SUBJECT— FINANCIAL ACCOUNTING

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BY::

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ACCOUNTING CONCEPTS AND CONVENTIONS

INTRODUCTION<u>**…ACCOUNTING CONCEPTS AND CONVENTIONS CAN BE UNDERSTOOD WELL ONLY IF WE ARE ABLE UNDERSTAND THE MEANING AND PRINCIPLES OF ACCOUNTING**</u>

<u>**CONCEPTS AND COVENTIONS ARE MADE IN ORDER TO BRING IN UNIFORMITY IN THE PRACTICE OF ACCOUNTING THROUGHOUT THE WORLD**</u>

MEANING AND FEATURES OF ACCOUNTING PRINCIPLES

For searching the goals of the accounting profession and for expanding knowledge in this field, a logical and useful set of principles and procedures are to be developed. We know that while driving our vehicles, follow a standard traffic rules. Without adhering traffic rules, there would be much chaos on the road. Similarly, some principles apply to accounting. Thus, the accounting profession cannot reach its goals in the absence of a set rules to guide the efforts of accountants and auditors. The rules and principles of accounting are commonly referred to as the conceptual framework of accounting.

ACCOUNTING PRINCIPLES

. The term ‘Concept’ is used to connote the accounting postulates, i.e., necessary assumptions and ideas which are fundamental to accounting practice. In other words, fundamental accounting concepts are broad general assumptions which underline the periodic financial statements of business enterprises. The reason why some of the these terms should be called concepts is that they are basic assumptions and have a direct bearing on the quality of financial accounting information. The term ‘convention’ is used to signify customs or tradition as a guide to the preparation of accounting statements. The following are the important accounting concepts and conventions:

Accounting Concepts Accounting Conventions

♦Separate Business Entity

♦Convention of Materiality

♦Convention of Conservatism

♦Convention of consistency

♦Money Measurement Concept

♦Dual Aspect Concept

♦Going Concern Concept

♦Accounting Period Concept

♦Cost Concept

♦The Matching Concept

♦Accrual Concept

♦Realisation Concept

ACCOUNTING CONCEPTS

The more important accounting concepts are briefly described as follows:

1. Separate Business Entity Concept. In accounting we make a distinction between business and the owner. All the books of accounts records day to day financial transactions from the view point of the business rather than from that of the owner. The proprietor is considered as a creditor to the extent of the capital brought in business by him. For instance, when a person invests Rs. 10 lakh into a business, it will be treated that the business has borrowed that much money from the owner and it will be shown as a 'liability' in the books of accounts of business.

2. Money Measurement Concept. In accounting, only those business transactions are recorded which can be expressed in terms of money. In other words, a fact or transaction or happening which cannot be expressed in terms of money is not recorded in the accounting books. As money is accepted not only as a medium of exchange but also as a store of value, it has a very important advantage since a number of assets and equities, which are otherwise different, can be measured and expressed in terms of a common denominator.

3. Dual Aspect Concept. Financial accounting records all the transactions and events involving financial element. Each of such transactions requires two aspects to be recorded. The recognition of these two aspects of every transaction is known as a dual aspect analysis. According to this concept every business transactions has dual effect. For example, if a firm sells goods of Rs. 10,000 this transaction involves two aspects. One aspect is the delivery of goods and the other aspect is immediate receipt of cash (in the case of cash sales). Infact, the term ‘double entry’ book keeping has come into vogue because for every transaction two entries are made . This idea is fundamental to accounting and could be expressed as the following equalities:

Assets = Liabilities + Owners Equity ....(1)

Owners Equity = Assets - Liabilities ....(2)

The above relationship is known as the ‘Accounting Equation’

4. Going Concern Concept. Accounting assumes that the business entity will continue to operate for a long time in the future unless there is good evidence to the contrary. The enterprise is viewed as a going concern, that is, as continuing in operations, at least in the foreseeable future

5. Accounting Period Concept. This concept requires that the life of the business should be divided into appropriate segments for studying the financial results shown by the enterprise after each segment.

6. Cost Concept. The term ‘assets’ denotes the resources land building, machinery etc. owned by a business. The money values that are assigned to assets are derived from the cost concept. According to this concept an asset is ordinarily entered on the accounting records at the price paid to acquire it.

7. The Matching concept. This concept is based on the accounting period concept. In reality we match revenues and expenses during the accounting periods. Matching is the entire process of periodic earnings measurement, often described as a process of matching expenses with revenues.

8. Accrual Concept. It is generally accepted in accounting that the basis of reporting income is accrual. Accrual concept makes a distinction between the receipt of cash and the right to receive it, and the payment of cash and the legal obligation to pay it. This concept provides a guideline to the accountant as to how he should treat the cash receipts and the right related thereto.

ACCOUNTING CONVENTIONS

1. Convention of Materiality. Materiality concept states that items of small significance need not be given strict theoretically correct treatment. Infact, there are many events in business which are insignificant in nature. The cost of recording and showing in financial statement such events may not be well justified by the utility derived from that information.

2. Convention of Conservatism. This concept requires that the accountants must follow the policy of ‘’playing safe” while recording business transactions and events. That is why, the accountant follow the rule anticipate no profit but provide for all possible losses, while recording the business events. This rule means that an accountant should record lowest possible value for assets and revenues, and the highest possible value for liabilities and expenses.

QUESTIONS (TO BE SENT ON WHATSAPP)

1. State whether the following statements are true or false

a) The 'materiality concept' refers to the state of ignoring small items and values from accounts.

b) Accounting principles are rules of action or conduct which are adopted by the accountants universally while recording accounting transac tions.

c) The 'separate entity concept' of accounting is not applicable to sole trading concerns and partnership concerns.

d) The 'dual aspect' concept result in the accounting equation: Capital+Liabilities = Assets.

e) The 'conservatism concept' leads to the exclusion of all unrealised profits.

f) The balance sheet based on 'Cost concept' is of no use to a potential investor.

g) Accounting standards are statements prescribed by government regulatory bodies.

h) Accounting statements are statements prescribed by professional accounting bodies.

i) Accounting concepts are broad assumptions.