Accounting: concepts and conventions

Accounting Concepts, Conventions, Bases & Policies

- Concepts vs Conventions

Concepts are the basic ideas, the theories on how and why certain categories of transactions should be treated in a particular manner.

Once the theories have been established and tested and proved to be acceptable, the task of the C**onventions** is to set out the limit of their applications.

Accounting Concepts

- 1. Business Entity Concept – business is a separate entity.
- 2. Money Measurement Concept – money common denominator of measurement.
- 3. Going Concern Concept – perpetual succession.
- 4. Accounting Period Concept – pre-determined periodicity generally an year.
- 5. Cost Concept – an asset’s cost is the basis of all subsequent accounting.

Accounting Concepts

- 6. Realisation Concept – revenue should be recognized “when it is earned”.
- 7. Matching Concept – associating the cause and effect relationship of revenues and expenses.
- 8. Accrual Concept – similar to matching, period should be decided on the basis of accrual.
- 9. Dual Aspect Concept – 2 aspects must be examined – the giving and the receiving.

Accounting Conventions

- 1. Consistency – method once adopted should be followed.
- 2. Disclosure – all relevant facts concerning financial position must be communicated to users.
- 3. Materiality – concerned with significant information.
- 4. Objectivity – unbiased and subject to verification by external expert.
- 5. Stable Monetary Unit – the Indian Rupee.
- 6. Conservatism or Prudence – when in doubt, choose the solution that is least likely to overstate net assets and net income for the current period.

Some Important Terminology Of Accounting

- ***Assets :*** **The economic resources which are owned by a business and are expected to benefit future operations. Assets may have definite physical form, such as buildings, machinery or merchandise.**

- ***Equity :*** **this is the claim against the assets owned by the business. Equities or claim against the assets indicate the sources from which the assets of a business were obtained.**

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Liabilities **: liabilities are the debts owed by a business to out side parties (called creditors). This includes amount owed to suppliers for goods or services purchased amount borrowed from banks or other lenders, salaries and taxes due but not paid.**

Net worth **: the term net worth, proprietorship, owner's investment, or capital– all have the same meaning in accounting : namely, the owner's equity or interest in the assets of the business. It is the difference between what the business owns and what it owes.**

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- *Revenue :* It may be defined as the inflow of cash assets resulting from the sale of goods and services in the ordinary course of business. For eg., interest received on investments, commission received, rent received etc. Revenue cause an increase in capital.

- *Expenses :* it may be defined as the cost of the goods and services used up in the process of obtaining revenue. Example include - the cost of goods sold, wages and salaries of employees, charges for news paper, advertising etc.