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Accounting Concepts and Conventions

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Accounting Principles are the ideas and the rules followed by all accountants while recording and reporting the business transactions.

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Importance-
1) Standard Rules
2) Objective Rules
3) Reliable Accounts
4) Complete
5) Correct Measurement

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Accounting Concepts

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- The term 'concept' is used to connote accounting postulates, that is necessary assumptions and conditions upon which accounting is based.

These are the theories on how and why certain categories of transactions should be treated in a particular manner.

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Business Entity Concept

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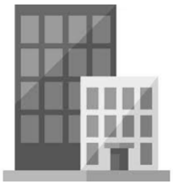
• The business and its owner(s) are two **separate entities**



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The Books Of Accounts are prepared from the point of view of the business

Hence…

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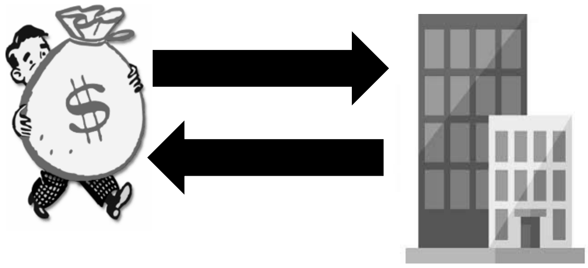

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The Personal Transactions of the Owner are not recorded.

For Example:
A computer purchased by the owner for personal use is not Recorded in the Books Of Account Of the Business.

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Going Concern Concept

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It is assumed that the entity is a going concern, i.e., it will continue to operate for an indefinitely long period in future and transactions are recorded from this point of view.

Hence, we record fixed assets, deferred revenue expenditure and long-term liabilities.

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Money Measurement Concept

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In accounting, a record is made only of those transactions or events which can be measured and expressed in terms of money.

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Non monetary transactions are not recorded in accounting.

~~Innovativeness~~ ~~Attitude~~ ~~Experience~~ ~~skill~~ ~~Team work~~ ~~Honesty~~ ~~Passion~~

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Accounting Period Concept

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For measuring the financial results of a business periodically, the working life of an undertaking is split into convenient short periods called accounting period.

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Revenue Recognition

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Revenue from sales is recognised when the seller has transferred the ownership in the goods to the buyer for a price.

Total revenue includes sales, fees for services, interest on loans given, dividend earned, royalty, etc.

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Cost Concept

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An asset acquired by a concern is recorded in the books of accounts at **historical cost** (i.e., at the price actually paid for acquiring the asset). The **market price of the asset is ignored.**

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Historical Cost Of

2018 2020

Rs.35,000

Market Value Of

Rs.35,000 Rs.25,000

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Dual - Aspect Concept

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For Every Debit, there is a Credit

Every transaction should have a two- sided effect to the extent of same amount

Debit = Credit

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For Example:
Cash Sales Rs. 10,000

Debit
- Cash Account Rs. 10,000

Credit
- Sales Account Rs. 10,000

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For Example:
Purchased From Ram goods worth Rs. 20,000 and discount received Rs. 2,000.

Debit
- Purchases Account Rs. 20,000

Credit
- Ram's Account Rs. 18,000
- Discount Recd. Account 2,000

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This Concept has resulted in

THE ACCOUNTING EQUATION

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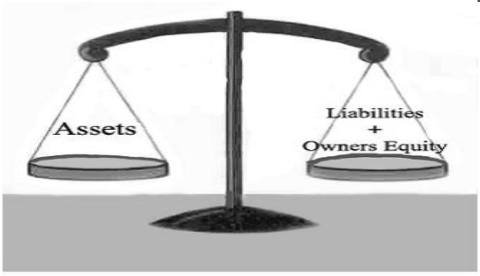

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Accrual

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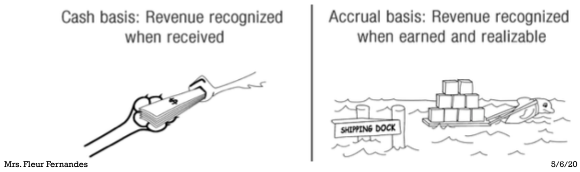
Cash basis - Income recorded when actually received and expense recorded when actually paid

Accrual basis – Income is recorded when it is earned and expense when it becomes payable Both cash and credit transactions are recorded.



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It gives rise to heads like sundry debtors, sundry creditors, accrued income, outstanding expenses.

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Realisation Concept

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Profit is earned when goods or services are **provided / transferred** to customers. Thus it is incorrect to record profit when order is received, or when the customer pays for the goods (advance).

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Matching Concept

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The matching principle ensures that revenues and all their associated expenses are recorded in the **same accounting period**.

The matching principle is the basis on which the **accrual accounting method** of book-keeping is built.

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For Example

Electricity bill paid in 2018-19 relating to 2017-18

Such salary is treated as Expenditure for 2017-18 under **Outstanding Electricity expenses,** not for the year 2018-19

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Accounting Conventions

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Accounting Conventions are the **common practices** which are **universally followed** in recording and presenting accounting information of business. It **helps in comparing** accounting data of different business or of same units for different periods.

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Materiality

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Only those transactions, important facts and items are shown which are useful and material for the business. The firm **need not record immaterial and insignificant items.**

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Illustration:
Company XYZ Ltd. bought 6 months supplies of stationary worth $600.

Question:
Should the Company spread the cost of this stationary for 6 months by expensing off $100 per month to the income statement?

Answer:
Based on this concept, as the amount is so small or immaterial, it can be expensed off in the next month instead of tediously expensing it in the next 6 months.

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Full Disclosure

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Financial Statements and their notes should present all information that is **relevant and material** to the user's understanding of the statements.

The information should be-
Understandable
Relevant
Reliable
Comparable

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Full Disclosure

Circumstances and events that make a difference to financial statement users should be disclosed.

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Conservatism

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Anticipate No ~~Profits~~ but Provide for all Losses

Record only actual income and not expected income. But record both actual and expected losses.

Accountant should always be on side of safety.

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For Example

- Making Provision for Bad and Doubtful Debts
- Showing Depreciation on Fixed Assets, but not appreciation
- Valuation of closing stock at cost price or market price, whichever is lower.

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Consistency

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The accounting practices and methods should remain consistent from one accounting period to another.

Whatever accounting practice is followed by the business enterprise, should be followed on a consistent basis from year to year.

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However, a firm can change the accounting methods according to the changed circumstances of the business.

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For Example

Year	2009-10	2010-11	2011-12
Method of Depreciation followed	Straight Line Method	Written Down Value Method	Units of Measure Method

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Objectivity Concept

Accounting transactions should be recorded in an objective manner, free from the personal bias of either management or the accountant who prepares the accounts.

It is possible only when each transaction is supported by verifiable documents & vouchers such as cash memos, invoices.

Thank you