Accounting Concepts

Accounting concept means the **basic rule or idea** accountants follow when preparing financial statements.

Accounting Concepts

✅ **Going Concern**
A business is assumed to continue operating in the foreseeable future.
➡️ Assets and liabilities are recorded on the basis that the company will not close down soon.

✅ **Accrual Accounting**
Transactions are recorded when they occur, not when cash is received or paid.
➡️ Income is recognized when earned, and expenses when incurred.

✅ **Materiality**
Only information that can influence users' decisions should be included.
➡️ Small insignificant items can be ignored or simplified in reporting.

✅ **Offsetting**
Assets and liabilities or income and expenses should not be set off against each other unless a standard allows it.
➡️ For example, debtor balances cannot be offset against creditor balances.

✅ **Consistency**
The same accounting methods should be used from one period to another.
➡️ This allows comparison of financial statements over time.

Accounting Concepts

✅ **Prudence**
Do not overstate assets or income, and do not understate liabilities or expenses.
➡️ Example: record doubtful debts as an expense.

✅ **Duality**
Every transaction has two sides – debit and credit.
➡️ Example: Buying furniture for cash increases furniture (asset) and decreases cash (asset).

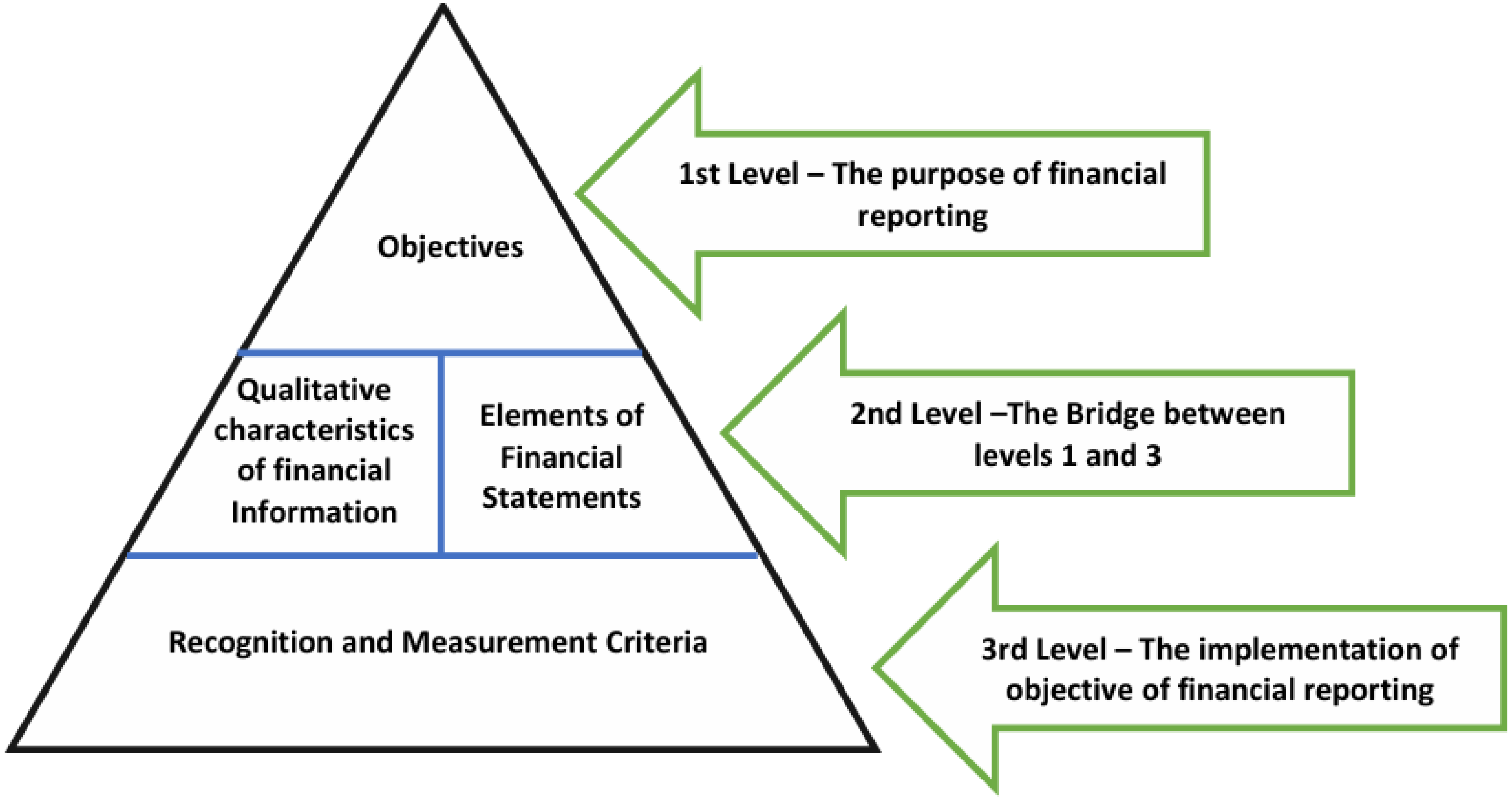
✅ **Business Entity**
The business and its owner(s) are treated as separate.
➡️ Owner's personal transactions are not mixed with business accounts.

✅ **Historical Cost and Current Value**
Assets are usually recorded at the price paid (historical cost), but sometimes shown at fair/current value.
➡️ Example: Land at purchase price (historical cost), investments at market value (current value).

✅ **Substance over Form**
Transactions should be recorded based on their economic reality, not just legal form.
➡️ Example: Assets taken on finance lease are shown as owned, even if legally not.

Conceptual Framework

A set of rules which helps to make functions and limitations of financial accounting and financial statements are known as conceptual framework



Objective of the Conceptual Framework

The main objective is to **provide a foundation for accounting standards** and to help in preparing financial statements that give useful information.

Key purposes:

- To help **develop consistent accounting standards**.
- To guide **preparers of financial statements** when no specific standard applies.
- To assist **users (investors, lenders, others)** in understanding and interpreting financial reports.
- To promote **comparability, transparency, and accountability** in financial reporting.

IASB Framework identifies the **going concern** as the underlying assumption of financial reporting.

Elements of Financial Statements

ASSET

An asset is an economic resource controlled by the entity as a result of past transactions / events and form which future economic benefits are expected to flow to the entity.

LIABILITY

A liability is a present obligation of the entity arising from past transactions / events. The settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

EQUITY

Equity is the residual interest in the assets the entity after deducting all its liabilities.

INCOME

Income is increased in economic benefits during the accounting period in the form of inflows or increases of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants.

EXPENSE

Expenses are decreases in economic benefits during the accenting period in the form of outflows of assets or incurrence of liabilities that result in decreases in equity, other than those relating to distribution to equity participants.

Qualitative Characteristics

Qualitative Characteristics

Fundamental Qualitative Characteristics

1. Relevance
   - Materiality
   - Predictive value
   - Confirmatory value
2. Faithful Representation
   - Complete
   - Neutral
   - Free from Errors

(b) Enhancing Qualitative Characteristics

3. Verifiability
4. Understandability
5. Comparability
6. Timeliness

Fundamental Qualitative Characteristics

1. Relevance

Relevant financial information is capable of making a difference in the decision made by use$If financial information is to be useful it must consist following sub characteristics.

- Predictive value
  (Financial information should help users make forecasts or predictions about future outcomes)
- Confirmatory value
  (It should confirm or validate expectations or previous assessments of financial performance)
- Materiality
  (Information should be significant enough to influence the decisions of its users)

2. Faithful representation

Economic phenomena represented in financial reports should be faithfully presented. To be a perfectly faithful representation a depiction would have following characteristics.

- Complete
  (All necessary information is included, with nothing important omitted)
- Neutral
  (Information is presented without bias or influence toward a particular outcome)
- Free from error
  (The information is accurate and contains no mistakes or inaccuracies)

Enhancing Qualitative Characteristics

Comparability

If data of one entity can be compared with similar information about another entity's and with similar information about the same entity for another period is known as comparability.

Verifiability

Means that financial information can be checked and confirmed by different people to ensure that it accurately represents what it claims to show.

Timeliness

Timeliness means having information available to decision making in time to be capable of influencing their decisions.

Understandability

Presenting information clearly and concisely makes it understandable to the use$

Recognition and Measurement of Elements of Accounts

Recognition Criteria of The Elements of Accounts

An element is recognized in the financial statements if it meets all of the following:

- It meets the definition of an element
- Entity will get or give up future economic benefits.
- Value that can be measured reliably (e.g. skilled employees value cannot be measured).

Recognition and Measurement of Elements of Accounts

Measurement of The Elements of Accounts

Measurement Basis	Meaning	Example
Historical Cost	Original purchase price of an asset	Machinery bought for $500,000 shown at $500,000
Current Cost	Cost to replace the asset today	Same machinery now costs $650,000 to buy
Fair Value	Price received to sell an asset or paid to transfer a liability in the market	Land valued at $2,000,000 in current market
Value in Use / Present Value	Present value of future cash flows from using the asset	Machine expected to generate $800,000 today
Realizable (Net Realizable) Value	Amount expected from sale after deducting costs to sell or complete	Inventory sells for $100,000, costs $15,000 → NRV = $85,000
Settlement Value	Amount needed to settle a liability	Loan repayment of $1,200,000 due