

THE IMPACT OF ACCOUNTING CONSERVATISM ON THE FIRM'S VALUE

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Abstract: This study examines the impact of accounting conservatism on firm value among selected publicly listed firms over the period 2019-2023. Accounting conservatism, defined as the timely recognition of losses relative to gains, is analyzed as a financial reporting practice that may improve transparency, reduce information asymmetry, and strengthen investor confidence. The study uses a quantitative panel-data approach with 25 firms from technology, manufacturing, and financial services sectors, producing 125 firm-year observations. Firm value is measured through Tobin's Q and market-based indicators, while conservatism is measured using accrual-based and market-based proxies. Control variables include firm size, leverage, and profitability. Descriptive statistics, correlation analysis, and multiple regression are employed to test the hypotheses. The findings show that selected firms practice a moderate and increasing level of accounting conservatism. Accounting conservatism has a positive and statistically significant effect on firm value (coefficient = 0.5362, $p = 0.000$), and the model explains 66.2% of variation in firm value. Firm size has a positive significant effect, leverage has a negative significant effect, and profitability is not statistically significant. The study concludes that balanced conservatism enhances reporting credibility and market valuation.

Keywords: accounting conservatism, firm value, financial reporting, investor confidence, Tobin's Q, leverage

1. Introduction

1.1 Introduce the Problem

Accounting conservatism is one of the most enduring principles in financial reporting. It requires firms to recognize potential losses and liabilities in a timely manner while recognizing gains and assets only when they are sufficiently certain. This asymmetric treatment of gains and losses supports prudence and has been widely discussed in accounting literature, particularly through Basu's (1997) asymmetric timeliness view and Watts' (2003) contracting explanation.

The problem addressed in this study is that the effect of accounting conservatism on firm value remains contested. Supporters argue that conservative reporting improves financial statement credibility, reduces managerial opportunism, lowers information asymmetry, and strengthens investor confidence. Opposing views caution that

excessive conservatism may understate assets and earnings, thereby reducing the relevance of accounting information and potentially causing undervaluation. This tension makes it necessary to investigate empirically whether conservatism enhances or weakens firm value in practice.

The study focuses on selected publicly listed firms observed from 2019 to 2023. The analysis evaluates whether conservative accounting practices contribute to market valuation after controlling for firm size, leverage, and profitability. By connecting accounting policy choices with market-based valuation indicators, the research bridges financial reporting theory and investor decision-making.

1.2 Explore Importance of the Problem

The importance of the problem arises from the central role of financial statements in capital-market decisions. Investors, creditors, managers, and regulators rely on accounting information to assess risk, forecast performance, and evaluate firm value. When reporting is not sufficiently prudent, financial statements may overstate performance and expose stakeholders to unexpected losses. However, when conservatism is applied excessively, it may obscure economic performance and reduce the usefulness of reported numbers.

For investors, conservatism may function as a signal of reporting quality and managerial discipline. For managers, it can strengthen governance by limiting opportunistic earnings reporting. For creditors, it can protect contracting interests by requiring earlier recognition of adverse information. For regulators and standard setters, the findings can help clarify how prudence should be balanced with relevance and fair presentation.

The purpose of this research is therefore to examine the impact of accounting conservatism on the market valuation of firms and to identify whether balanced conservative reporting can optimize firm value. The research questions ask: what is the extent of conservatism adopted by firms, how does conservatism affect firm value, does it influence investor perceptions and market performance, and what reporting practices optimize the balance between prudence and value creation?

1.3 Describe Relevant Scholarship

The literature explains accounting conservatism through agency theory, information asymmetry theory, and contracting theory. Agency theory views conservatism as a mechanism for limiting managerial incentives to overstate earnings. Information asymmetry theory emphasizes the timely recognition of bad news, which helps external stakeholders make better decisions. Contracting theory highlights the use of accounting numbers in debt and compensation arrangements, where conservative recognition protects creditors and improves contract efficiency.

Prior empirical studies present substantial but not uniform evidence on conservatism. Basu (1997) introduced the asymmetric timeliness model, while Givoly and Hayn (2000) developed accrual-based evidence of conservative reporting. Ahmed and Duellman (2007), Lara et al. (2009), LaFond and Watts (2008), and Beaver and Ryan (2005) generally find that conservatism improves governance, lowers information asymmetry, and supports valuation. Conversely, Penman and Zhang (2002) warn that excessive conservatism may reduce earnings relevance by systematically understating assets and income.

The literature also suggests that firm-specific characteristics influence both reporting choices and valuation. Firm size can affect visibility, governance, and access to capital. Leverage can create creditor demand for conservative reporting but may also reduce firm value by increasing financial risk. Profitability affects market perception, although its independent explanatory power can vary once other factors are controlled. Sectoral context is also relevant because financial services, manufacturing, and technology firms differ in regulation, asset structure, and growth opportunities.

1.4 State Hypotheses and Their Correspondence to Research Design

The study is guided by four objectives and corresponding hypotheses. The design connects the hypotheses to panel-data measures of accounting conservatism, firm value, and control variables. The conceptual framework below summarizes the expected direct relationship between accounting conservatism and firm value, the mediating role of investor confidence and market performance, and the control effects of firm size, leverage, and profitability.

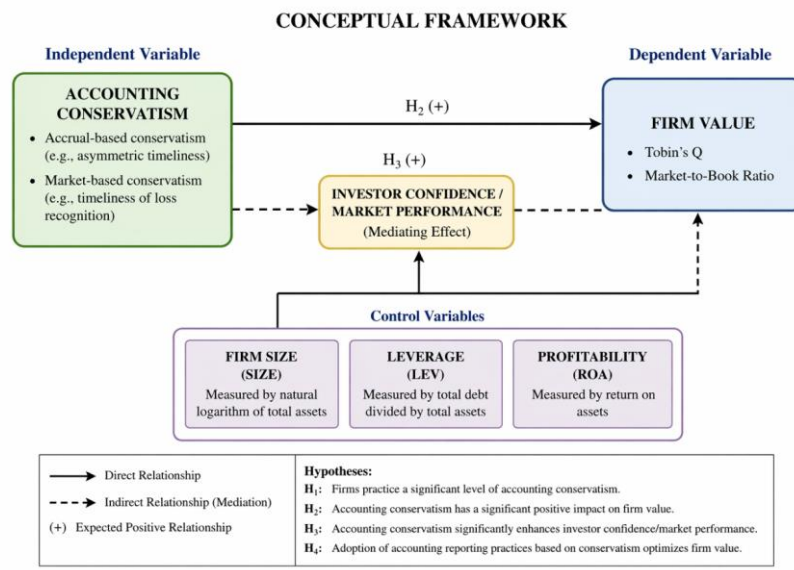


Figure 1. Conceptual framework of accounting conservatism and firm value

Description: The figure presents accounting conservatism as the independent variable, firm value as the dependent variable, investor confidence/market performance as a mediating effect, and firm size, leverage, and profitability as control variables.

- 1) H01: There is no significant level of accounting conservatism practiced by the selected firms. H11: The selected firms practice a significant level of accounting conservatism.
- 2) H02: Accounting conservatism has no significant impact on firm value. H12: Accounting conservatism has a significant positive impact on firm value.
- 3) H03: Accounting conservatism does not significantly influence investor confidence or market performance. H13: Accounting conservatism significantly enhances investor confidence and positively influences market performance.
- 4) H04: Adoption of accounting reporting practices based on conservatism does not optimize firm value. H14: Adoption of accounting reporting practices based on conservatism optimizes firm value.

2. Method

The Method section describes the research design, sample, data sources, variables, measurement procedures, model specification, and analytical techniques used to test the hypotheses. The study is non-experimental and relies on secondary financial and market data from selected publicly listed firms.

2.1 Identify Subsections

The method is organized into subsections covering sample characteristics, sampling procedures, sample size and precision, measures and covariates, research design, and the absence of experimental manipulations. This structure follows the template requirement that the reader should be able to evaluate and replicate the procedures used in the study.

2.2 Participant (Subject) Characteristics

The units of analysis are firm-year observations rather than human participants. The population consists of publicly listed firms operating across major stock exchanges. The selected firms represent three broad sectors: technology, manufacturing, and financial services. The use of multiple sectors allows the study to capture variation in reporting practices, regulatory pressures, capital structure, profitability, and market valuation.

2.3 Sampling Procedures

A purposive sampling technique was used to select firms that satisfied three criteria: complete financial data for the 2019-2023 period, consistency in financial reporting practices, and accessibility of annual reports and market data. Data were collected from annual reports, audited financial statements, stock market databases, and financial platforms such as Bloomberg and Reuters. The data were cross-verified across sources to improve accuracy and reliability.

2.3.1 Sample Size, Power, and Precision

The final sample contains 25 firms observed over five years, resulting in a balanced panel dataset of 125 firm-year observations. This structure provides sufficient variation for descriptive analysis, correlation testing, and regression estimation in an undergraduate empirical accounting study. Conclusions are limited to the selected firms and sectors and should not be generalized beyond comparable listed companies without caution.

2.3.2 Measures and Covariates

The dependent variable is firm value, measured using Tobin's Q and the market-to-book ratio. The independent variable is accounting conservatism, measured through accrual-based and market-based proxies grounded in the literature. Firm size, leverage, and profitability are included as control variables to isolate the effect of conservatism on firm value.

Table 1. Variables and measurements used in the study

Variable	Expected Role in the Model	Measurement
Accounting conservatism (AC)	Independent variable	Accrual-based and market-based conservatism proxies
Firm value (FV)	Dependent variable	Tobin's Q and market-to-book ratio
Leverage (LEV)	Control variable	Total debt divided by total assets
Firm size (SIZE)	Control variable	Natural logarithm of total assets
Profitability (ROA)	Control variable	Return on assets

Description: The table summarizes the operational definitions of the dependent, independent, and control variables used in the regression model.

The main formulas applied in the study are presented below. Tobin's Q is calculated as market value of the firm divided by total assets, and the market-to-book ratio is calculated as market price per share divided by book value per share.

$$\text{Tobin's Q} = \text{Market Value of Firm} / \text{Total Assets} \quad (1)$$

$$\text{Market-to-Book Ratio} = \text{Market Price per Share} / \text{Book Value per Share} \quad (2)$$

$$\text{FV}_i = \beta_0 + \beta_1 \text{AC}_i + \beta_2 \text{LEV}_i + \beta_3 \text{SIZE}_i + \beta_4 \text{ROA}_i + \epsilon_i \quad (3)$$

2.3.3 Research Design

The study adopts a quantitative descriptive and correlational research design. The descriptive component examines the level and distribution of accounting conservatism, firm value, leverage, firm size, and profitability. The correlational and regression components test whether accounting conservatism is associated with and predicts firm value after controlling for other firm-specific variables. The panel-data structure combines cross-sectional variation across firms with time-series variation across years.

2.3.4 Experimental Manipulations or Interventions

No experimental manipulation or intervention was used. Firms were not assigned to treatment and control groups. The research observes existing accounting and market outcomes from publicly available secondary data, so the findings support statistical associations rather than controlled experimental causality.

3. Results

3.1 Recruitment

Because the study uses secondary data, recruitment refers to sample identification and data screening rather than human-subject enrollment. The initial screening targeted listed firms with complete financial and market data from 2019 to 2023. After applying the inclusion criteria, 25 firms remained in the sample, and all 125 firm-year observations were retained for analysis. No missing observations were identified.

3.2 Statistics and Data Analysis

Data analysis was performed using descriptive statistics, correlation analysis, and multiple regression. The descriptive statistics examine the central tendency and dispersion of the study variables. The correlation matrix provides preliminary evidence of relationships among variables. Regression analysis tests the independent effect of accounting conservatism on firm value while controlling for leverage, firm size, and profitability.

Table 2. Descriptive statistics

Variable	N	Mean	Std. Dev.	Min	Max
AC	125	0.476	0.141	0.193	0.784
FV	125	1.008	0.162	0.624	1.43
LEV	125	0.456	0.152	0.112	0.763
SIZE	125	10.435	0.945	8.881	12.026
ROA	125	0.084	0.052	-0.031	0.192

Description: N = 125 firm-year observations. AC represents accounting conservatism, FV represents firm value, LEV represents leverage, SIZE represents firm size, and ROA represents return on assets.

The descriptive results indicate that accounting conservatism has a mean value of 0.476, suggesting a moderate level of prudence in financial reporting. Firm value has a mean of 1.008, indicating that firms are, on average, valued slightly above benchmark levels. Leverage is moderate at 0.456, while firm size and profitability show sufficient variation for inferential analysis.

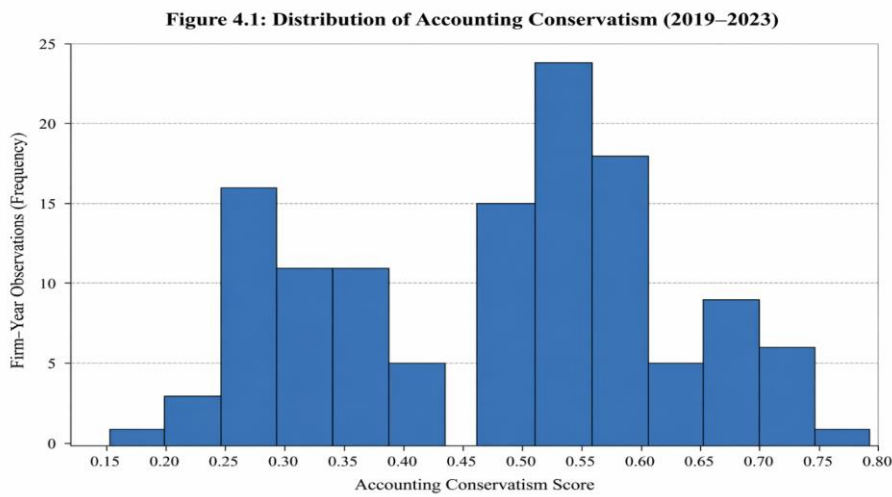


Figure 2. Distribution of accounting conservatism

Description: Most firm-year observations are concentrated around moderate conservatism values, suggesting balanced reporting practices and no extreme concentration in the sample.

Table 3. Year-wise mean values of study variables

Year	AC	FV	LEV	SIZE	ROA
2019	0.443	0.959	0.452	10.437	0.081
2020	0.457	1.015	0.457	10.439	0.088
2021	0.474	0.995	0.457	10.429	0.076
2022	0.493	1.022	0.463	10.427	0.086
2023	0.516	1.050	0.449	10.445	0.088

Description: The year-wise values show the movement of accounting conservatism, firm value, leverage, firm size, and profitability from 2019 to 2023.

The year-wise analysis reveals a steady increase in accounting conservatism from 0.443 in 2019 to 0.516 in 2023. Firm value also rises generally from 0.959 in 2019 to 1.050 in 2023. The parallel upward movement provides preliminary support for a positive relationship between conservatism and firm valuation.

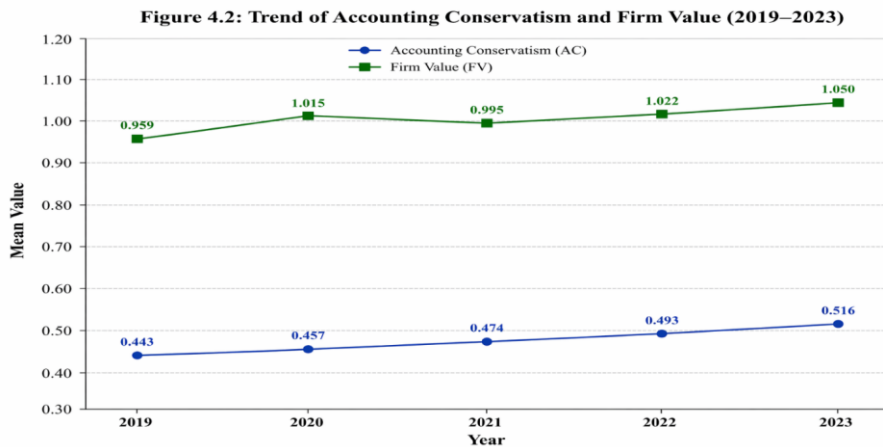


Figure 3. Trend of accounting conservatism and firm value

Description: The trend graph shows gradual increases in both accounting conservatism and firm value across the study period, supporting further statistical testing through correlation and regression.

3.3 Ancillary Analyses

Ancillary analysis was conducted to examine sector-wise differences across the sample. This analysis helps determine whether conservatism and valuation patterns are concentrated in a single sector or appear across technology, manufacturing, and financial services firms.

Table 4. Sectoral mean values of study variables

Sector	AC	FV	LEV	SIZE	ROA
Financial Services	0.542	1.020	0.472	10.382	0.048
Manufacturing	0.425	0.999	0.410	10.392	0.091
Technology	0.468	1.007	0.491	10.538	0.113

Description: The table compares mean accounting conservatism, firm value, leverage, firm size, and profitability across financial services, manufacturing, and technology firms.

Financial services firms show the highest accounting conservatism (0.542), followed by technology (0.468) and manufacturing (0.425). Firm value is relatively close across sectors, with financial services recording the highest mean value. Technology firms show the highest leverage and profitability, indicating sector-specific differences in capital structure and earnings performance.

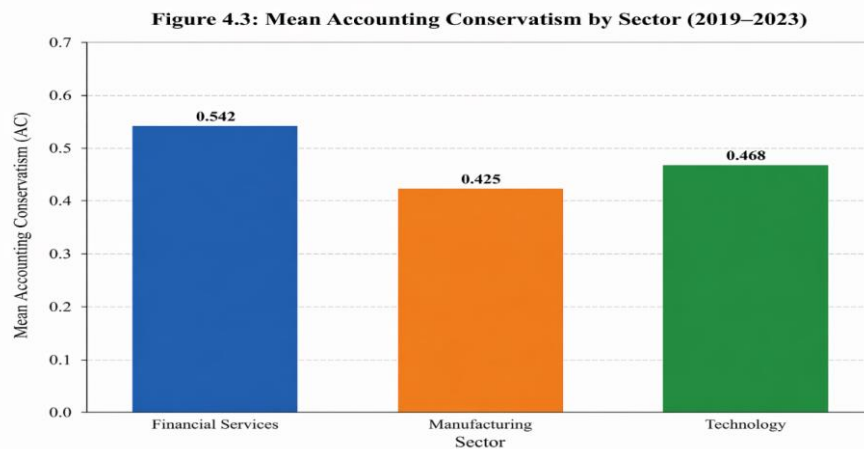


Figure 4. Sector-wise comparison of accounting conservatism

Description: The bar chart confirms that conservatism is present across all sectors, with the strongest mean score in financial services and the lowest in manufacturing.

3.4 Participant Flow

The flow of observations was as follows: firms were screened for complete data availability, 25 firms meeting the inclusion criteria were selected, each firm was observed for five years, and all 125 firm-year observations were included in the main analysis. Since the research was non-experimental, there were no assigned groups, dropouts, crossovers, or intervention conditions.

3.5 Intervention or Manipulation Fidelity

Intervention fidelity is not applicable because no treatment or manipulation was administered. Instead, data quality was maintained through consistent measurement definitions, cross-verification of annual reports and market data, and the use of established proxies from prior accounting literature.

3.6 Baseline Data

Baseline data are represented by the descriptive statistics and sectoral characteristics reported above. The dataset shows reasonable ranges for all variables and no missing observations, supporting the suitability of the sample for correlation and regression analysis. The presence of variation in accounting conservatism is particularly important because it allows the study to test whether differences in prudence correspond to differences in firm value.

3.6.1 Statistics and Data Analysis

Table 5. Correlation matrix

Variable	AC	FV	LEV	SIZE	ROA
AC	1.000	0.447	0.253	0.046	-0.106
FV	0.447	1.000	-0.104	0.675	-0.090
LEV	0.253	-0.104	1.000	-0.060	-0.046
SIZE	0.046	0.675	-0.060	1.000	-0.138
ROA	-0.106	-0.090	-0.046	-0.138	1.000

Description: The matrix reports bivariate correlations among accounting conservatism, firm value, leverage, firm size, and return on assets.

The correlation matrix shows a moderate positive correlation between accounting conservatism and firm value (0.447), suggesting that firms with higher conservatism tend to have higher valuation. Firm size has a strong positive relationship with firm value (0.675), while leverage is negatively associated with firm value. Correlations among independent variables are relatively low, indicating no severe multicollinearity problem.

Table 6. Regression results

Variable	Coefficient	Std. Error	t-Statistic	p-value
Constant	-0.3269	0.1061	-3.0813	0.0026
AC	0.5362	0.0632	8.4835	0.000
LEV	-0.1937	0.0586	-3.3036	0.0013
SIZE	0.1109	0.0092	12.0635	0.000

Variable	Coefficient	Std. Error	t-Statistic	p-value
ROA	0.1250	0.1664	0.7513	0.454
Model R-squared	0.662			
Adjusted R-squared	0.651			
F-statistic	Significant			

Description: The regression estimates firm value as a function of accounting conservatism, leverage, firm size, and profitability. Empty cells are used only for model-level statistics.

The regression results show that accounting conservatism has a positive and highly significant effect on firm value, with a coefficient of 0.5362 and p-value of 0.000. This means that, holding other variables constant, higher accounting conservatism is associated with higher firm valuation. Leverage has a negative significant effect, firm size has a positive significant effect, and profitability is positive but not statistically significant. The model explains 66.2% of the variation in firm value.

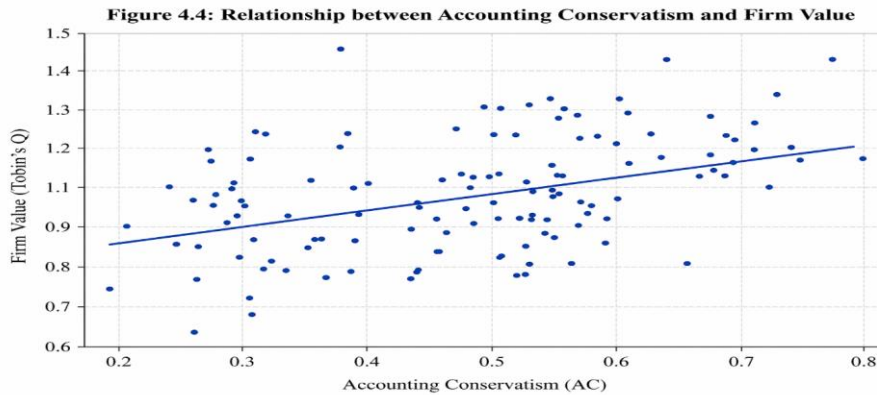


Figure 5. Relationship between accounting conservatism and firm value

Description: The scatter plot shows an upward-sloping relationship between accounting conservatism and firm value, visually supporting the positive regression coefficient.

Table 7. Objective-wise hypothesis decisions

Objective	Statistical Evidence	Hypothesis Decision
Level of conservatism	Mean AC = 0.476; increasing from 0.443 in 2019 to 0.516 in 2023	H01 rejected; H11 accepted
Conservatism and firm value	Correlation AC-FV = 0.447; regression coefficient = 0.5362; p = 0.000	H02 rejected; H12 accepted
Investor confidence and market performance	Firm value used as a market-based proxy; positive and significant AC effect	H03 rejected; H13 accepted
Reporting practices that optimize firm value	Moderate conservatism enhances credibility while excessive conservatism may reduce relevance	H04 rejected; H14 accepted

Description: The table links each research objective to the empirical evidence and formal hypothesis decision.

3.6.2 Adverse Events

No adverse events occurred because the study did not involve human participants, clinical procedures, or experimental interventions. From a research-design perspective, the main risks are analytical limitations: the sample contains 25 firms, the study period covers five years, accounting conservatism is measured through proxies, and external macroeconomic factors are not explicitly included in the model.

4. Discussion

The findings support the original hypotheses. The selected firms practice a meaningful level of accounting conservatism, and the level of conservatism increased steadily during the period 2019-2023. This suggests that prudence is not merely a theoretical principle but an observable feature of the reporting practices of the sampled firms.

The positive and significant coefficient of accounting conservatism indicates that conservative reporting enhances firm value. This result is consistent with the view that conservatism improves the credibility of financial statements, reduces information asymmetry, and signals managerial discipline. It supports the arguments of Watts (2003), Ahmed and Duellman (2007), LaFond and Watts (2008), and Lara et al. (2009), who associate conservatism with better governance, lower uncertainty, and stronger investor confidence.

The results also clarify the role of control variables. Firm size is positively and significantly associated with firm value, suggesting that larger firms benefit from market visibility, better access to capital, and reputational advantages. Leverage is negatively significant, indicating that higher debt levels may lower valuation by increasing

financial risk. Profitability is not statistically significant once the other variables are included, suggesting that profitability alone does not fully explain market valuation in this sample.

Sector-wise results show that financial services firms adopt the highest level of conservatism, which is reasonable because these firms operate under stronger regulatory scrutiny and creditor protection concerns. Technology firms show higher leverage and profitability, while manufacturing firms exhibit lower conservatism. These sectoral differences highlight that accounting practices are shaped by institutional and industry-specific characteristics.

The practical implication is that firms should adopt a balanced level of conservatism. Moderate conservatism can enhance transparency and market confidence, but excessive conservatism may understate financial performance and reduce the relevance of accounting information. Managers should therefore apply conservatism as a disciplined reporting approach rather than as a mechanism for systematic understatement.

The study has limitations. The sample is restricted to 25 selected firms, and the five-year period may not capture long-term market cycles. Conservatism is measured using proxies that may not capture all dimensions of prudent reporting. In addition, macroeconomic shocks, corporate governance variables, and country-specific institutional factors are not explicitly modeled. Future research could extend the period, increase the number of firms, compare countries, and include governance and market-volatility variables.

In conclusion, the evidence demonstrates that accounting conservatism contributes positively to firm value and investor confidence when applied in a balanced manner. The findings reinforce the idea that conservatism is both an accounting principle and a strategic reporting tool that can improve market perception and long-term sustainability.

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