal stated that the possessions must be valued at present market value. Term "conservatism" can be defined by many researchers and also definitions are set by accounting standard-setters are as: "Accounting Policies or tendencies that contribute to a downward bias in accounting net asset value relative to economic net asset value"(Basu, 1997; Watts, 2003).

"Conservatism is a prudent reaction to uncertainty to try to ensure that uncertainties and risks inherent in business situations are adequately considered. Thus, if two estimates of amounts to be received or paid in the future are about equally likely, conservatism dictates using the less optimistic estimate (SFAC No. 2)"(Board, 1980b).

Prudence (conservatism) can be discussed or defined in at least in two different perspectives. In first perspective conservatism is distinctly defined as "the speed of bad news recognition in earnings (losses) relative to the speed of good news recognition in earnings (gains)." (Ball, Robin, & Wu, 2003; Bushman & Piotroski, 2006; Givoly & Hayn, 2000). While, in second perspective Basu (1997) and others explained conservatism as "the incremental time lines of bad news recognition over good news recognition. Whereas, the preceding literature recommends that prudence is desirable and helpful for obligation(debt) holders and also for contracting purpose (Ball, Robin, & Sadka, 2008; Beatty et al., 2008).

An ongoing stream of research has filled out this gap but researchers are unable to look into how speculators response to the exposure of financial data. (Ball & Shivakumar, 2005; Watts, 2003) suggests that prudence benefits the users or clients of financial summaries by compelling supervisor's opportunistic artful payments to themselves and other concerned bodies, mitigates organizational issues related with administrative investment decisions, builds obligation and different projects agreements efficiency and encourages the monitoring of agreements. Furthermore, perspective of conservatism is further explained by splitting it in two types. **Unconditional Conservatism**

We classified prudence (accounting conservatism) as the overall modest representation of the net assets book value with respect to their fairly estimated market worth and also as alternate confirmation ability that is expected to recognize incomes and costs which lead to a decrease of earning sources (Basu, 1997). From prior available literature, conservatism is showed in two general yet in different ways.

First way of recognizing conservatism is "ex-ante" or "news independent" relatively known as "unconditional conservatism". Unconditional accounting conservatism suggests those aspects of monetary bookkeeping procedure decided at the origin of liabilities as well as assets yield anticipates unrecorded goodwill (Gassen, Uwe Fülbier, & Sellhorn, 2006; Iatridis, 2011).

2.2. Conditional Conservatism

Second type of accounting conservatism or prudence is "conditional conservatism" basically is "ex-post or news dependent", implies to facilitate on the basis that assets book values are recorded under adequately undesirable or antagonistic circumstances however, not reviewed under desirable circumstances. An instance of conditional conservatism incorporates lower of costs and impairment enduring for long-life assets (Ahmed & Duellman, 2013; Basu, 2005; Roychowdhury, 2006). Delkhosh and Sadeghi (2017) explained conditional conservatism as the timely acknowledgement of misfortunes or losses in case of bad, terrible and critical reports.

2.3. Earning Management

Earning Management is a defensive step to maintain a strategic distance from an in-default situation in a credit agreement, lessens the administrative costs by increasing the administrative advantages. To acquire advantage for the organization, administration and concerned bodies relates to a firm is the primary objective of procuring earning management practices (Danastri & Christine, 2017; Shahzad, et al., 2017).

The term "earnings management" refers to a wide determination of accounting techniques used to accomplish specific earnings objective by the executives (management). Whereas, there is no single acceptable definition of earning management, available resources deliver different accounts of the practice. Uwuigbe, Peter, and Oyeniyi (2014) and Akers, Giacomino, and Bellovary (2007) find out it as "Efforts of management to control reported earnings by applying certain accounting methods, recognizing non-recurring items or by using other techniques designed to influence short-term earnings". Cornett, Marcus, and Tehranian (2008) find out as "A defensive way to avoid in-default circumstances to condense the regulatory cost, in a loan agreement and in order to increase the regulatory profit".

The term "Earning Management" is a prominent issue of discussion by the firms and lot of studies have been published and still the term is in discussion like (Fields, Lys, & Vincent, 2001; Hassan & Ahmed, 2012; Kumar & Khatun, 2018; Ujah & Brusa, 2011). The main origin of setting standards for earning management is due to agency conflicts (discussed by agency theory), also examined the large sized firms demand and use better earning management mechanism for enhancing the quality of earning (Ali, Salleh, & Hassan, 2008). The studies also examines that there is a significant relationship between financial institutions' expenditures on loan loss provisions and their outcomes, an evidence of earnings management (El Sood, 2012; Kanagaretnam, Lobo, & Yang, 2005). The researchers also argued about earning management that to deceive stakeholders to ensure that the firm's fiscal(financial) targets have been achieved in the sequence of business, the manipulation of such accounting figures is due to operational practices arise from management (Gajevszky, 2014; Healy & Wahlen, 1999; Roychowdhury, 2006).

Mosazadeh (2016) explains that earning management is practiced by managers or directors which are intended to build (decrease) current reported earnings of the unit for which the administrator is dependable. Over the last decades due to its significance and effect on firm's stakeholders earning management has gotten a specific attention and a subject to discuss for researchers. Nugroho and Eko (2012) and Jianxin (2007) explains that earning management is a corporate phenomenon in the market sector and the information among existing or potential investors. They overcome on a suggestion by giving focus on earning management that it is an action to betray by making riddle of mysteries numbers and furthermore cause a reason to hurt concerned stakeholders rationally and financially. Earning management is used as a strategic tool by the firm's management or administrators for to intentionally manipulate and to control the firm's earnings so that the pre-decided targets should be achieved. A motivation behind such practice is for the reason of smoothing earnings (Hamid, Eddine, Ayedh, & Echchabi, 2014; Sun & Liu, 2008). Dilawer (2012).

2.4. Earning Quality

The term Earnings quality is defined as, an income generated by the firm is represented faithfully in his report, where representational faithfulness means *"correspondence or agreement between a measure or description and the phenomenon that it purports to represent"* (Nurnberg, 1993). "*Earnings quality as the magnitude of estimation errors in accruals, and provide empirical estimates of this construct based on the relation between accruals and cash flows"* (Dechow & Dichev, 2002).

The income detailed by a firm are as much an element of its bookkeeping strategies as they are a proportion of its business achievement also called quality of earnings (Arkan, 2015; Azibi & Rajhi, 2013; Soliman & Ragab, 2013). Likewise, incomes that are determined moderately are considered to have higher quality than those determined by forceful bookkeeping arrangements. Nature of profit can likewise be disintegrated by administrators who embrace obscure bookkeeping rehearses so as to shroud poor deals or expanded business chance.

Organizations that control profit are said to have poor or low income quality; on the other hand, organizations that don't control income have a high caliber of income. One proportion fundamental analysis that analyst follow net gain. It gives a review of how well the organization is getting along from a profit point of view. Cohen and Zarowin (2010) and Radzi, Islam, and Ibrahim (2011), In the event that net gain is higher than it was the earlier year and additionally beats investigator gauges, it speaks to a success for the organization, however how solid are these income.

3. HYPOTHESIS DEVELOPMENT

Delkhosh and Sadeghi (2017) examined the nexus of conservatism and earning sustainability(earning quality), and afterward the information required to analyze is gathered from fiscal statements of the listed firms in TSE(Tehran Stock Exchange), by using a sample of 123 companies accepted between 2009 to 2014(5-years period) and report a "negative(inverse) and significant" nexus among variables.

Baghban, Yazdani, and Zare investigated the nexus between prudence (conservatism) and accrual-based earning quality with a sample of overall non-financial firms listed on Tehran Stock Exchange (2008-2013). An examination strategy for the study is descriptive and correlational. The findings demonstrate that by expanding the dimension of conservatism the chances of benefit the board are restricted and administrators or managers have no incentives to deal with accumulation based benefits that keep the reported earnings progressively precise or confined from maneuvering and conclude that "there is a negative and significant relationship among variables"

Ismail and Elbolok (2012). The research is based on to analyze the impact of restrictive (conditional) and unrestrictive (unconditional) conservatism on dispersion of profits (earning quality) in Egyptian context. By using cross sectional data analysis, a sample of 30 Egyptian companies during the period of 2005-2009(5-years period) investigates that conditional conservatism has a significant relation and negatively influences the earning quality of firms. While, unconditional conservatism does not influence earning quality of Egyptian firms.

Velury & Jenkins, (2006) investigated a significant and negative nexus between variables with a financial crises period during 2004 to 2010 by using a sample of 32 firms having a financial crises and 82 other companies and the commercial code article 141 is used for the recognition of financial crises firms.

Razzaque, Ali, and Mather (2016) has examined the nexus of real earning management with dispersion of profits of family firms, by taking a sample in light of panel data over a six year time frame from 2006 to 2011 from listed companies in Bangladesh. Sample includes 105 firms for 2006, 109 firms for 2007, 116 firms for 2008, 117 firms for 2009, 122 firms for 2010 and 122 firms for 2011 respectively. The study founds a significant and negative relationship between earning management and earning quality and provides an evidence that earning management leads to lower future firm performance.

Achleitner et al, 2014) surveys the impact of earning management on quality of earnings with a sample of 402 German listed family firms from 1998 to 2008 a tenure of 10 years and concludes that family firms go for earning management very rarely. The study founds a significant and positive relationship between earning management and earning quality and provides an evidence that earning management leads to lower future firm performance and findings investigates that the practice of earning management is used strategically to help the firms for survival in market.

Adams & Ferreira, (2008) research is based on to properly evaluate firm's financial performance for investors, financer, lenders and stakeholders that the disclosed earnings should reflect the true picture of economic position of organizations throughout the disclosed time frame. By using cross sectional data analysis, a sample of 353firm's companies during the period of 1996-2000(5-years period) investigates that earning management has a significant relation and positively influences the earning quality of firms.

Noor and Ali (2015) discussed that the speculators concerns on the dispersion of profits after financial crisis become more concentrated topic and closure of large prestigious organizations. Hence, the disclosed quality of earnings should be better indicator of future and current earnings of the firm. The research is based on to analyze the impact of restricted "conditional conservatism" and prospective "unconditional conservatism" on dispersion of profits (earning quality) in Pakistani context by obtaining a data from textile sector listed in KSE(Karachi Stock Exchange)over a period of 5-years from 2010 to 2014 and find a significant and positive impact of earning quality with conservatism.

Yasir (2018) held his research with the primary objective of to evaluate the effect of prudence "conservatism" on firm's investment efficiency on the basis of financial reports. To explore his findings he used a panel data sample from 1998 to 2015 listed Pakistani non-financial firms in Karachi Stock Exchange. And found a significant and positive impact of prudence with quality or earnings.

Shah, Yuan, and Zafar (2010) studied the nexus of earning management with dividend policy. Their research is an exertion to find out the comparison of dividend payout ratio in the presence of earning management practices for two countries Pakistan and China. To find out the impact, set of listed firms had been selected from a period of 2003-2007 for Pakistan and 2001-2007 for China to analyze the relationship and finds no impact of earning management on dividend payout ratio in Pakistan but China dividend payout policy is effected be earning management practices

On the foundation of the above discussion it can be argued that conservatism and earning management has a prominent effect on dispersion of earnings. Therefore, in-line to the available discussed literature of conservatism (prudence) and earning management is likely predicted to influence the quality of earnings of Pakistani firms. Following the significant nexus between variables through theoretical and empirical evidence, current study assumes a significant association among conservatism and quality of earning. Thus, the proposed developed hypothesis are as follows:H_1: There is a significant and positive nexus of conservatism (prudence) with earning quality.

H_2: There is a significant and positive nexus of earning management with earning quality.

4. RESEARCH METHODOLOGY

Since this study is intended at examining the effect of investment efficiency on financial performance of firms of Pakistan. This is a descriptive-correlational study and is among applied research. Based on the research objective a correlational study analyses the relationship between variables. And to test the hypothesis the variables will be regressed.

Empirical evaluation of the variables related to disclosure of profits of Pakistani Listed Firms is the prime endeavor behind the study. To evaluate this research all non-financial firms of Karachi Stock Exchange (KSE) 100 index are selected as sample. The sources used to extract essential data for the evaluation of current study is from: (i) Audited Annual Reports of Non-Financial firms, (ii) Database of State bank of

Pakistan (DBSBP), (iii) KSE official website and (iv) Business Recorder site. 70 Pakistani listed firms have been selected as a sample from KSE 100 index for the study. Sample contains a period of ten years i-e from 2008 to 2017 which contains 700 observations that are utilized in the study. Present research centers around basic fundamental standards or principles used for particular company for the purpose of selection procedure of firms. Firms 10 years financial and annual reports data from 2008 to 2017 should be available. The criterion is specified for the following particular reasons. Firstly, the beginning financial year available for the researcher was 2008 and final financial year is 2017. Second, the utilization of 10-years period for the current study makes it distinctive from other different studies of similar kind.

4.1.   Variables

In this research, "Earning Management" and "Accounting Conservatism" is selected as independent (explanatory) variables with control variables of Firm Size, Growth, Leverage, Sales volatility and "Earning Quality (Earning Sustainability)" as dependent variable.

i.   Earning Management

Generally executed effort to reduce variations in earning used by managers is a practice of Earning Management. In this study, "Modified Jones Model" was selected as a tool to measure earning management by optional accruals (DAm) presented by Dechow et al., (1995). Furthermore the previous literature provided on measurement of earning management concludes that this model is the appropriate, prominent and strongest test to examine earning management. The Modified Jones Model was:

$$DAm = [TACm/Am - 1] - NDAm$$

Whereas, DAm are optional or discretional accruals, $NDAm$ are non-discretionary accruals, $Am - 1$ total assets and TAC_m are total accruals

- $TACm = Em - OCFm$
- $TACm/Am - 1 = \alpha0\,(1/Am - 1) + \alpha1\,(\Delta REVm/Am - 1) + \alpha2\,(PPEm/Am - 1) + \varepsilon m$
- $NDAm/Am - 1 = \alpha1\,[1/Am - 1] + \alpha2\,[(\Delta REVm - \Delta RECm)/Am] + \alpha3[PPEm/Am - 1]$

Whereas, TAC_m are Total Accruals, E_m are Operating Earnings, OCF_m are Net Operating Cash flows, ΔREV_m are net income change m between year m-1 and m, PPE_m are property equipment machinery of company and ΔREC_m are volatility in trading receivables and net income accounts.

ii.   Conservatism

Conservatism is measured by taking Basu Reverse Regression Approach and Negative Accrual Measures Approach. Basu Reverse Regression Approach was presented in 1997 by (Basu, 1997) and make known to established a signal of reporting earnings linked with the bad news in relationship with the good news to public (Lai, Lu, & Shan, 2013). The approach is expressed as:

$$Xy = \beta o + \beta_1 Dy + \beta_2 Ry + \beta_3 DyRy + \varepsilon y$$

Whereas, X: earnings of the year, D: virtual variable, 1 if bad news otherwise 0,   R: Return on equity (E.V – B.V + Adj), y: indicates a firm and β_3: measures the conservatism.

iii.   Earning Quality

The technique used to measure Earning Quality is Accrual Quality measure presented by (Desai & Dharmapala, 2006; Lyimo, 2014). Accrual Quality is demonstrated by the distinction of cash from recorded and operating earnings. So far Accrual measurement technique for quality of earnings

concentrating on magnitude and on error is also generally used as proxy to evaluate earning quality (Desai & Dharmapala, 2006; Lyimo, 2014). Model Specification evaluations for measuring earning quality through Accrual Quality indicator are as follows:

$$ACCRUAL\ QUALITY\ =\ (EARNINGS - CFO)/TOTAL\ ASSETS$$

The smaller the value of accrual quality will tends high quality of earnings and larger value will persist poor earning quality and rank our earnings quality indicator similar with prior studies (Desai & Dharmapala, 2006; Francis, 2004).

4.2.   The Model

For answering the research questions by leading through panel data following reasons will support our analysis of findings. Basic reason is to snatch or grab the intentions of financing bodies and to overdue the financing choices of organizations more effectively and viably than time-series and cross-sectional procedure (Blundell, Griffith, & Reenen, 1995; Elghuweel, 2015; Hsiao, 1985). Second purpose is by expanding the freedom level, dimensions of opportunities and diminishing multiple correlational issues, panel data permits the researcher to econometrics assessments ratio (Antoniou, Guney, & Paudyal, 2008; Gujarati & Porter, 2004; Sabiwalsky, 2008). Moreover, (Hsiao, 1985) in lined this aspect as "panel data permits us to make and test more accurate behavioral models which could not be recognized by time-series or cross-sectional data".

In light of the theoretical literature and available prior observational (empirical) examinations on earning quality persistence of non-financial firms, the present study has determined the Non-Financial Pakistani listed firms from KSE 100 index. OLS regression equations will be assessed for research findings. Dependent variable, "earning quality" is selected to test proposed hypothesis in current research. The explained (dependent) variable with the nexus of explanatory (independent) variables is presented in the model specified as:

Model:
$$EQ = \beta_0 + \beta_1 CON + \beta_2 EM + \beta_3 Size + \beta_4 GTH + \beta_5 LEV + \beta_6 ROA + \mu$$

Whereas, EQ refers to Earning Quality, CON refers to Conservatism, EM refers to Earning Management, Size represents the firm size of the firm, GTH represents the Change in Sales, LEV is Financial Leverage and ROA represents Return on Assets.

At the point when more number of factors (variables) is incorporated in the study, at that point some methodological issues arises which should be tended to be addressed. It can be contended that when a range of variables are incorporated in study, they cause a statistical issues of normality, heteroscedasticity, multicollinearity and autocorrelation. While, it is to be pretended by (Waters, 1994) that large number of variables then fewer variables are enhanced to be better. Moreover, each variable which are being considered in this study have core arguments from empirical and theoretical prospective which can interface indirectly or directly to tackle the nexus which are to be analyzed.

4.3.   Descriptive Statistics

An examining procedure for research interprets a sample of 70 Non-Financial listed firms of Pakistan from a period of 2008 to 2017 bringing about 700 observations. A descriptive statistical analysis can be seen to acquire an overview of the research data in Table 1. E-Q (Earning Quality) demonstrates a mean value of 0.42143 with 0.4941 std. deviation and E-Q shows a range 0 to an extreme value of 1. Similarly, CONS (Prudence or Conservatism) shows an average value of 0.9986 ranges from minimum value of 0 to a maximum value of 1 with 0.0378 std. deviation and Earning management presents a minimum range of

-1.2707 to extreme maximum range of 1.9150 having an average value of -0.0164 with a standard deviation value of 0.1791.

Table 1: Descriptive Statistics

	Mean	Median	Maximum	Minimum	Std. Dev.
E-Q	0.42143	0	1	0	0.4941
CONS	0.9986	1	1	0	0.0378
E.M	-0.0164	-0.0265	1.9150	-1.2707	0.1791
F_SIZE	16.9090	16.8658	20.2569	12.6871	1.3818
GROWTH	0.2044	0.1155	12.9999	-0.9944	0.8582
LEVERAGE	0.5560	0.5102	4.4881	0.0237	0.40076
ROA	0.0897	0.0780	1	-1.4144	0.16603

Note: E.Q represents "Earning Quality of a firm", CONS demonstrate "Accounting Conservatism", EARN MANG demonstrates "Earning Management", Growth represents the growth of a firm, ROA demonstrates "Return on Assets" and F.Size represents the Firm size on the basis of total assets of a firm. Matrix represents the nexus of quality and strength among the selected variables.

4.4. Correlation Analysis

Correlation coefficient among independent variable i-e Prudence(accounting conservatism) and Earning Management with a dependent variable of Earning Sustainability or Quality of firms is presented in correlation matrix table with a probability value of 0.000 reflects the significance nexus or relationship among variables.

Table 2: Correlation Matrix

	E.Q	CONS	E M	Growth	ROA	Lev	F.Size
E.Q	1						
CONS	.419**	1					
E M	.555**	.516**	1				
Growth	.041	-.023	.024	1			
ROA	.238**	.180**	.644**	.088*	1		
Leverage	-.161**	-.079*	-.150**	.012	-.225**	1	
F.Size	-.019	-.055	-.038	-.006	.019	-.040	1

Note: E.Q represents "Earning Quality of a firm", CONSE demonstrate "Accounting Conservatism", EARN MANG demonstrates "Earning Management", Growth represents the growth of a firm, ROA demonstrates "Return on Assets" and F.Size represents the Firm size on the basis of total assets of a firm. Matrix represents the nexus of quality and strength among the selected variables.

As the P-value is significant and is less than 0.05 which explains that the assumption of null hypothesis is unproven. Thus, the correlational analysis with a 95% probability validates the existence of positive significant nexus among variables. Moreover, the Table 2 also explains the correlational level among given selected variables and shows a highest correlation coefficient of 0.664 between return on assets and earning management and similarly lowest correlation coefficient of -0.225 among return on assets and leverage. The Pearson parametric results represent no multicollinearity among variables.

5. RESULTS AND DISCUSSIONS

5.1. Nexus of Conservatism with Quality of Earnings

To find a linear relation among explained (dependent) and explanatory (independent) variables as well as to check that the overall regressed model is significant or regression coefficient table is used to be interpret.

Table 3 examined the confirmation of overall significance of regressed model as shown by F-Statistic of 10.80 with a P-value 0.000 which is lower than 0.01. The probability value with 99% confidence finds the nexus among the observed variables as linear. Hence, confirming the significance of first hypothesis (H_1).

Table 3 explains that adjusted coefficient of determination i-e adjusted R^2 is 0.065. The adj. R^2 value explains the variation in explained variable by the explanatory or independent variables. Coefficient of determination here explains or interprets 6.5% of variation in response (dependent) variable that is" Earning Quality" by the explanatory variable "conservatism" with controlled variables.

Following "Multiple Linear Regression Model" is used to test the required hypothesis for the given model i-e.:

$$E.Q = 1.1875 + 0.5471CONS + 0.0429GRWTH + 0.628ROA - 0.1398Leverage - 0.0120Size$$

Table 3: Regression Analysis between Conservatism with Quality of Earnings

Variable	Coefficient	t-Statistic	Prob.
C	1.187563844	2.2401	0.025402
CONSE	0.547160064	1.1423	0.253701
F_SIZE	-0.012047495	-0.9207	0.357555
GROWTH	0.042901733	0.7048	0.48116
LEVERAGE	-0.139851653	-3.0184	0.002634
ROA	0.627534727	5.5931	0.0000
R-squared	0.072179966		
Adjusted R-squared	0.065495383		
F-statistic	10.79797682		
Prob(F-statistic)	0.000		

Note**:** E.Q represents "Earning Quality of a firm", CONSE demonstrate "Accounting Conservatism", EARN MANG demonstrates "Earning Management", Growth represents the growth of a firm, ROA demonstrates "Return on Assets" and F.Size represents the Firm size on the basis of total assets of a firm. Matrix represents the nexus of quality and strength among the selected variables.

Study examined that Independent variable "Accounting Conservatism" has an insignificant and positive impact on dependent variable "Earning Quality. According to the regressed model, Prudence (conservatism) in this study has an insignificant value of 0.253701 which is greater than to 0.05. Conservatism variable has a beta coefficient value i-e. 0.5471 which explains a positive relationship of conservatism on quality of earnings.

5.2. Nexus of Earning Management with Quality of Earnings

Table 4 examined the confirmation of overall significance of regressed model as shown by F-Statistic of 73.44 with a P-value 0.000 which is lower than 0.01. The probability value with 99% confidence finds the nexus among the observed variables as linear. Hence, confirming the 2nd hypothesis (H_2).

Table 4 explains that adjusted coefficient of determination i-e adjusted R^2 is 0.346. The adj. R^2 value explains the variation in explained variable by the explanatory or independent variables. Coefficient of determination here explains or interprets34.6% of variation in response (dependent) variable that is" Earning Quality" by the explanatory variables "conservatism and earning management" with controlled variables.

Study also examined that Independent variables "Earning Management" have a significant impact on dependent variable "Earning Quality". According to the regressed model, Prudence (conservatism) in this study has a significant p-value of 0.00 which is lower than to 0.01 and beta value of earning management obtained is 1.89 which explain a positive nexus on dispersion of profits (earning quality).

Table 4: Regression between Earning Management with Quality of Earnings

Variable	Coefficient	t-Statistic	Prob.
C	0.5767	3.0595	0.002
E.M	1.8990	8.1015	0.001
F_SIZE	0.00028	0.0255	0.032
GROWTH	0.07776	1.5221	0.128
LEV	-0.13682	-3.5193	0.0461
ROA	-0.69775	-5.7203	0
R-squared	0.346028621		
Adjusted R-squared	0.341317012		
F-statistic	73.44170435		
Prob(F-statistic)	0.000		

Note**:** E.Q represents "Earning Quality of a firm", CONSE demonstrate "Accounting Conservatism", EARN MANG demonstrates "Earning Management", Growth represents the growth of a firm, ROA demonstrates "Return on Assets" and F.Size represents the Firm size on the basis of total assets of a firm. Matrix represents the nexus of quality and strength among the selected variables.

5.3. Nexus of Conservatism and Earning Management with Quality of Earnings

To find a linear relation among explained (dependent) and explanatory (independent) variables as well as to check that the overall regressed model is significant or not Table 5 is used to be interpret. Table interprets the linear nexus among variables and the significance of model as follows:

Table 5 examined the confirmation of overall significance of regressed model as shown by F-Statistic of 65.027 with a P-value 0.000 which is lower than 0.01. The probability value with 99% confidence finds the nexus among the observed variables as linear. Hence, confirming the second hypothesis (H_2).

Table 5 explains that adjusted coefficient of determination i-e adjusted R^2 is 0.420. The adj. R^2 value explains the variation in explained variable by the explanatory or independent variables. Coefficient of determination here explains or interprets 42% of variation in response (dependent) variable that is" Earning Quality" by the explanatory variables "conservatism and earning management" with controlled variables.

Table 5: Conservatism and Earning Management with Quality of Earnings

Variable	Coefficient	t-Statistic	Prob.
C	0.5275	2.8207	0.005
CONSE	4.358	3.9188	0.000
E.M	1.631	4.5931	0.000
F_SIZE	0.0023	0.2124	0.421
GROWTH	0.0815	1.612	0.107
LEV	-0.1302	-3.3806	0.001
ROA	-0.5859	-4.7229	0.000
R-squared	0.554321037		
Adjusted R-squared	0.420136		
F-statistic	65.02704196		
Prob(F-statistic)	0.000		

Note**:** E.Q represents "Earning Quality of a firm", CONSE demonstrate "Accounting Conservatism", EARN MANG demonstrates "Earning Management", Growth represents the growth of a firm, ROA demonstrates "Return on Assets" and F.Size represents the Firm size on the basis of total assets of a firm. Matrix represents the nexus of quality and strength among the selected variables.

Following "Multiple Linear Regression Model" is used to test the required hypothesis for the given model i-e.:

$$E.Q = 0.5275 + 4.358 CONS + 1.631 E.MANAG + 0.0815 GRWTH - 0.5859 ROA - 0.130 Leverage + 0.0023 Size$$

Study examined that Independent variables "Accounting Conservatism and Earning Management" have a significant impact on dependent variable. According to the regressed model, Prudence (conservatism) in this study has a significant value of 0.001 which is lower than to 0.01. Conservatism variable has a beta coefficient value i-e 4.358 which explains a positive nexus of conservatism on quality of earnings. Similarly, beta value of earning management obtained is 2.48explaining a positive nexus on dispersion of profits (earning quality).

6. CONCLUSION AND RECOMMENDATIONS

To predict the performance of firms by provided useful information for investors is primary objective of financial accounting. For investment decisions the necessity of monetary report as a prime foundation for executives and analysts. Among financial statement's user the net income always one of the most important issue and its quality and management is also a subject of attention for investors and creditors. This study concentrated on answering questions identified with the link between accounting conservatism, earning management and earning quality of an emerging economy Pakistan. For the evaluation of empirical analysis a large data sample is selected that includes a data from 70 non-financial Pakistani firms listed in KSE 100 index for the purpose of making a research horizon broader for better understanding about the financial disclosure decisions made by firms and for investor's and other concerned bodies for understanding financial statements disclosed by firms and who make investment decisions on basis of such disclosed reports. Similar studies are also done by many researchers with foreign context and few with national context like (Ahmed & Duellman, 2013; Ahmed & Henry, 2012; Ali et al., 2008; Dilawer, 2012; Noor & Ali, 2015; Saeed & Saeed, 2018; Shahzad et al., 2017; Yasir, 2018).

We conclude that disclosure of earnings is allied with earning management practices and accounting conservatism in a constructive manner. We examined the stated relationship by creating composite measures of conservatism, accrual based earnings and earning quality. We find the association of conservatism and earning management with earning quality and are summarized and in lined with hypothesis as. According to the analysis of first hypothesis H_1, existence of insignificant and positive relationship between earning quality and prudence has been observed. If we examined the results, it can

be seen that in Pakistan usage of conservatism factor is done by firms in disclosure of financial statements and we see an increase in conservatism measure by the administration in constructive manner for the beneficial assessment of firm financial position. The result of hypothesis H_2 interprets the practice of accrual-based earnings in accounting figures and can be seen that earning management practices manipulate the real accounting figures and hide the true financial position of firm. If we look at the results we find positive impact of earning manipulation in Pakistani context but literature also evaluate that earning management practice is not acceptable in the long run. Similarly, after analyzing the individual effects of earning management and accounting conservatism measure on earning quality, we also made our research to check the combined effect of both variables with earning quality. The findings of third hypothesis H_3 also shows a positive and significant impact of conservatism and earning management on earning quality of firms. Our findings are similar to the findings of (Ahmed & Duellman, 2013; Ali et al., 2008; Noor & Ali, 2015; Saeed & Saeed, 2018; Shah et al., 2010; Yasir, 2018) with Pakistani context.

In this study we demonstrate that conservatism influences the investor's or speculator disagreement around annual earnings declaration. So, disagreement is a vital and critical issue for equity market, the subject of whether prudence influences disagreement is a highly significant accounting issue. Key subject of discussion over the quality of conservatism in financial statements grown over the recent past decades, particularly after when the standard setters have taken grounded position in practicing of non-conservative practices (Watts, 2003). The basic idea behind the research is to provide evidence to the stock brokers, managers, planners, policy makers, investors and regulatory authorities that they actively share financial information about the firms which may be used for future decisions about stocks and investors in Pakistan. In recent decades, the disclosed earning quality has got a subject of table by some researchers when the world's largest and standard firms such as Enron, Tyco, World.com are pledged in an earning manipulation scam and such scam raised a question for investors and speculators about the point how to rely on reported financial statements. Empirical investigations throughout the periods had demonstrated that the ability to use conservative and earning management practices have impact on earning quality of firm's yet few researchers has examined the combined relationship.

On the basis of academic and empirical literature on conservatism and earning management, we find the variations in empirical evidence with current selected variables finds that the results are indifferent in Asian region with the rest of the world. International studies had found a significant and negative impact of conservatism and earning management on earning quality but the studies done in Pakistan, India and other countries had found a significant and positive relationship as similar to our findings. In this area researchers need to work a lot more to relay their findings directly to the standard setters. Because of limitations of data it was exceptionally difficult to utilize other alternative measures for the selected variables. The future evaluations of this study might be benefit by examining the listed financial and non-financial firms. Moreover, the present study is done with the variables those have direct impact on earning quality of firm's but other variables like audit quality, corporate governance and ownership structure are those factors which have a direct link to the quality of earnings. The researchers in future horizon investigate the results by using all such concerned factors. Each variable has different measures; one can precede it by using other model measures to compare the empirical results with the current investigations.

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