

What is Accounting Conservatism?

- Provide for all probable future losses, but anticipate no future gains (i.e. gains require stronger verification).
- It is the accountant's reaction to uncertainty. It is all pervasive in GAAP.
- Example 1: Revenue recognition - When there is uncertainty, revenue is not recognized. It is deferred or pushed into the future.
- Example 2: Expensing vs. Capitalization - When the outcome is uncertain, costs like R&D, training and advertising are expensed and not capitalized.



Accounting Conservatism Implies

- It results in:
 - Slower recognition of revenues
 - Faster recognition of expenses
 - Lower value of assets
 - Higher values of liabilities
- It is this 'timing' difference that empiricists have used to quantify conservatism.

Types of Accounting Conservatism

	Conditional Conservatism	Unconditional Conservatism
Nature	Depends on news events	Does not depend on news events. Routine policy.
Example	(a) Impairment of fixed assets; (b) ruling of food regulators on Nestle's Maggi	(a) Expensing of R&D, training and advertising costs. (b) Provision for doubtful debt.