Accounting Concepts, principles & conventions

To maintain uniformity and consistency in prepairing and maintaining books of accounts. We need to understand the concepts, principles & conventions.

Generally Accepted Accounting Principles (GAAP)

Defination by AICPA: A general law or rule adopted by or professed as a guide to action, as ettled ground or basis of conduct or practice.

International Financial Reporting Standards : issued by International Accounting Standard Boards.

→ vare set of international accounting standard stating how particular types of transactions vand other events should be reported in financial statements.

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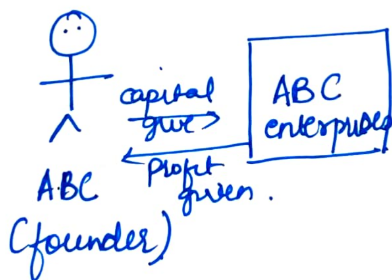
Concepts

Business entity concept:



The company/enterprise is separated from the owner.
All the transaction are from the point of view of ABC enterprises

* private expenses of owner cannot be added as expenses of bussiness.
There is a boundary between the two

Money measurement concept: states that only those transaction and happening in an organisation which can be expressed in terms of money are to be recorded in the books account.

eg sales of product, expenses of raw material included but appointment of manager, research done by org not included.

→ This concepts gives idea to accountants what to add and what not to add in the books of accounts.

going concern concept: it assumes that business firm would carry out its functions indefinately.

eg. computer bought with life of 5 years & price 50,000. The expense will be 50000/5 → 10000 for every year, not 50000 for 1st year.

On this concept: depreciation is charged.

Accounting period concept: The time period for which books of accounts are made. This to make easy comparison within different periods of organisation and comparison among organisations. eg: One can't compare two year period with three year.

Companies Act 1956 provided financial year starting from 1 April and ends on 31st March.

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Accounting Cost concept: states that all assets are recorded in the books of accounts at their purchase price, which includes cost of acquisition, transportation & installation not only the market price.

Cost means original or acquisition cost for new assets only. for used ones cost → original cost — depreciation. This cost concept is called historical cost concept.

Note: To be continued in next pdf.

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Accounting concepts part 2

In the ~~acc~~ last part we were discussing accounting concepts. This pdf is second part of it.

<u>Dual Aspect Concept</u>: It states that every transaction has a dual or two fold effect and should therefore be recorded at two places.

eg. Anil Nagar started Adda247 by investing a sum of Rs 50,00,000. The amount of money brought in by Anil Nagar will result in an increase in the assets (cash) of business as we as equity of owner or capital will also increase.

Assets = Liabilities + Capital

Dual aspect concept based on the above formula.

Lets see the effect of various transaction on this equation

Transaction	Assets	Liabilities	Capital
Capital brought by owner	↑ in assets		↑ in capital
Purchase of machinery	↑ in assets ↓ in Bank balance		
Rent paid in cash	↓ in cash.	↓ liabilities	

each transaction has two effects. as can be seen through the table

This concept helps in detecting errors.

<u>Revenue Recognition (Realisation) Concept</u>: Revenue from any business transaction should be included in the accounting records only when it is realised.

Realisation means creation of legal right to recieve money. Selling goods is realisation, recieving order is <u>not</u>.

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Accrual concept: Revenues are recognised when they become receivable. The meaning of accrual is something that becomes due especially an amount of money that is yet to be paid or received at the end of the accounting period.

Matching concept: The process of ascertaining the amount of profit earned or the loss incurred during a particular period involves deduction of related expenses from the revenue earned during that period.

Conservation concept: requires that profit should not be recorded until realised but all losses, even those which may have a remote possibility, are to be provided for in the books of account.

Note: Deliberate attempt to underestimate the value of assets should be discouraged as it will lead to hidden profits called secret reserves.

Consistency concept: To compare various balance sheet, it is important to use the same rules, accounting policies & practices followed by, enterprises. are uniform and consistent over the period of time.

Full disclose concept: giving full information about the financial health of the company.

Objectivity concept: It requires that accounting transaction should be recorded in an objective manner. This can be possible when each of the transaction is supported by verifiable documents or vouchers.

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Convention of materiality: It states that to make financial statements meaningful, only material fact i.e. important and relevant information should be supplied to the users of accounting information

Accounting

Classification of Accounts

Classification is done by different approaches

① Traditional Approach/ British approach.

There are three accounts

1. Real accounts
2. Nominal accounts } → Impersonal accounts.
3. personal accounts

Personal accounts : are accounts that are used to record transactions relating to individual persons, firms, companies or other organisations

Types

1. Natural persons : accounts belonging to humans
2. Artificial persons : These are those persons who are not human beings but can act & work like humans eg Hindu undivided families, cooperative societies.
3. Representative persons.

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Real accounts : exist even after the end of accounting period. For the next accounting period, these accounts start with a non-zero balance, which is carried forward from the previous accounting period.

Types

(a) Tangible Real accounts : It comprises of those assets, properties or possessions that one can touch, see and measure. eg Building a/c, Furniture a/c

Intangible real account : It comprises of those assets or possessions that one cannot touch, see or measure. But these possess a monetary value. eg goodwill, Patents, Copyrights, Trademarks etc.

Nominal accounts : are closed at the end of the accounting period. For the next account period, these accounts start with a zero balance. These are temporary accounts. eg expenses, losses, incomes & gains.

These data can be used to prepare income statements or trading & profit & loss accounts. For this reason they are referred to as income statement accounts.

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Classification of Accounts under the modern (or American) Approach.

There are five types under this classification

1. Asset accounts : eg: land a/c, machinery a/c. cash a/c.
2. Liability a/c : eg loan a/c, accounts payable a/c, rent payable a/c.
3. Revenue a/c : eg sales a/c, service revenue a/c
4. Expense a/c : eg wage expense account, commission expense a/c.
5. Capital / owner equity a/c :