

# 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

	<b>Conditional Conservatism</b>	<b>Unconditional Conservatism</b>
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.