

Journal of Finance and Accounting



ISSN Online: 2616-4965



Effect of Accounting Conservatism on Firm Value of Non-Financial Firms Listed on the Nairobi Securities Exchange

Ronoh, K. Shadrack, Josphat Cheboi Yegon & Lucy Rono

ISSN: 2616-4965

Effect of Accounting Conservatism on Firm Value of Non-Financial Firms Listed on the Nairobi Securities Exchange

^{*1}**Ronoh, K. Shadrack**

PhD Student, Department of Accounting & Finance, School of Business & Economics, Moi University

*Email: ronohshadrack98@gmail.com

²**Josphat Cheboi Yegon**

Department of Accounting & Finance, School of Business & Economics, Moi University

³**Lucy Rono**

Department of Accounting & Finance, School of Business & Economics, Moi University

How to cite this article: Ronoh, S. K., Yegon, J. C. & Rono, L. (2026), Effect of Accounting Conservatism on Firm Value of Non-Financial Firms Listed on the Nairobi Securities Exchange, *Journal of Finance and Accounting*, 10(7) pp.42-55. <https://doi.org/10.53819/81018102t4424>

Abstract

This paper examined the effect of accounting conservatism on firm value among non-financial firms listed on the Nairobi Securities Exchange. The study was anchored in Signaling Theory and adopted a positivist philosophy and an explanatory longitudinal design. The target population comprised 40 non-financial listed firms, of which 33 met the inclusion criteria for the period 2015-2024, yielding a balanced panel of 330 firm-year observations. Secondary data were obtained from audited annual reports, published financial statements, Capital Markets Authority records, and Nairobi Securities Exchange handbooks. Firm value was measured using approximate Tobin's Q, while conditional accounting conservatism was measured using the Basu asymmetric-timeliness model. Data were analyzed in STATA using descriptive statistics, correlation analysis, diagnostic tests, panel unit-root tests, the Hausman specification test, and fixed-effects regression. Accounting conservatism was positively correlated with firm value ($r = .277$, $p < .01$). The fixed-effects model was statistically significant, $F(6, 281) = 51.68$, $p < .001$, and accounting conservatism had a positive and statistically significant effect on firm value after accounting for the other financial-reporting dimensions and firm controls ($\beta = 0.880$, $SE = 0.278$, $t = 3.160$, $p = .002$; 95% CI [0.332, 1.428]). The null hypothesis was therefore rejected. The study concludes that prudent recognition of losses and delayed recognition of uncertain gains enhance the credibility of financial statements and support higher market valuation. Firms should institutionalize consistent conservative reporting, strengthen audit oversight, and apply impairment, provision, and contingent-liability policies in line with applicable financial-reporting standards. Regulators should reinforce consistent compliance and disclosures without encouraging deliberate understatement that could obscure a firm's underlying economic performance.

<https://doi.org/10.53819/81018102t4424>

Keywords: *Accounting Conservatism, Firm Value, Non-Financial Firms, Nairobi Securities Exchange, Fixed Effects*

1.0 Introduction

Firm value represents the market's assessment of a company's present condition and future prospects. It is central to shareholder wealth, access to capital, investor confidence, and long-term organizational continuity (Shuaibu et al., 2019). Market-based measures are useful because they combine accounting information with investors' expectations about future cash flows. Tobin's Q is especially common because it compares the market value of a firm with the book value or replacement cost of its assets and is less directly affected by managers' choice of accounting methods than purely accounting-based performance measures (Chung & Pruitt, 1994; Robiyanto et al., 2021). A high value indicates strong market expectations, whereas a persistent decline may signal weak performance, poor governance, unreliable reporting, or limited confidence in the firm's future.

Accounting conservatism is one aspect of financial reporting quality that can shape these market expectations. Conservatism requires stronger verification before uncertain gains are recognized and more timely recognition of probable losses or adverse economic news (Basu, 1997; Ball & Shivakumar, 2005). It is therefore a cautious response to uncertainty rather than a mechanical preference for low profit. Properly applied, it restrains aggressive recognition of income and assets, supports timely impairment and provision decisions, and reduces the risk that reported performance will later require large downward corrections. Watts (2003) argues that conservatism also has contracting, governance, litigation, taxation, and regulatory functions, while more recent evidence shows that its application depends on economic policy uncertainty and corporate-governance conditions (Alkhalaileh et al., 2024).

The expected valuation effect arises through credibility and information risk. Managers normally possess better information about operations, asset quality, liabilities, and future prospects than outside investors. This gap creates uncertainty and can lead investors to discount the value of a firm's securities (Healy & Palepu, 2001). Conservative reporting can reduce this discount by limiting the overstatement of net assets and profits and by ensuring that bad news enters reported earnings promptly. Investors may consequently regard a conservative reporting system as evidence of disciplined management, effective monitoring, and lower downside risk. Reliable corporate reporting has similarly been associated with stronger investor decisions and higher firm value in emerging markets (Mohammadiyan, 2024; Ogundajo et al., 2023).

However, conservatism may not always increase market value. Excessive caution can understate economic assets, delay recognition of value-creating investments, and make current earnings less informative about growth opportunities. Research also suggests that strong conservatism may discourage innovation expenditure or suppress short-term market appreciation even when it reduces crash risk (Talawa & Badwan, 2024; Zou & Othman, 2024). The effect is therefore an empirical question: investors may reward prudence as a credible safeguard, or they may treat it as an understatement of the firm's economic potential. The balance may differ across legal systems, ownership structures, sectors, and levels of investor protection.

The Kenyan capital market provides an important setting for this question. Non-financial firms listed on the Nairobi Securities Exchange operate under common financial-reporting and disclosure requirements, yet their market values have varied substantially. The thesis data showed that average firm value was highly volatile during 2015-2024 and declined to below one during

<https://doi.org/10.53819/81018102t4424>

the final years of the study. Wider market evidence also recorded a decline in the NSE 20 Share Index and a reduction in market capitalization during periods of economic and political uncertainty (Nairobi Securities Exchange, 2022). Such movements reinforce the need to identify reporting practices that can sustain investor trust, particularly where public information, enforcement capacity, and analyst coverage may be more limited than in developed markets.

Prior findings remain inconclusive and are concentrated outside Kenya. Some studies report that conservatism improves valuation by restraining opportunism and protecting investors, whereas others associate it with lower firm or share values. This difference leaves both a contextual and an empirical gap for non-financial firms listed on the NSE. The present paper addresses that gap by isolating the coefficient of accounting conservatism within the thesis's fixed-effects panel model. It asks whether changes in conservatism within the same firm are associated with changes in market value after controlling for accruals quality, earnings quality, financial transparency, firm size, firm age, and time-invariant firm characteristics.

2.1 Theoretical Review

The relationship between accounting conservatism and firm value is explained in this paper through Signaling Theory. Spence (1973) developed the theory to explain how an informed party communicates otherwise unobservable quality to a less-informed party. In capital markets, managers have private information about the firm's performance and risk, while investors must infer that quality from observable corporate actions and disclosures. Financial statements can therefore operate as signals when their preparation is sufficiently credible and when weak firms cannot imitate the reporting choices of strong firms without cost. Transparent and reliable disclosure can reduce perceived information risk, strengthen confidence, and improve valuation (Bae et al., 2018; Mohammadiyan, 2024).

Conditional conservatism provides such a signal by requiring adverse news to be recognized in earnings more quickly than favorable news. The timely recording of impairments, provisions, and probable losses informs investors that management is not postponing bad news merely to improve reported performance. It also signals a willingness to accept short-term reductions in earnings in exchange for more credible financial statements. Investors may respond by reducing the risk premium attached to reported assets and earnings, thereby increasing Tobin's Q. This reasoning is consistent with the monitoring and contracting explanations of conservatism advanced by Basu (1997), Ball and Shivakumar (2005), and Watts (2003).

The signaling effect nevertheless depends on disciplined application. If managers apply conservatism inconsistently or use it to create hidden reserves, the signal becomes less useful and may obscure economic performance. The theory therefore predicts a positive valuation effect when conservatism reflects genuine prudence and timely loss recognition rather than arbitrary understatement. In the NSE context, where the cost of information asymmetry can be substantial, consistent conservative reporting is expected to signal credible management and lower the uncertainty investors attach to financial statements.

2.2 Empirical Review

Empirical evidence on accounting conservatism and firm value is mixed. Wu et al. (2024) examined publicly listed firms in the United States from 2000 to 2017 and found that corporate diversification reduced firm value, but conservative reporting mitigated this adverse effect. The benefit was stronger where information asymmetry was high or corporate governance was weak.

Their findings suggest that conservatism can serve as a stabilizing monitoring mechanism when organizational complexity makes a firm's economic condition more difficult for investors to assess.

Positive evidence has also been reported in Indonesia. Mardiana and Meilani (2024) analyzed 43 manufacturing companies and found a statistically significant positive relationship between accounting conservatism and firm value after considering ownership and capital-structure conditions. Pasupati (2020) similarly found that conservative accounting supported corporate equity valuation among firms in the LQ45 index, with governance influencing the strength of the relationship. Both studies imply that caution in recognizing income and assets can increase financial-statement credibility and make valuation less vulnerable to aggressive reporting.

Muslim and Setiawan (2024) extended the analysis by considering institutional ownership and value relevance. Their results indicated that conservatism enhanced the usefulness of accounting information, although its contribution varied with ownership structure and innovation strategy. This conditional result is important because a reporting practice may be valued differently in family and non-family firms or in firms with different monitoring environments. Related studies show that board independence, institutional ownership, and state ownership influence the extent to which firms report conservatively (Aburishah et al., 2022; Kimouche & Boussenna, 2024).

Contrary findings have also emerged. Korniawati and Nurcahyono (2024) studied energy-sector companies listed on the Indonesia Stock Exchange from 2019 to 2023 and reported a negative relationship between accounting conservatism and firm value. Their results imply that investors may interpret conservative earnings and asset values as weak current performance, particularly in a capital-intensive sector. Talawa and Badwan (2024) likewise observed a negative association between conservatism and share prices among firms listed on the Palestine Stock Exchange. Although conservatism helped reduce the risk of price collapse, it could also limit upward price movement.

African evidence remains limited and frequently examines outcomes other than market valuation. Aminu and Hassan (2016), for example, associated accounting conservatism with the investment efficiency of listed Nigerian conglomerates, supporting the view that prudence can improve resource allocation. However, such evidence does not establish whether investors on the NSE reward conservative reporting through higher Tobin's Q. Differences in market depth, investor protection, enforcement, ownership concentration, and disclosure quality also limit the direct transfer of findings from the United States, Indonesia, Palestine, or Nigeria to Kenya.

The reviewed studies therefore reveal three gaps. First, their results are directionally inconsistent. Second, few focus on African capital markets, and direct evidence for Kenya's non-financial listed firms is scarce. Third, many use cross-sectional or sector-specific designs that cannot control for stable, unobserved firm characteristics. By using a ten-year balanced panel and firm fixed effects, the present study evaluates whether within-firm changes in conservatism predict changes in firm value. Guided by Signaling Theory and the positive valuation mechanism of credible loss recognition, the study tests the following hypothesis:

H3: Accounting conservatism has a significant effect on firm value of non-financial firms listed on the Nairobi Securities Exchange.

3.0 Methodology

The study adopted a positivist research philosophy and an explanatory longitudinal design to test the effect of accounting conservatism on firm value. Positivism was appropriate because the study

specified measurable variables, tested an a priori hypothesis, and used statistical evidence to estimate the direction and magnitude of the relationship. The longitudinal panel design followed the same firms from 2015 to 2024 and enabled the analysis to distinguish changes within firms over time from stable differences across firms. This design was also appropriate because the variables were derived from audited financial records rather than respondent perceptions (Cooper & Schindler, 2013).

Sampling

The target population comprised all 40 non-financial companies listed on the Nairobi Securities Exchange as at 31 December 2024. The population covered agriculture, automobiles and accessories, commercial and services, construction and allied activities, energy and petroleum, investment, manufacturing, telecommunications, and related non-financial sectors. Purposive inclusion criteria were applied because consistent panel estimation required firms to have traded throughout the study period and to have complete audited financial information for every year. Seven firms failed these criteria. The final balanced panel therefore contained all 33 eligible firms observed for ten years, giving 330 firm-year observations.

Data Collection

The study used secondary panel data obtained from audited annual reports and financial statements of the selected firms for 2015-2024. Relevant figures were drawn from statements of profit or loss, statements of financial position, cash-flow statements, notes to the accounts, published market information, Capital Markets Authority records, and NSE handbooks. A structured document-review guide was used to capture the same items for each firm and year. Figures obtained from company reports were cross-checked against NSE and regulatory sources to improve completeness and consistency. Secondary data were suitable because they had already been subjected to statutory audit and allowed new relationships to be examined without altering the original records (Polit & Beck, 2003).

Measurement of Variables

Firm value was measured using the approximate Tobin's Q developed by Chung and Pruitt (1994). The measure relates the market value of equity and the book value of debt to total assets and captures investors' assessment of the firm's earning potential relative to the assets employed. A value below one suggests that the market values the firm below the book value of its asset base, whereas a value above one indicates that market valuation exceeds the recorded asset value (Robiyanto et al., 2021).

$$Approximate\ Q_{it} = (MVE_{it} + DEBT_{it}) / TA_{it} \tag{1}$$

Where MVE is the market value of equity, calculated from the average share price and outstanding ordinary shares; DEBT is the value of short-term liabilities plus long-term debt; and TA is the book value of total assets.

Accounting conservatism was measured using Basu's (1997) asymmetric-timeliness model. The model captures conditional conservatism by comparing the sensitivity of earnings to negative and positive stock returns. A dummy variable identifies negative returns, which proxy bad news. The interaction between the negative-return dummy and stock return measures the incremental speed with which earnings recognize bad news. A positive incremental coefficient indicates that losses

are recognized more quickly than gains, consistent with conditional conservatism (Ball & Shivakumar, 2005).

$$NI_{it} = \beta_0 + \beta_1 DR_{it} + \beta_2 R_{it} + \beta_3 (DR_{it} \times R_{it}) + \varepsilon_{it} \tag{2}$$

Where NI is earnings per share scaled by the beginning-of-year share price, R is the firm's stock return, DR equals one when R is negative and zero otherwise, and β_3 captures asymmetric recognition of bad news. The analysis also included accruals quality, earnings quality, and financial transparency to isolate the unique contribution of conservatism within financial reporting quality. Firm size, measured as the logarithm of total assets, and firm age, measured as years since incorporation, were included as control variables (Berger & Udell, 1998; Boone et al., 2007; Laeven et al., 2014; Tariverdi et al., 2014).

Table 1: Measurement of Variables

Variable Name	Measurement/Formula	Sources
Dependent Variable		
Firm Value	Approximate Tobin's Q = (MVE + DEBT) / TA	Chung & Pruitt (1994); Tobin & Brainard (1968)
Focal Independent Variable		
Accounting Conservatism	Basu asymmetric-timeliness model; incremental response of earnings to negative returns	Basu (1997); Ball & Shivakumar (2005)
Control Variables		
Firm Size; Firm Age	Log of total assets; years since incorporation	Tariverdi et al. (2014); Boone et al. (2007)

Source: Author's operationalization from the thesis

Data Analysis and Model Specification

Data were coded and analyzed in STATA because of its capacity to manage balanced panel and time-series data. Descriptive statistics summarized distribution and variability, while Pearson correlation coefficients assessed bivariate associations. Diagnostic tests assessed residual normality, first-order autocorrelation, heteroscedasticity, and multicollinearity. Fisher-type unit-root tests examined stationarity. Both random-effects and fixed-effects specifications were estimated, and the Hausman test selected the estimator whose assumptions were supported by the data (Greene, 2008; Wooldridge, 2002). The following direct-effects model was estimated:

$$FV_{it} = \beta_0 + \beta_1 AQ_{it} + \beta_2 EQ_{it} + \beta_3 AC_{it} + \beta_4 FT_{it} + \beta_5 FS_{it} + \beta_6 FA_{it} + \mu_i + \varepsilon_{it} \tag{3}$$

Where FV denotes firm value; AQ, EQ, AC, and FT denote accruals quality, earnings quality, accounting conservatism, and financial transparency; FS and FA denote firm size and firm age; μ_i is the unobserved firm-specific effect; ε_{it} is the idiosyncratic error; i identifies firms;

and t identifies years. The focal parameter is β_3 , which estimates the unique within-firm effect of accounting conservatism on firm value after the remaining variables are held constant.

4.0 Results

4.1 Descriptive Analysis

Table 2 presents descriptive and correlation statistics for the focal variables based on 330 firm-year observations. Firm value ranged from 0.000 to 316.940, with a mean of 4.092 and a standard deviation of 19.839, indicating substantial differences in market valuation among the sampled firms. Accounting conservatism ranged from -1.291 to 7.284, with a pooled mean of 0.006 and a standard deviation of 0.981. The near-zero mean shows that conservative reporting was weak and inconsistent on average, while the wide range indicates considerable variation across firms and years. Firm size averaged 7.086, and firm age averaged 75.320 years.

Accounting conservatism was positively and significantly correlated with firm value ($r = .277$, $p < .01$). This preliminary result suggests that firms with stronger conditional conservatism tended to have higher market valuations. Conservatism had only weak, non-significant correlations with firm size ($r = -.077$) and firm age ($r = .007$), reducing concern that the focal relationship merely reflected the size or maturity of the firms. Firm value was negatively related to firm size ($r = -.409$, $p < .01$) and positively related to firm age ($r = .196$, $p < .01$).

Table 2: Descriptive and Correlation Statistics

n = 330	Min	Max	Mean	SD	FV	AC	FS	FA
FV	0.000	316.940	4.092	19.839	1			
AC	-1.291	7.284	0.006	0.981	.277**	1		
FS	4.806	8.474	7.086	0.580	-.409**	-.077	1	
FA	19.000	155.000	75.320	31.788	.196**	.007	-.315**	1

** Correlation is significant at the .01 level (two-tailed).

Key: FV = firm value; AC = accounting conservatism; FS = firm size; FA = firm age.

Unit Root Test

Panel stationarity was tested to avoid spurious long-run relationships and invalid statistical inference (Baltagi, 2021; Wooldridge, 2002). Four Fisher-type tests were used: inverse chi-squared, inverse normal, inverse logit t, and modified inverse chi-squared. The null hypothesis in each test was that all panels contained a unit root. As shown in Table 3, the p-values for firm value, accounting conservatism, firm size, and firm age were below .05 across the four procedures. The null hypothesis was therefore rejected, confirming that the variables were stationary at level and could be entered in the panel regression without differencing.

Table 3: Unit Root Tests

Variable	Measure	Inverse chi-squared (66)	Inverse normal Z	Inverse logit t (169)	Modified inv. chi-squared
FV	Statistic	184.329	-4.822	-6.623	10.299
	p-value	0.000	0.000	0.000	0.000
AC	Statistic	177.397	-3.954	-5.901	9.696
	p-value	0.000	0.000	0.000	0.000
FS	Statistic	488.532	-10.659	-21.082	36.777
	p-value	0.000	0.000	0.000	0.000
FA	Statistic	2309.762	-45.396	-111.145	195.294
	p-value	0.000	0.000	0.000	0.000

Null hypothesis: all panels contain unit roots.

Source: Field data (2025)

Hypothesis Testing

Before model estimation, diagnostic tests assessed whether the data met the assumptions required for reliable panel inference. The residual skewness and kurtosis tests were non-significant ($p = .076$ and $p = .127$), and the joint normality test was also non-significant, $\text{chi-square}(2) = 5.49$, $p = .164$. The Jarque-Bera, Mardia, and Doornik-Hansen procedures likewise supported residual normality. The Wooldridge test found no first-order serial correlation, $F(1, 44) = 0.884$, $p = .3541$, while White's test supported homoscedasticity, $\text{chi-square}(14) = 18.41$, $p = .1888$. Variance inflation factors ranged from 1.08 to 1.69, with a mean of 1.27, which was well below conventional thresholds and indicated no material multicollinearity.

The Hausman specification test compared the random-effects and fixed-effects estimators. The null hypothesis was that the explanatory variables were uncorrelated with unobserved firm-specific effects, making random effects consistent and efficient. The test was statistically significant, $\text{chi-square}(5) = 29.83$, $p < .001$. The null hypothesis was rejected, and fixed effects were selected because unobserved firm characteristics were correlated with the regressors. This estimator controls for stable firm attributes and identifies the relationship from changes within each firm over time.

The fixed-effects model was statistically significant, $F(6, 281) = 51.68$, $p < .001$. The within R-squared of .525 indicates that 52.5% of the change in firm value within firms over time was explained jointly by the financial-reporting dimensions and controls. The between R-squared was .186 and the overall R-squared was .356. The firm-effect variance share was $\rho = .564$, and the test that all firm effects were zero was significant, $F(32, 281) = 6.62$, $p < .001$, further supporting the panel fixed-effects specification.

The study tested whether accounting conservatism significantly affected firm value. Table 4 shows a positive and statistically significant coefficient for accounting conservatism ($\beta = 0.880$, $SE = 0.278$, $t = 3.160$, $p = .002$; 95% CI [0.332, 1.428]). Holding the other reporting dimensions, firm

<https://doi.org/10.53819/81018102t4424>

size, firm age, and time-invariant firm characteristics constant, a one-unit increase in the conservatism measure was associated with a 0.880-unit increase in approximate Tobin's Q. Because p was below .05 and the confidence interval excluded zero, the null hypothesis of no effect was rejected and H3 was supported.

Table 4: Fixed-Effects Regression Results

Fixed-effects (within) regression Group variable: firm			Number of observations = 330 Number of groups = 33		
R-squared: within = .525; between = .186; overall = .356			F(6, 281) = 51.68; Prob > F = .000		
FV	Coefficient	Std. Error	t	p	95% Confidence Interval
Accounting conservatism (AC)	0.880	0.278	3.160	.002	[0.332, 1.428]
Firm size (FS)	-8.457	2.476	-3.420	.001	[-13.332, -3.582]
Firm age (FA)	-1.163	1.243	-0.940	.350	[-3.609, 1.284]
Constant	21.839	5.462	4.000	.000	[11.088, 32.590]
sigma_u = 1.148; sigma_e = 1.010; rho = .564			corr(u_i, Xb) = -.237		
F test that all u_i = 0: F(32, 281) = 6.62, p = .000					
Dependent variable: approximate Tobin's Q. Values reported as .000 denote p < .001.					

Source: Field data (2025)

4.2 Discussion

The results establish that accounting conservatism has a positive and statistically significant effect on firm value among non-financial firms listed on the Nairobi Securities Exchange. This means that, within the same firm, periods characterized by more timely recognition of adverse news were associated with higher approximate Tobin's Q after the remaining reporting-quality dimensions and firm controls were held constant. The finding is economically meaningful because it identifies a unique valuation contribution for conservatism rather than merely reflecting the general quality of earnings or disclosure.

A plausible explanation is that conservative reporting limits the risk of overstated assets, revenues, and current performance. Prompt recognition of impairments and probable losses reduces the likelihood of sudden future write-downs and reassures investors that management has not delayed unfavorable information. In an emerging capital market, where investors may face greater information gaps and fewer alternative information sources, this prudence can lower uncertainty and make accounting numbers more credible. The positive coefficient therefore supports the monitoring and contracting roles identified by Basu (1997), Ball and Shivakumar (2005), and Watts (2003).

The result agrees with Wu et al. (2024), who found that conservatism protected firm value where organizational complexity and information asymmetry were high. It is also consistent with Mardiana and Meilani (2024) and Pasupati (2020), whose findings linked conservative reporting to higher valuation, and with Muslim and Setiawan (2024), who showed that conservatism can strengthen the value relevance of accounting information. Taken together, these studies suggest that investors reward prudence when it improves the dependability of reported net assets and earnings.

The finding differs from Korniawati and Nurcahyono (2024) and Talawa and Badwan (2024), who reported negative valuation effects. The divergence may reflect differences in market structure, sector composition, ownership, measurement, and study period. Energy firms may have large, long-horizon investments whose accounting values are especially sensitive to impairment and cautious recognition. Likewise, investors may interpret lower current earnings negatively in a thin or highly volatile market even when conservatism reduces crash risk. The NSE sample covered several non-financial sectors and used firm fixed effects, allowing the result to be identified from changes within firms rather than from cross-sectional differences alone.

Signaling Theory provides a coherent interpretation of the result. By recognizing bad news without delay, management communicates that it is willing to report unfavorable outcomes and is less likely to inflate performance for short-term benefit. That signal can strengthen trust in future earnings and balance-sheet amounts. The result should not, however, be interpreted as support for arbitrary understatement. Conservatism creates value when it reflects consistent, standards-based prudence and timely verification; deliberate bias or hidden reserves may instead reduce comparability and the usefulness of financial statements.

5.0 Conclusion

The study concludes that accounting conservatism is an important positive determinant of firm value among non-financial firms listed on the Nairobi Securities Exchange. Conditional conservatism, reflected in the faster incorporation of bad news than good news into earnings, supports higher market valuation by improving the credibility of financial reports and reducing the risk of overstatement. The significant coefficient remained after accruals quality, earnings quality, financial transparency, firm size, firm age, and stable firm characteristics were controlled, demonstrating that conservatism contributes distinct information to investors.

The conclusion is especially relevant because the descriptive results showed that conservative reporting practices were weak and inconsistent across the study period. The near-zero pooled mean and substantial dispersion suggest that listed firms did not apply conditional conservatism uniformly. Firms that establish consistent policies for timely impairment, provision, and loss recognition are therefore more likely to provide the dependable information required to sustain investor confidence and protect long-term firm value.

6.0 Recommendations

Boards, audit committees, chief financial officers, and internal auditors should embed prudent and consistent loss-recognition policies in the financial-reporting process. Particular attention should be given to impairment testing, expected credit losses, provisions, contingent liabilities, inventory valuation, and the verification of uncertain revenue. These judgments should be supported by documented assumptions, independent review, and clear disclosures so that prudence cannot be used to create discretionary reserves or conceal operating weakness.

The Capital Markets Authority, the Nairobi Securities Exchange, and the Institute of Certified Public Accountants of Kenya should reinforce guidance and enforcement on the consistent application of relevant financial-reporting standards. Regulatory reviews should assess both delayed loss recognition and excessive understatement. Training for directors, audit committees, preparers, and external auditors should emphasize that useful conservatism is conditional, evidence-based, and transparent. Firms should also explain material changes in estimates and provisions to help investors distinguish prudent reporting from deteriorating economic performance.

Theoretical Implication

The positive coefficient supports Signaling Theory by demonstrating that an accounting recognition policy can convey credible information about managerial discipline and reporting reliability. Conservative loss recognition functions as a signal because management accepts the current reporting cost of recording adverse outcomes instead of postponing them. Investor response is reflected in higher Tobin's Q. The evidence therefore extends signaling arguments beyond voluntary disclosure and dividend announcements to the timing of recognition within audited financial statements. It also suggests that the market value of the signal depends on consistent application and verification.

Policy and Managerial Implications

For policy, the results indicate that prudence remains relevant to investor protection in Kenya's capital market. Enforcement should focus on whether listed firms recognize deterioration promptly and disclose the judgments supporting impairments and provisions. Comparable sector guidance can reduce variation in practice and improve investors' ability to interpret conservative estimates. Regulators should nevertheless avoid rules that promote systematic understatement, since neutral and faithfully represented information remains the objective of general-purpose financial reporting.

For management, the results show that short-term efforts to avoid recognizing losses may weaken market confidence and firm value. A governance culture that rewards accurate estimates, protects the independence of finance functions, and enables audit committees to challenge optimistic assumptions is more likely to produce credible reports. Management should coordinate conservative recognition with clear investor communication so that the market understands the economic basis of charges and does not mistake prudent accounting for undisclosed operating decline.

Future studies should test the relationship in financial firms, privately held companies, and other African securities markets to establish whether the valuation effect is specific to the NSE's institutional setting. Researchers could compare conditional measures such as Basu's asymmetric timeliness with balance-sheet or accrual-based measures of unconditional conservatism. Dynamic panel, instrumental-variable, or quasi-experimental designs could address possible reverse causality and time-varying omitted variables. Further work should also examine whether audit quality, board independence, ownership concentration, investor protection, economic policy uncertainty, or sector conditions strengthen or weaken the valuation effect. Finally, research could distinguish beneficial prudence from excessive understatement and test whether the relationship is nonlinear, since moderate conservatism may improve credibility while extreme conservatism may reduce relevance and obscure growth opportunities.

REFERENCES

- Aburishah, K. E., Dahiyat, A. A., Owais, W. O., Al Shanti, A. M., & AlQudah, L. A. (2022). The effect of ownership structure and board structure on accounting conservatism throughout financial reporting: Evidence from Jordanian industrial corporations. *Cogent Business & Management*, 9(1), 2112819.
- Alkhalaileh, A. H. R., Hamid, M. A. B. A., Saidin, S. F. B., & Khan, F. (2024). Accounting conservatism in the face of economic policy uncertainty in GCC countries. *Polish Journal of Management Studies*, 29.
- Aminu, L., & Hassan, D. S. (2016). Accounting conservatism and investment efficiency of listed Nigerian conglomerate firms. *Scholedge International Journal of Business Policy & Governance*, 3(11), 167–180.
- Bae, S. M., Masud, M. A. K., & Kim, J. D. (2018). A cross-country investigation of corporate governance and corporate sustainability disclosure: A signaling theory perspective. *Sustainability*, 10(8), 2611.
- Ball, R., & Shivakumar, L. (2005). Earnings quality in UK private firms: Comparative loss recognition timeliness. *Journal of Accounting and Economics*, 39(1), 83–128.
- Baltagi, B. H. (2021). *Econometric analysis of panel data* (6th ed.). Springer.
- Basu, S. (1997). The conservatism principle and the asymmetric timeliness of earnings. *Journal of Accounting and Economics*, 24, 3–37.
- Berger, A. N., & Udell, G. F. (1998). The economics of small business finance: The roles of private equity and debt markets in the financial growth cycle. *Journal of Banking & Finance*, 22(6–8), 613–673.
- Boone, A. L., Field, L. C., Karpoff, J. M., & Raheja, C. G. (2007). The determinants of corporate board size and composition: An empirical analysis. *Journal of Financial Economics*, 85(1), 66–101.
- Botosan, C. A. (2006). Disclosure and the cost of capital: What do we know? *Accounting and Business Research*, 36(sup1), 31–40.
- Chung, K. H., & Pruitt, S. W. (1994). A simple approximation of Tobin's q. *Financial Management*, 23(3), 70–74.
- Cooper, D. R., & Schindler, P. S. (2013). *Business research methods* (12th ed.). McGraw-Hill.
- Dechow, P. M., & Dichev, I. D. (2002). The quality of accruals and earnings: The role of accrual estimation errors. *The Accounting Review*, 77(s-1), 35–59.
- Francis, J., LaFond, R., Olsson, P., & Schipper, K. (2005). The market pricing of accruals quality. *Journal of Accounting and Economics*, 39(2), 295–327.
- Greene, W. H. (2008). *Econometric analysis* (6th ed.). Pearson Prentice Hall.
- Healy, P. M., & Palepu, K. G. (2001). Information asymmetry, corporate disclosure, and the capital markets: A review of the empirical disclosure literature. *Journal of Accounting and Economics*, 31(1–3), 405–440.

- Kimouche, B., & Boussenna, H. (2024). Accounting conservatism in non-state companies and consolidated financial statements. *Folia Oeconomica Stetinensia*, 24(2), 141–161.
- Korniawati, L., & Nurcahyono, N. (2024). The effect of conservatism accounting and tax risk on firm value: Agency costs as a moderating factor. *Economics and Business International Conference Proceeding*, 1(2), 286–298.
- Laeven, L., Ratnovski, L., & Tong, H. (2014). *Bank size and systemic risk*. International Monetary Fund.
- Mardiana, D. N. M., & Meilani, S. E. R. (2024). The effect of accounting conservatism, capital structure, and concentrated ownership on firm value with firm performance as a moderating variable. *Proceedings of the International Conference Economic Management Accounting*, 2(1), 148–175.
- Mohammadiyan, M. (2024). The impact of financial reporting quality on investment decisions: Evidence from Tehran Stock Exchange. *Creative Economy and New Business Management Approaches*, 92–105.
- Muslim, A. I., & Setiawan, D. (2024). Institutional ownership and value relevance in Indonesia: The nexus of accounting conservatism. *Rajagiri Management Journal*.
- Nairobi Securities Exchange. (2022). *Quarterly statistical bulletin*. Nairobi Securities Exchange.
- Ogundajo, G. O., Adegbe, F. F., Oyegoke, S. K., Akande, F., & Ajayi-Owoeye, E. A. (2023). Examining the impact of corporate governance and corporate financial reporting on firm value: A study of selected banks in Nigeria. *International Journal of Applied Economics, Finance and Accounting*, 16(2), 106–117.
- Pasupati, B. (2020). The impact of accounting conservatism on corporate equity valuation moderated by good corporate governance. *European Exploratory Scientific Journal*, 4(2), 1–12.
- Penman, S. H., & Zhang, X. J. (2002). Accounting conservatism, the quality of earnings, and stock returns. *The Accounting Review*, 77(2), 237–264.
- Polit, D. F., & Beck, C. T. (2003). *Nursing research: Principles and methods*. Lippincott Williams & Wilkins.
- Robiyanto, R., Putra, A. R., & Lako, A. (2021). The effect of corporate governance and intellectual capital toward financial performance and firm value of socially responsible firms. *Contaduría y Administración*, 66(1).
- Shuaibu, K., Ali, I., & Amin, M. (2019). Company attributes and firm value of listed consumer goods companies in Nigeria. *Quest Journals Journal of Research in Humanities and Social Science*, 7(5), 40–49.
- Spence, M. (1973). Job market signaling. *The Quarterly Journal of Economics*, 87(3), 355–374.
- Talawa, M., & Badwan, N. (2024). Impact of accounting conservatism and corporate governance on stock price breakdown in firms listed on the Palestine Stock Exchange. *Asian Journal of Accounting Research*, 9(3), 229–256.
- Tariverdi, Y., Lashgari, Z., & Jalalpour, M. (2014). Investigations of the effect of institutional shareholders, ownership concentration, return on assets, and discretionary accruals on

- restatement of financial statements. *International Research Journal of Applied and Basic Sciences*, 8(8), 986–992.
- Tobin, J., & Brainard, W. C. (1968). Pitfalls in financial model building. *American Economic Review*, 58(2), 99–122.
- Watts, R. L. (2003). Conservatism in accounting part I: Explanations and implications. *Accounting Horizons*, 17(3), 207–221.
- Wooldridge, J. M. (2002). *Econometric analysis of cross section and panel data*. MIT Press.
- Wu, C. Y. H., Tsao, S. M., & Lin, C. H. (2024). Accounting conservatism, corporate diversification and firm value. *Review of Quantitative Finance and Accounting*, 1–45.
- Zou, W., & Othman, A. (2024). The impact of accounting conservatism on enterprise innovation investment. *Heliyon*, 10(16).