Name : Akinola olajumobi oluwatosin

Matric no: 18/sms09/008

Department: IRD

Course code: Pol 202

Question: In not more than Five (5) Pages discuss and evaluate the idea of conservatism.

**Define conservatism:**

Accounting conservatism is a breach of accounting that requires a high degree of verification before making a legal claim to any profit as it requires recognition for all probable losses as they are discovered and most expenditures as they are incurred. Revenue will be deferred until it is verified as strict revenue recognition criteria is one of the most common forms of accounting conservatism.

The conservatism principle is a concept that suggests a less than optimal estimate should be used when given and option. In other words, when there is an uncertain event, accountants should error on the side of caution and moderation. This generally means in a situation where income and expenses are uncertain, less income is recorded and more expenses are recorded. This isn’t always the case, but minimizing profits is generally more conservative that maximizing them.

**What Does Conservatism Principle Mean?**

GAAP requires that accountants view estimates and uncertain business events with skepticism. Management will almost always lean toward the most optimal and opportunistic outcome in any situation. It’s the accountant’s job to look at the reality of the transaction and record it with a less than optimal outcome.

Remember, the conservatism principle doesn’t say that we always have to estimate outcomes unfavorably. Accountants just have to choose the most conservative outcome if two different outcomes are available.

This principle also intends to ensure that the users who use financial statements receive enough and reliable information as they should be.

For example, Assets and Revenue could be recorded unless it is clear that the entity could measure those transactions reliably. In addition, the expenses and liabilities are records at the highest value where assets and revenues are records at the lowest value.

This principle could help to minimize the entity to overstate the revenue and assets and understate the liabilities and expenses in its FS. For example, without using this concept, the accountant could manipulate the accounting records where those transactions are not reliable.

**Example of Conservatism Principle:**

For example, the entity should recognize the liabilities that claim to the employee for the legal case even the entity not sure if they are failing. And the recognition should be at the highest value.

But, the entity should recognize assets for legal claim from an employee unless there is a clear statement from the court.

And if assets are recognized, it should be at the lowest value. In this case, it is helping users of FS to understand all types of liabilities and expenses that probably happen to the entity. And, it assures that the revenues recorded are realistic.

Conservatism principle assumes the entity could possibly try to overstate assets and revenues, and understate expenses and liabilities.

For recognition revenue, Conservatism Principle, the entity could recognize the revenue if the revenue transaction could not measure reliably and the outcome of those transactions are unpredictable.

The conservatism principle does *not* say that accountants are to be super conservative. Accountants should be *fair* and *objective*. The conservatism principle says if there is doubt between two alternatives, the accountant should opt for the one that reports a lesser asset amount or a greater liability amount, and a lesser amount of net income.

Reference :

* www.wikiaccounting.com
* www.coursehero.com