

Accounting Conservatism

-the economic analysis of accounting history and the rediscovery of GAAP-

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This paper reexamined the significance and the need of the concept, so-called “conservatism,” for accounting. This research is motivated by the fact that the discussion over accounting conservatism seems to be in confusion more than other fundamental topics in the recent process of developing international accounting standards. So, I addressed the fundamental reason for accounting conservatism with the economic analysis of the accounting history and the effect of downward bias for the accounting information system.

This paper is consisted of two parts. In the first part, after reviewing the position of conservatism in the system of accounting principles (ch.1), I analyzed the background and the logic for it in the context of accounting history (ch.2, 3). Then, in the second part, after classifying the concept of conservatism into four types according to the combination of the informational effects caused by its downward bias (ch.4), I economically analyzed two types in each remaining chapter (ch.5, 6). In the course of the discussions, I introduced the notions: “the paradox of conservatism,” “the conservatism in Florence,” “the paradox of the principle of conservatism,” “the dilemma of conservatism” in the first part. And in the second part, I employed the moral-hazard model with the information system in which we are able to analyze the effect of downward bias for the optimal decision-making of the interested parties.

The conclusion of this paper can be summarized in the form of five advices concerning accounting conservatism as below. The accounting standards setting body should 1) realize that there are four types of conservatism, and 2) realize that the cash flow statement plays a complementary role for conservatism, then 3) abolish the principle of conservatism, but 4) hold the conservative accounting standards for now, with 5) the self-consciousness of being faced with “the dilemma of conservatism.”