Accounting Principles /Assumptions

Going concern concept

1. *As per this concept the enterprise is normally viewed as a going concern i.e. as continuing operations for the foreseeable future.*
2. *It is assumed that the enterprise has neither the intention nor the necessity of liquidation or curtailing materially its scale of operations.*
3. *It is because of the going concern assumption that the assets are classified as current assets and fixed assets and liabilities are classified as short term liabilities and long term liabilities.*
4. *It is on this concept that we record fixed assets at their original cost and depreciation is charged on these assets without reference to their market value.*
5. *In case this concept is not followed, the fact should be disclosed in the financial statement together with reason.*

Consistency Assumption

1. *This concept states that accounting principles and methods should remain consistent from one year to another. These should not be changed from year to year, in order to enable the management to compare the profit and loss account and balance sheet of the different periods and draw important conclusions about the working of the enterprise.*
2. *For example if the inventory is valued on LIFO basis, this basis should be followed year after year.*
3. *Similarly if a particular asset is depreciated according to WDV, this method should be followed year after year.*
4. *If a firm adopts different accounting principles in two accounting periods, the profits of current period will not be comparable with the profits of the preceding period.*

5. *However according to changed circumstances firm is allowed to change the accounting methods and adopt improved techniques of accounting stating the nature and effect of the change of method by way of foot notes. This will prevent the accounting being non flexible.*

Accrual Concept

1. *The accrual concept in accounting means that expenses and revenues are recorded in the period they occur, whether or not cash is involved. That is revenue is recorded when earned and not when they are received in cash and recording expenses when they are incurred and not when they are paid.*
2. *The benefit of the accrual approach is that financial statements reflect all the expenses associated with the reported revenues for an accounting period.*

Business entity principles

1. *The business entity concept states that the transactions associated with a business must be separately recorded from those of its owners or other businesses.*
2. *Doing so requires the use of separate accounting records for the organization that completely exclude the assets and liabilities of any other entity or the owner.*
3. *In other words, the owner of a business is always considered as distinct and separate from the business he owns and the capital invested by proprietor in the business treated as a liability for the firm because it is assumed that the firm has borrowed funds from its own proprietors instead of borrowing it from outside parties.*

Money measurement principle

1. *According to this principle only those transactions and events are recorded in accounting which is capable of being expressed in terms of money.*
2. *An event, even though it may be very important for the business, will not be recorded in the books of the business unless its effect can be measured in terms of money with a fair degree of accuracy.*
3. *For example accounting does not record a quarrel between the production manager and sales manager, it does not report that a strike is beginning. These facts or happenings cannot be expressed in money terms and thus are not recorded in the books.*

Accounting period principle

It is also known as periodicity principle or time period principle. According to this principle, the economic life of an enterprise is artificially split into periodic intervals which are known as accounting periods, at the end of which an income statement and position statement are prepared to ascertain the financial performance and position respectively.

It requires that the allocation of expenses between capital and revenue. That portion of capital expenditure which is consumed during the current period is charged as an expense to income statement and the unconsumed portion is shown in the balance sheet as an asset for the future consumption.

Principle of full disclosure

1. *This principal requires that all significant information relating to the economic affairs of the enterprise should be completely disclosed to the users of financial statements such as proprietor, creditors, present and potential investors and others.*
2. *In the Companies Act 2013 ample provisions are made for the disclosure of essential information in the financial statements of a*

company. The proforma and contents of balance sheet and profit and loss account are prescribed by companies act.

3. *Various items or facts which do not find place in accounting statements are in the balance sheet by way of footnotes. For example if there is a change in the method of valuation of stock, or for providing depreciation it should be disclosed in the balance sheet by way of footnote.*
4. *Further disclosing of material facts does not mean leaking out the secrets of the business but disclosing sufficient information which is of material interest to the users of the financial statements.*

Principle of materiality

1. *This principal is an exception to the principal of full disclosure. According to this principle, items having an insignificant effect or being irrelevant to the users of financial statement need not to be disclosed, otherwise accounting statements will be overburdened.*
2. *As per American Accounting Association," An item should be regarded as material if there is reason to believe that knowledge of it would influence decision of informed investor".*
3. *It should also be noted that what is material for one concern may be immaterial for another. For instance, the cost of small tools may be material for a small repair workshop, but the same figure may be immaterial for escorts limited. Thus the accountant should judge the importance of each transaction to determine its materiality.*

Principle of prudence or conservatism

1. *According to this principle, all anticipated losses should be recorded in the books of accounts, but all anticipated or unrealized gains should be ignored.*
2. *In other words, conservatism is the policy of playing safe. Provision is made for all known liabilities and losses even though the amount cannot be determined with certainty.*

3. *For example a) closing stock is valued at cost price or realizable value whichever less is. b) provision for doubtful debts is created in anticipation of actual bad debts.*
4. *The principal of conservatism should be used very cautiously otherwise it will have two effects:*

- *Profit and loss account will disclose lower profits in comparison to the actual profits.*

1. *Balance sheet will disclose understatement of assets and overstatement of liabilities in comparison to the actual values.*

Principle of dual aspect

According to this principle, every business transaction is recorded as having a dual aspect. In other words, every transaction affects atleast two accounts. If one account is debited, any other account must be credited i.e. double entry system. It is because of this principle that two sides of the balance sheet are always equal and the following accounting equation will always hold good at any point of time:

Assets = Liabilities + Capital.

Historical cost principal

1. *According to historical cost principle, an asset is ordinarily recorded in the accounting records at the price paid to acquire it at the time of its acquisition and the cost become the basis for the accounts during the period of acquisition and subsequent accounting periods.*
2. *The cost of an asset is systematically reduced from year to year by charging depreciation and the asset is shown in the balance sheet at book value i.e. cost less depreciation.*
3. *It may be noted that the purpose of depreciation is to allocate the cost of an asset over its useful life and not to adjust its cost so as to bring it close to the market value.*

Matching principal

According to matching principle, the expenses incurred in an accounting period should be matched with the revenues recognized in that period. It means that, if revenue is recognized on all goods sold during a period, cost of those goods sold should also be charged to that period. It is wrong to recognize revenue on all sales, but charge expenses only on such sales as are collected in cash till that period.