... actual physical existence.

C- Accounting Concepts, Conventions and Principles, Accounting Standards, Concepts and Objectives

C-1 Meaning and Importance of Accounting concepts

Book keeping and Accountancy is an art of recording, classifying and summarizing transactions of business concern in a systematic manner. If there is no uniformity in the principles followed by different business organization while preparing accounts, nobody will be in a position to interpret the financial statements and draw the conclusions. Auditors will also find it difficult to check the accounts without knowing the principles followed while preparing the same. Therefore accounting principles are those rules which are to be adopted by the accountants.

These generally accepted accounting principles are confirming established practices and procedures in terms of recording transactions. These principles are usually developed by professional accounting bodies.

Meaning of Accounting Concept :- Accounting is the language of business. In the absence of systematic approach, accountants may use their own language and it may not be understood in the same sense by all concerned parties. With a view to make accounting language a standard language, certain accounting concepts have been developed over a course of period. Accounting concepts are general guidelines for sound accounting practices.

Importance of Accounting Concepts :-

1) Reliable financial statements
2) Uniformity in presentation
3) Generally acceptable basis of measurement
4) Proper information to all
5) Valid and appropriate assumptions

Some of the important concepts are as follows :

C-2 Business Entity

The business unit is separate from its owner is the basic meaning of entity. Under this concept sole trading concern and sole proprietor are treated as two different entities. According to the concept only business transactions are recorded in the business books of accounts. Proprietor's personal transactions are not recorded in the business books of accounts.

e.g.: Half of the building is used for business office and other half of the building is used for the residence of the proprietor. If the total rent of the building is ₹ 40,000 then only ₹ 20,000 will be deducted as drawings from proprietor's capital.

Why proprietor's personal transactions are not recorded in business books of accounts ?

C-3 Money Measurement :

There is a need to express business transactions in common unit of measurement. Every transaction is recorded in terms of money. In India all the accountants use only Indian currency i.e. 'Rupee' (₹) Because of this concept only monetary items are recorded.

e.g.: A businessman owns following properties
Land 20,000 Sq. Mtrs. Cost ₹ 5,00,000, Building 40 Rooms, Cost ₹ 7,00,000,
Raw Material 4 Tonnes, Cost ₹ 4,00,000

Here total assets will be recorded by common unit of money measurement and will be valued at ₹16,00,000/- in the books of accounts.

C-4 Cost Concept :

An asset is recorded in the books at the value of its price paid at the time of its purchase and the cost paid will be the base for all further accounting. The said asset may have different value in future as realizable value or replacement value or latest value or present value or recording of fixed asset and current assets at their proper values.

e.g.: Building is purchased for ₹ 5,00,000/- and same cost has been recorded in the books. In case the market value goes to ₹ 1,50,000/- or ₹ 2,00,000/- It will not be considered.

C-5 Consistency Concept :

Any policy adopted for accounting should be continuous or consistent throughout the business and it need not be changed generally unless and until circumstances demand. However it does not stop any improvement of new techniques. But that should be disclosed with a note.

e.g.: A company adopts fixed installment method for charging depreciation on fixed asset from the beginning till the end of estimated life of asset.

C-6 Conservatism

While recording the business transactions we have to anticipate no profit but provide for all possible losses. It encourages the certain secret reserves by making excess provision to prevent losses. The income statement may show lower income and the Balance Sheet overstates the liabilities and understates the assets. This policy of recording is asking the accountant 'to play safe' while writing the accounts.

e.g.: The closing stock in the factory is valued at ₹ 25,000/- at cost price and ₹ 35,000/- at its market price. But while recording in the books the value of ₹ 25,000/- will be considered being the lowest of all.

C-7 Going Concern :

It is the basic assumption that business will continue for a quite long time, it will go on and on and will not be closed down or stopped for a quite long time. Business is not to be closed at its early stage but should give a long life. This principle helps many investors to invest, many suppliers to give credit, many workers or employees to give services.

e.g.: A stall for marketing of any product or introduction of new product of any business has to be closed immediately after the exhibition is over. But once the business is set up, it continues for a long time.

C-8 Realization :

Income is recorded only when it is realized i.e. either it is received or earned. Revenues are recorded only when sales are affected or the services are rendered. Sales revenues are considered as recognized when sales are effected during the accounting period irrespective of the fact whether cash is received or not.

e.g.: 1) A company gets an order for sale of goods ₹ 1,00,000/- in May 2011 goods of only ₹ 60,000/- are sold and delivered in June 2011. Cash is received for ₹ 60,000/- in Sept., 2011. As per the principle of realization, sale is to be recorded in June 2011.

2) A businessman purchased 2 washing machines from manufacturers for ₹ 15,000/- each. One out of two is sold for ₹ 17,000/- and earned a profit of ₹ 2,000/-. The other one is not sold out but still he can't anticipate and record a profit of ₹ 2,000/- on the second machine unless and until a sale is realized.

C-9 Accrual :

Income is recorded when it accrues (earned) and expenses are recorded when they accrue (become payable) All expenses and revenues related to the accounting period are to be considered irrespective of the fact the revenues are received in cash or not or expenses are paid in cash or not.

e.g.: A company invested ₹ 1,00,000 with a bank for one year on 1st Oct, 2010. Bank has to pay interest at 10% p.a. on its maturity i.e. on 30th Sept. 2011
As per the principle of accrued interest of 6 months is ₹ 5,000 (1,00,000 x 10 / 100 x 6/12) to be shown as "Interest Accrued" on the credit side of Profit and Loss Account during financial year 1st April 2010 to 31st March 2011.

C-10 Dual Aspect :

Every business transaction has two effects and involves exchange of benefits. Benefit received and benefit given both the aspects should be recorded in the books. The system which records such dual aspects in the books is known as Double Entry System.

This principle also considered as the concept of debit and credit. The account where the benefit comes in is debited and the account where benefit goes out is credited.

e.g.: A proprietor invested ₹1,00,000 into the business. At one side business gets asset (Cash) ₹1,00,000 /- and the other side business owes ₹1,00,000 /- as capital to the proprietor. Thus, all the debit in the ledger will be equal to all the credits.

C-11 Disclosure :

The accounts must disclose all material information. The accounting reports should disclose full and fair information to the related parties. The financial position and performance should be disclosed very honestly to all the users. The financial position means the Balance Sheet of the business and financial performance means business results in terms of profits or losses and income and expenses in profit and loss account.

All the information disclosed should be relevant, reliable, comparable and understood by all the concerned authorities.

C-12 Materiality :

It will be very much uneconomical to record small details in accounting. As per this principle relatively important and significant monetary matters are to be recorded. This concept essentially relates to the time, efforts and cost of accounting in relation to the utility of date related. Only those items should be recorded and disclosed in financial statements which have value / weightage on the determination of financial condition. Unimportant items are either left out or merged with other items or shown as foot notes.

C-13 Revenue Recognition Principle :

This principle is mainly concerned with the revenue, being recognized in the Income Statement of an organization. Revenue is the gross inflow of cash receivables or other considerations arising in the course of ordinary activities.

e.g.: Sale of goods, rendering of services and use of resources by other yielding interest, royalties and dividends. It excludes the amount collected on behalf of third parties such as certain taxes. In an agency relationship the revenue is the amount of commission and not the gross inflow of cash receivable or other considerations. Revenue is recognized in the period in which it is earned irrespective of the fact whether it is received or not received during that period.

C-14 Matching Principle :

Expenses incurred in an accounting period should be matched with the revenues recognized in that period. e.g. if revenue is recognized on all goods sold during a period, cost of those goods sold should also be charged to that period.

This concept is considering accrual basis and therefore considers all adjustments of prepaid expenses, outstanding expenses, accrued revenue and unaccrued revenues. Matching does not mean that expenses must be identifiable with revenues,. Expenses charges of a period may or may not be related to the revenue recognized in that period. The appropriate costs have to be matched against the appropriate revenues for that accounting period.