# Accounting Concepts, Principles and Conventions

## 1. Introduction

- Accounting is language of business. financial statements prepared by entities to communicate financial information to various stakeholders for decision making purpose. Now, if every entity starts following his own norms for accounting of different items, then there will be complete confusion.

- To avoid confusion and to acheive uniformity, accounting process is applied within the conceptual framework of GAAP i.e. Generally Accepted Accounting Principles. The term GAAP is used to describe rules developed for the preparation of financial statements are called Concepts, Conventions, Principles, etc.

## 2. Accounting Principles

- Accounting principles are basic norms and procedure which are followed universally at the time of recording of various transactions and events.

- There are two categories of Accounting Principles -
  - i) Accounting concepts
  - ii) Accounting conventions

## 3. Accounting Concepts

- These are the assumptions on the basis of which financial statements of an entity are prepared. followings are the various accounting assumptions -

### a. Entity Concept

Entity concepts states that business entity is separate from its owners. Business transactions are recorded in books of account of business and owner's transactions in his personal Books of Account.

It means entity is liable to the owner for capital investment made by the owner. Since owner is taking risks, he will also be entitled to the Profit of business.

- Due to this concept only, Capital (including Profit) is Liability for business.

b. Money Measurement Concept

As per this concept, only those transactions, which can be measured in terms of money, can be recorded in books of account.

c. Going concern Concept

- The financial statements are normally prepared on the assumption that an enterprise is a going concern and will continue its operations for forseeable future. It means entity has neither the intention nor the need to liquidate the business.

- If such intention or need exists, then the financial statements may have to be prepared on different basis and if so, the basis should be disclosed.

d. Periodicity Concept

- As per going concern Concept an indefinite life of entity is assumed. So, a small but workable fraction of time is Choosen out of infinite life cycle of the business entity for measuring performance.

- Generally, one year period is taken as accounting Period but it may be of less than one year in case of first and last year of business.

## e. Accrual Concept

Revenue and Expenses should be recognised in the period in which they are earned or incurred and not when money is received or paid.

## f. Matching Concept

As per this concept, if any revenue is being recognised in the financial statement then expense incurred to earn that revenue should also be recognised to get correct profit earned.

## g. Cost Concept

As per this concept, value of an asset is to be determined on the basis of historical or acquisition cost.

## h. Realisation Concept

This concept closely follows the cost concept. Any change in the value of an asset is to be recorded only when the business realises it.

## i. Full Disclosure Concept

This concept require a business to report all necessary information about their financial statements and other relevant information to the stakeholders.

## J. Dual Aspect Concept

Every transaction has two effects. This concept is core of Double entry system-

- It increases one asset and decreases another asset.
- It increases an asset and simultaneously increases a liability.
- It decreases one asset and decreases a liability.
- It increases one liability and decreases other liability.
- It increases a liability and increases in an asset.

## 4. Accounting Conventions

- Accounting conventions emerge out of accounting practices adopted, commonly known as accounting principles, adopted by various organisation over a period of time. Following are some accounting conventions

### a. Principle of Conservatism / Prudence Concept

- It states that the accountant should not anticipate any future income but should make provision for all possible losses. It is not prudent to count unrealised gain but it is desirable to guard against all losses.

### b. Consistency Concept

In order to acheive comparability of financial statement, the accounting policies are followed consistently from one period from one period to another. A change in accounting policy is made only in certain exceptional circumstances.

### c. Materiality Concept

Materiality permits other concepts to be ignored, if the effect is not considered material. This principle is an exception to full disclosure concept.

## Adjustment Entries

1. Salaries outstanding ₹ 10,000

2. Rent Prepaid ₹ 15000

3. Fee accrued and due but not received ₹ 30,000

4. Fee received in advance ₹ 20,000.

5. **Fundamental Accounting Assumptions**

- Going Concern
- Accrual
- Consistency.