Abstract: - My study proposes to prepare an analysis of papers related to research limitations of accounting conservatism pre and after mandatory adoption of IFRS by listed companies in Europe. We compared the limitations presented by Stephen Ryan in his paper entitled "Identifying Conditional Conservatism", published in 2006, with limitations presented by the authors of papers regarding accounting conservatism in the conditions of adopting IFRS. We found that recently the interest of papers authors moved from the limitations of the research process of accounting conservatism, to the limitations of the general conditions of manifestation of accounting conservatism.

Key-Words: - limitations, accounting conservatism, IFRS adoption, listed companies, Europe

1 Introduction
Accounting conservatism is a financial approach many companies use to limit the amount of risk in their accounting information.
To some extend, conservatism has been viewed in the academic literature as evidence of tradition and convention, rather than as a practice that can be justified conceptually (Sterling, 1970). Conservatism or prudence in asset measurement and the reporting of profits is perceived as a fundamental attitude of accountants the world over (Gray 1988). Conservatism was presented as capturing accountants’ tendency to require a higher degree of verification for recognizing good news than bad news in financial statements (Basu 1977). Conservatism is defined as a stronger verifiability requirement for the recognition of gains than for the recognition of losses. The extreme form of this definition is the old adage: Anticipate 'no profit, but anticipate all losses.' (Watts, 2003).
In Section 2, we show the International Accounting Standards Board (IASB) point of view, related to accounting conservatism. In Section 3 we present the research limitations of the accounting conservatism prior to mandatory adoption of IFRS, as this topic is presented by Stephen Ryan, and in Section 4 we present the research limitations of the accounting conservatism subsequent to mandatory adoption of IFRS, as the topic is presented in the scientific papers related to accounting conservatism published after 2006. Section 5 is destined for conclusions and discussion.

2 What say the IASB about conservatism
Previously, IASB defined conservatism as follows: “…Prudence is the inclusion of a degree of caution in the exercise of the judgments needed in making the estimates required under conditions of uncertainty, such that assets or income are not overstated and liabilities and expenses are not understated. However, the exercise of prudence does not allow, for example, the creation of hidden reserves or excessive provisions, the deliberate understatement of assets and income or the deliberate overstatement of liabilities or expenses because the financial statements would not be neutral and therefore not have the quality of reliability.” (IASB Framework for Preparation and Presentation of Financial Statements, 2001, paragraph 37).
Actually the situation explained above was available until recently. Because conservatism is excluded from IASB (International Accounting Standards Board) Conceptual Framework for Preparation and Presentation of Financial Statements, as 2010, as a result of joint project between IASB and Financial Accounting Standards Board (FASB).
George Gotti (2008), atrage atenția asupra faptului că în 2006, the US Financial Accounting Standard Board (FASB), jointly with the International Accounting Standard Board (IASB), stated: Neutrality is incompatible with conservatism, which
implies a bias in financial reporting information. [...] Conservative or otherwise biased financial reporting information is equally unacceptable. Now, IASB considers that fundamental qualitative characteristics of useful financial information, are relevance and faithful representation. And by increasingly broad adoption of International Financial Reporting Standards (IFRS) globally they find that companies move their interest from the conservative accounting to fair value accounting (Lu and Trabelsi, 2013).

While the IASB argues that the reason for omitting the concept is related to trying to be unambiguous and to avoid misinterpretations, others argue for the need to explicitly reintroduce the concept of prudence in the Conceptual Framework (Gebhardt, Mora and Wagenhofer, 2014).

Paul Andre and Andrei Filip (2012) show that IFRS are more principle based than rule based. Examples of IFRS neutrality include greater use of fair values, impairment testing rather than amortization including the possibility to reverse prior impairments and clearer rules on how and when to book provisions. Although, IFRS present numerous mechanisms to manifest conservatism. Richard Macve (2014) citing (Lambert, 2010) suggest that the relevant issue is not so much “fair value versus conservatism” but rather “how much conservatism for different purposes and situations?”

Although the boards suggest that the improved framework will not include prudence or conservatism as desirable qualities, a more valid description is that consistently conservative accounting treatments will be replaced by accounting methods that leave more opportunities for temporary conservatism. Niclas Hellman (2008), speaks about changes in accounting estimates that temporarily understate net assets via the creation of hidden reserves which later may be reversed. From user’s perspective, temporary conservatism is demanded because of the increased income-shifting between periods. The mixing of consistent and temporary conservatism may lead to counter-intuitive interpretations of the underlying business activities that, in turn, make the information less relevant to users.

3 Research limitations of the accounting conservatism prior to mandatory adoption of IFRS

My study proposes to prepare an analysis of papers related to the research limitations of accounting conservatism after the mandatory adoption of IFRS by listed companies in Europe.

In this respect we stopped on paper "Identifying Conditional Conservatism,” which was published by Stephen Ryan, in 2006. In his paper, Stephen Ryan makes a review of the previously published literature about conservatism.

We stopped on this paper in the first place, because, being published in 2006, it took into account the papers published prior to 2005. Please note that 2005 is the year in which it began the mandatory adoption of IFRS by listed companies, in the European Union. Secondly, we stopped on this paper because in Section 2, the author takes into account the limitations of accounting conservatism research presented in the papers published prior to 2006. The author identifies and comments on the various limitations of asymmetric timeliness identified in the literature and describes the general approaches taken to address those limitations. Thirdly, we stopped on this paper because it is complex and it takes into account the most important papers, i.e. the papers which present the most quotations on Google Academic. Ryan, S. (2007), presents seven research limitations of accounting conservatism that we render them briefly below:

1. First, returns are not equivalent to non-earnings news;
2. Second, conditional conservatism is preempted (i.e., applied less frequently and / or in smaller amounts) by unconditional conservatism;
3. Third, even if conditional conservatism in not preempted, bad news may not be immediately recognized in earnings because of buffers to impairment write-downs in GAAP, practical difficulties in assessing impairment, and discretionary accounting behavior;
4. Fourth, it can be difficult to observe asymmetric timeliness empirically when multiple shocks are aggregated in returns and earnings, even when individual shocks are accounted for in an asymmetrically timely fashion;
5. Fifth, certain economic phenomena, such as the abandonment option and the tendency for winners to win over time and to defer gains for tax purposes while losers lose and realize losses for tax purposes more quickly- yield asymmetric timeliness;
6. Sixth, certain types of discretionary accounting behavior, such as big bath write-downs and cookie jar reserving - also yield asymmetric timeliness;
7. Seventh, there is little time-series consistency in estimates of asymmetric timeliness at the firm level and even for cross-sections of firms grouped based on the level of asymmetric timeliness, despite the
fact that such consistency generally should be expected in the absence of significant changes in the firm’s characteristics, choices, or economic context. Note that the limits presented by Stephen Ryan target exclusively the research process and not the general conditions in which the study is conducted.

4 Research limitations of the accounting conservatism subsequent to mandatory adoption of IFRS

In order to perform our study, we searched using Google Academic and we found a total of 12 papers treating the accounting conservatism which were published after the adoption of IFRS in Europe, i.e. after 2005. We considered only the papers presenting studies made on listed companies and we didn’t take into account theoretical papers. It is true that the total of papers is very small, but we significantly reduced the area of our research to papers treating companies in Europe, and most of discussion on accounting conservatism evolves in USA. In addition, keep in mind that the adoption of IFRS in the European Union has been made gradually (eg. in Romania, the adoption of IFRS by listed companies became mandatory only at the end of 2012), and it is needed more financial years for studying conservatism.

Of those 12 papers, 5 papers don’t present in their contents the limitations of accounting conservatism research, so we excluded them from our study. Next, for the 7 papers remained in our study, we present the research objective and the limits presented in the paper by the authors.

1. Paul André, Andrei Filip, (2012), Accounting Conservatism in Europe and the Impact of Mandatory IFRS Adoption: Do country, institutional and legal differences survive? Objectiv: - Legal Incentives (code law countries versus common law countries); - Governance, Investor Protection and Enforcement; - The Relative Importance of Equity Markets and Debt Markets; - Combining Legal, Governance, Enforcement and Market type; - Tax Book Conformity; - Sensitivity Analysis: Accounting differences. Limits: The IASB and FASB have proposed a Conceptual Framework that eliminates conservatism or prudence as a desirable qualitative characteristic of reported financial information and focuses on the principle of faithful representation and neutrality (IASB 2010).

2. Paul André, Andrei Filip, Luc Paugam, (2013), Impact of Mandatory IFRS Adoption on Conditional Conservatism in Europe Objectiv: (i) Conservatism and Mandatory IFRS Adoption (ii) The effect of institutional factors on conditional conservatism (iii) The effect of impairment test on conditional conservatism Limits: IFRS are conceptually conditionally conservative but inappropriate application of conditional conservatism principles may have prevented financial reporting from reaching the level of conservatism targeted by the IASB. The form of ‘prudence’ that the Board intended to eliminate from the conceptual framework (and financial reporting) can be clearly related to unconditional conservatism, not to conditional conservatism. Additionally, fair value for financial assets does not significantly impact many industries other than the financial sector, and if firms decide to follow the fair value option, both unrealized gains (good news) and unrealized losses (bad news) are recognized in earnings (or other comprehensive income). Fair value cannot be considered less conditionally conservative than amortized cost. Conversely, IFRS do include various mechanisms ensuring the application of conditional conservatism.

3. Cristy Lu, Samir Trabelsi, (2013) Information Asymmetry and Accounting Conservatism under IFRS Adoption Objectiv: The information asymmetry might be a determinant of accounting conservatism. The primary research objective of this paper is to study by investigating the change in the level of conservatism after mandatory IFRS adoption, and the effect of IFRS on this relationship. The second research objective of this paper is to examine the relationship between accounting conservatism and information environment. Limits: One disadvantage of Basu coefficient is that it cannot make firmspecific measurements. In particular, the Basu (1997) coefficient has to be estimated either on an annual basis using a cross-section of observations or on a firm-specific basis using time-series observations. Both estimation methods have limitations. The former method assumes all firms in the industry are homogeneous and the latter method assumes that the firm’s operating characteristics are stationary.

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Objectiv: This study is performed to understand if, and to what extent, the IFRS implementation has affected conservatism in Sweden and the contradicting literary evidence highlights the need for a quantitative evaluation.

Limits: Test I: There is an indication that the relationship between returns and earnings has decreased during the time period. The usefulness of this finding is however limited due to low statistical significance in some years.

Test III: When tracing the pattern on a yearly basis, it becomes evident that the results from the more recent years show erratic behavior as well as decreasing statistical significance. This anomaly could be attributed to the recent financial instability that has affected all sectors (as compared to earlier instabilities during the late 1990s which were primarily sector specific). This theory is supported by a year-to-year analysis which indicate that the most inconsistent years are 2009 and 2010 which would be the fiscal years that started showing the impacts of the global financial downturn.

This study does not explain the causes behind the decreasing conservatism in Sweden. Hellman (2008) states that it has been a matter of two conflicting forces at work in Sweden, one which strives to maintain the conservative accounting practices of the past and another which is ready to embrace the capital market-oriented approach that IFRS represents. We see that conservatism has indeed decreased after the adoption, but if it is as an effect of the IASB’s stance on conservatism or to a general movement in society is difficult to say.

5. Samira Demaria, Dominique Dufour, (2007), First time adoption of IFRS, Fair value option, Conservatism: Evidences from French listed companies

Objectiv: The paper studies the first adoption of IFRS within the perspective of the accounting options concerning the fair value method.

The optional standards included in the study are: fair value exemption of IFRS 1, IAS 16, 38 and 40.

The paper pursues two main objectives. Firstly, from an explanatory point of view, French fair value choices during the first adoption of the IFRS are presented. The second goal of the article is to reveal the determining factors behind those choices.

Limits: These results raise the question of ability of the positive accounting theory (PAT) for understanding the conservatism.

Findings show that the majority of French companies maintained historical cost for the valuation of assets, which is the conservative option. Despite introduction of IAS/IFRS standards, which cheer an economic view highlights by the substance over form principle, the traditional conservatism approach stays embedded in French practices. These results raise the question of ability of the PAT for understanding the permanence of historical cost. PAT seems not to explain the accounting choice made by French groups during the first adoption of IAS/IFRS standards.


Objectiv: Our study has three objectives.

First, it examines the consequences of mandatory adoption of IFRS on accounting conservatism in the United Kingdom (UK).

Second, it examines the effect of board of directors’ independence on accounting conservatism.

Third, the above two objectives are directed towards a general objective, which examines the combined impact of both IFRS and board of directors’ independence on accounting conservatism.

Limits: This study had several limitations.

First, we collected sample data from only one country. Consequently, it is infeasible to extend the results to generalize across other countries.

Second, we used only one dimension of corporate governance, namely, board of directors’ independence. It might be the case that other dimensions of corporate governance could reveal other results.

Third, the accounting conservatism measures suffered from some limitations. They use Givoly and Hayn’s (2000) accrual-based measure of accounting conservatism.


Objectiv: This study investigates the motives of UK listed companies when reporting high and low quality accounting disclosures. It also examines the relation between the quality of published financial statements and earnings management practices, for example, low quality accounting disclosures might be linked to earnings management.

The paper further studies the relation between financial reporting quality and the timely disclosure of losses and difficult-to-verify accounting items, i.e. conservatism. The focus here is on conditional and unconditional conservatism, their association and the variables that influence the asymmetric disclosure of losses.

Limits: The study is limited in the sense that it focuses on a common-law country with strong investor protection mechanisms and investor oriented financial reporting which would be likely
to facilitate conservatism to a greater extent than other settings, such as code-law countries. Also, while the study has focused on the period after the adoption of IFRSs, i.e. 2005, the examination of a larger period encompassing the transition from UK GAAP to IFRSs would be in position to describe the evolution of conservatism under different accounting rules or institutional characteristics.

5 Discussion and conclusions

In the papers above there were presented varied limitations of accounting conservatism research. At some of them, we have already expected, while others repeat the issues discussed by Stephen Ryan. Some of the limitations presented by the authors are specific to the study conducted by them, and we believe that is not the case to take a position related to them. Another category is the limitations with global character and we consider this category makes the subject of our study.

A limit which is general, although not mentioned by many authors, is the economic instability of the last period. Regarding the analysis of some economic events that occurred in recent years, the economic crisis from the last period led to anomalies in the research of accounting conservatism.

Another limit which characterizes presented studies, is relatively limited period considered. Since the transition from National GAAP to IFRSs is made gradually the period since 2005 until to date is very short in terms of research. Another limitation with general character is given even by the new accounting system. After mandatory adoption of IFRS it is debated the joint proposal of IASB and FASB to eliminate conservatism or prudence as a desirable characteristic of reported financial. From the presented papers we can see that the capacity of Basu’s coefficient is still questionable, it cannot make firm specific measurements but Givoly and Hayn’s (2000) accrual-based measure of accounting conservatism.

French listed companies’ decision to remain conservative in their accounting practices, given that the IASB is further moving away from this goal, leads to discrepancies in conceptual understanding and explaining the conservatism by means of positive accounting theory (PAT). Much less, PAT seems it doesn’t explain the accounting choice made by French groups during the first adoption of IAS/IFRS standards. Comparing the group of limitations presented in the papers published in the last period with the group of those seven limitations presented by Stephen Ryan, we find a clear distinction of objectives of interest.

Obviously Stephen Ryan was interested by the essential limitations of the research process. He sought and found such problems. One of the main objectives of Ryan's paper was to find problems in the process of research of conservatism, while the authors presented in Section 4 had as main objective research the accounting conservatism itself and only additionally, mentioning the limits encountered by them.

This explains the fact that 5 papers showed no limitations of their research at all. Then the papers taken into account by Ryan were tens, of which he chose those he was especially interested in them. Should not be neglected accounting regulations continuity in the US, which has led to the possibility to make complete papers regarding the accounting conservatism from several points of view, does not offer the opportunity for specific limitations.

Regarding the limitations shown in the seven papers presented above, we see that economic crisis and IFRS adoption put their mark on the last research. On one hand, it seems that Europe still has not recovered from the economic crisis, and on the other hand, companies’ adaptation to IFRS, tarries. Although IFRS seems to be the answer of the professional accountants to the demands of financial information market, they can’t find yet all the necessary conceptual explanations. Does IFRS is not consistent with financial information market needs or it is no longer necessary the conceptual explanation of the accounting conservatism?

We see therefore how conservatism, an issue which is no longer found under his own name in the current accounting regulations, stirs debates on general conditions of manifestation, and also
on the research process of this controversial concept.

6 Acknowledgement

This work was supported by the project “Excellence academic routes in doctoral and postdoctoral research - READ” co-funded from the European Social Fund through the Development of Human Resources Operational Programme 2007-2013, contract no. POSDRU/159/1.5/S/137926.

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