4 ACCOUNTING CONCEPTS

Objectives

At the end of this chapter, students should be able to:

- Identify counting concepts;
- Explain the accounting concepts such as entity, going concern, conservatism accrual / prudence, etc.

4.1 Introduction

In studying the principles and concepts of accounting, knowledge of their importance and application in the accounting field would bring about a better appreciation of the subject and at the same time arouse interest. A body of principles has been developed to regulate the practice of the accounting profession. These principles are known as "Accounting Concepts". They have been accepted and issued in the form of accounting standards by such bodies as the International Accounting Standard Committee (IASC) and Nigerian Accounting Standard Board (NASB).

4.2 Basic Accounting Concepts

1. **Business Entity Concept:** Every economic unit, regardless, of its legal form of existence, is treated as a separate entity (in accounting) from parties having proprietary or economic interest in it. What it means is that, the transactions recorded in a firm's book are the transactions that affect the firms only. The only attempt to show how the transactions affects the owners of a business is limited to showing how their capital in the firm is affected.

For example, if a proprietor adds N2,000 cash into the firm as capital, the books will show that the firm adds N2,000 more cash and that his capital has increased by N2,000. The accounting record will not show that he has N2,000 less cash in his private resources. Hence, this shows that the owner is separate and distinct from the firm.

2. **Going-Concern Concept:** It is believed that a business unit will continue to be in existence. A business is considered a going-concern if it is capable of making reasonable income and profit and there is no intention or threat from any source to reduce its life span.

3. **Conservative Concept:** It is the duty of the accountant to make a choice of what figure he will take for a given item. The implication of the convention of conservation means that the accountant will take the figure which will understate rather than overstate the profit. The convention can be stated alternatively as this could be expressed as choosing the figure which will cause the capital of the firm to be shown at a lower amount rather than at a higher one. On the other hand, it could also be said to make sure that all losses are recorded in the books but profits should not be anticipated and all possible losses

must be provided for. When it comes to valuation of assets, the lower value of cost and market value must be chosen by the accountant.

4. **Consistency Concept:** The concept of consistency holds that when a company selects a method, it should continue (unless conditions warrant a change) to use that method in subsequent periods so that a comparism of accounting figures over time is meaningful. The concept ensures that the accounting figures over time are meaningful. The concept ensures that the accounting treatment of like item is consistent from one accounting period to another. Constantly changing the methods would lead to a distortion of the profit calculated from the accounting records. The convention is that when a firm has chosen a method of the accounting treatment of an item, it will enter all similar items that follow in exactly the same way. It must not changed its method at will so that it will not lead to distortion.

5. **Historical Cost Concept:** This means that assets are normally shown at cost price and this forms the basis for assessing the future usage of the asset. It should be noted that the historical cost concept holds that cost is the appropriate basis for initial accounting recognition of all assets acquisitions, services rendered/received, expenses incurred, creditors and owners interest and it also holds that subsequent to acquisition, cost values are retained throughout the accounting process.

6. **Money Measurement:** Accounting is concerned with these facts that can be measured in monetary terms with a fair degree of objectivity. This means that accounting cannot disclose every aspects of business. Accounting cannot disclose to you whether you have a good manager or a bad one.

7. **Materiality Concept:** This principle states that only items of material value are recorded. An item will be considered material if its omission or misstatement could distort the financial statement.

8. **Prudence Concept:** This principle demands exercising great care the recognition of profit whilst all known losses in are adequately provided for. It is, however, not a justification for the creation of secret or hidden reserves.

Revenues should not be recognised until they are realised. On the other hand, all foreseeable losses should be provided for by changing them to the current period's profit and loss account. It is in compliance with the convention that such provision like provision for bad/doubtful debt and the unrealized profit are made. A strict application of prudence convention would ensure that profit and assets of the firm are not overstated.

9. **Dual Aspect Concept:** All transaction must have two aspects; debit and credit, there must be a giver and a receiver. This concept is based on the principle of doubleentry.

10.**Realisation Concept:** This states that the revenue is immediately recognized as soon as goods passes to the customer in exchange for money or payment.

11. **Accrual Concept:** It states that outstanding revenue and expenses must be recognized and charged to the profit and loss account.

12.**Matching Concept:** This concept states that all expenses are matched against revenue at any accounting period of time to determine the net profit or loss.

4.3 Summary

In this chapter, students have learnt:

- The meaning of accounting concepts.
- How to identify the accounting concepts..

4.4 Revision Questions

1. Explain the term ‘accounting concept’.

2. Explain the following concepts:

i. Going-concern

ii. Money measurement

iii. Materiality

iv. Conservative

3. State the accounting concepts of convention which best explain each of the following statements:

i. Accountants think the investments in the book are worthless.

ii. Accountants do not count chickens before they are hatched.

iii. Profits are recognized when goods are sold.