# Accounting concepts and conventions

# ACCOUNTING CONCEPTS

- Business entity concept
- Money measurement concept
- Going concern concept
- Accounting period concept
- Accounting cost concept
- Dual aspect concept
- Matching concept
- Realisation concept
- Accrual concept

# ACCOUNTING CONCEPTS

- Accounting concepts define the assumptions on the basis of which financial statements of a business entity are prepared.
- Concepts are those basic assumptions and condition  which form the basis upon which the accountancy has been laid.

# Business entity concept

This concept assumes that, for accounting purposes, the business enterprise and its owners are two separate independent entities. Thus, the business and personal transactions of its owner are separate. For example, when the owner invests money in the business, it is recorded as liability of the business to the owner. Similarly, when the owner takes away from the business cash/goods for his/her personal use, it is not treated as business expense.

# Money measurement concept

- This concept assumes that all business transactions must be in terms of money, that is in the currency of a country. In our country such transactions are in terms of rupees. Thus, as per the money measurement concept, transactions which can be expressed in terms of money are recorded in the books of accounts. For example, sale of goods worth Rs.200000, Rent Paid Rs.10000 etc. are expressed in terms of money, and so they are recorded in the books of accounts. But the transactions which cannot be expressed in monetary terms are not recorded in the books of accounts.
- For example, sincerity, loyality are not recorded in books of accounts because these cannot be measured in terms of money although they do affect the profits and losses of the business concern.

# Going concern concept

- This concept states that a business firm will continue to carry on its activities for an indefinite period of time. Simply stated, it means that every business entity has continuity of life. Thus, it will not be dissolved in the near future. This is an important assumption of accounting, as it provides a basis for showing the value of assets in the balance sheet.

# Accounting period concept

- **All the transactions are recorded in the books of accounts on the assumption that profits on these transactions are to be ascertained for a specified period. This is known as accounting period concept. Thus, this concept requires that a balance sheet and profit and loss account should be prepared at regular intervals. This is necessary for different purposes like, calculation of profit, ascertaining financial position, tax computation etc.**

# Accounting cost concept

- **It states that all assets are recorded in the books of accounts at their purchase price, which includes cost of acquisition, transportation and installation and not at its market price. It means that fixed assets like building, plant and machinery, furniture, etc are recorded in the books of accounts at a price paid for them.**

# Dual aspect concept

- Dual aspect is the foundation or basic principle of accounting. It provides the very basis of recording business transactions in the books of accounts. This concept assumes that every transaction has a dual effect, i.e. it affects two accounts in their respective opposite sides. Therefore, the transaction should be recorded at two places. It means, both the aspects of the transaction must be recorded in the books of accounts. Thus, the duality concept is commonly expressed in terms of fundamental accounting equation :

  Assets = Liabilities + Capital

# Matching concept

- **The matching concept states that the revenue and the expenses incurred to earn the revenues must belong to the same accounting period. So once the revenue is realised, the next step is to allocate it to the relevant accounting period. This can be done with the help of accrual concept** If the revenue is more than the expenses, it is called profit. If the expenses are more than revenue it is called loss. This is what exactly has been done by applying the matching concept.

.. Therefore, the matching concept implies that all revenues earned during an accounting year, whether received/not received during that year and all cost incurred, whether paid/not paid during the year should be taken into account while ascertaining profit or loss for that year.

- Significance

1. It guides how the expenses should be matched with revenue for determining exact profit or loss for a particular period.
2. It is very helpful for the investors/shareholders to know the exact amount of profit or loss of the business.

# Realisation concept

- This concept states that revenue from any business transaction should be included in the accounting records only when it is realised. The term realisation means creation of legal right to receive money. Selling goods is realisation, receiving order is not. In other words, it can be said that : Revenue is said to have been realised when cash has been received or right to receive cash on the sale of goods or services or both has been created.
- The concept of realisation states that revenue is realized at the time when goods or services are actually delivered.

- Let us study the following examples
- A Jeweller received an order to supply gold ornaments worth Rs.500000. They supplied ornaments worth Rs.200000 up to the year ending 31st December 2005 and rest of the ornaments were supplied in January 2006. The revenue for the year 2005 for a Jeweller is Rs.200000. Mere getting an order is not considered as revenue until the goods have been delivered.

- Bansal sold goods for Rs.1,00,000 for cash in 2006 and the goods have been delivered during the same year

The revenue for Bansal for year 2005 is Rs.1,00,000 as

# Accrual concept

- 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. It means that revenues are recognised when they become receivable. Though cash is received or not received and the expenses are recognised when they become payable though cash is paid or not paid. Both transactions will be recorded in the accounting period to which they relate.

# Contd….

- **Therefore, the accrual concept makes a distinction between the accrual receipt of cash and the right to receive cash as regards revenue and actual payment of cash and obligation to pay cash as regards expenses. The accrual concept under accounting assumes that revenue is realised at the time of sale of goods or services irrespective of the fact when the cash is received.**

# ACCOUNTING CONVENTIONS

- Consistency
- Full Disclosure
- Materiality
- Conservatism

# ACCOUNTING CONVENTION

- An accounting convention refers to common practices which are universally followed in recording and presenting accounting information of the business entity. Conventions denote customs or traditions or usages which are in use since long. To be clear, these are nothing but unwritten laws. The accountants have to adopt the usage or customs, which are used as a guide in the preparation of accounting reports and statements. These conventions are also known as doctrine.

# Convention of consistency

- The convention of consistency means that same accounting principles should be used for preparing financial statements year after year. A meaningful conclusion can be drawn from financial statements of the same enterprise when there is comparison between them over a period of time. But this can be possible only when accounting policies and practices followed by the enterprise are uniform and consistent over a period of time. If different accounting procedures and practices are used for preparing financial statements of different years, then the result will not be comparable.

# Convention of full disclosure

Convention of full disclosure requires that all material and relevant facts concerning financial statements should be fully disclosed. Full disclosure means that there should be full, fair and adequate disclosure of accounting information. Adequate means sufficient set of information to be disclosed. Fair indicates an equitable treatment of users. Full refers to complete and detailed presentation of information. Thus, the convention of full disclosure suggests that every financial statement should fully disclose all relevant information. Let us relate it to the business.

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**The business provides financial information to all interested parties like investors, lenders, creditors, shareholders etc. The shareholder would like to know profitability of the firm while the creditor would like to know the solvency of the business. In the same way, other parties would be interested in the financial information according to their requirements. This is possible if financial statement discloses all relevant information in full, fair and adequate manner.**

# Convention of materiality

- The convention of materiality 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. The question that arises here is what is a material fact. The materiality of a fact depends on its nature and the amount involved. Material fact means the information of which will influence the decision of its user.

# Convention of conservatism

- This convention is based on the principle that "Anticipate no profit, but provide for all possible losses". It provides guidance for recording transactions in the books of accounts. It is based on the policy of playing safe in regard to showing profit .
- The main objective of this convention is to show minimum profit. Profit should not be overstated. If profit shows more than actual, it may lead to distribution of dividend out of capital. This is not a fair policy and it will lead to the reduction in the capital of the enterprise.

# Contd……

**Thus, this convention clearly states that profit should not be recorded until it is realised. But if the business anticipates any loss in the near future provision should be made in the books of accounts for the same**.

. For example, valuing closing stock at cost or market price whichever is lower, creating provision for doubtful debts, discount on debtors, writing off intangible assets like goodwill, patent, etc. The convention of conservatism is a very useful tool in situation of uncertainty and doubts.


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