Chp-1. Theoretical Framework

Unit 2 : Accounting Concepts, Principles & Conventions

⇒ Accounting principles refer to basic norms, general rules for accounting to avoid confusions & to achieve uniformity.

⇒ Accounting principles must satisfy the following conditions :-

(i) They should be based on real assumptions.

(ii) They must be simple, understandable & explanatory.

(iii) They must be followed consistently.

(iv) They should be able to reflect future predictions.

(v) They should be informational to users.

⇒ Accounting Principles

Accounting Concepts	Accounting Conventions (प्रथा)
→ Assumptions on the basis of which financial statements are prepared.	→ Outcomes of accounting principles, derived by usage and practice.
Fundamental Accounting Assumptions :- (i) Going concern (ii) Consistently (iii) Accrual	
If nothing is mentioned it is assumed that these are followed.	

① Going Concern

→ It is assumed that business ~~will~~ will continue for forseeable future & there is no intention to close the business.

RE < 1 year benefit
CE > 1 year benefit

→ It is because of this assumption, we make distinction between Revenue expenditure & Capital expenditure.

→ If this assumption is no longer valid then fixed assets are valued at Net Realisable Value or Market value.

② Consistency

→ Accounting practice once selected & adopted should be applied year after year.

→ Accounting practice may be changed :-

(i) If Law requires.

(ii) If Accounting Standards (AS) requires.

(iii) For better presentation of financial statements [true and fair view].

③ Accrual

→ Transaction is recorded when it takes place, not when the settlement takes place.

④ Business Entity Principle

→ Business is considered to be separated ~~from~~ from owner.

→ Accounting is done from business point of view.
E.g: Capital is treated as liability.

⑤ Money Measurement

→ Transactions and events that can be measured in money terms are recorded.

⑥ Periodicity

→ Life of an enterprise is broken into smaller period.

→ Generally this period is of 1 year [i.e. Know -n as Accounting period].

⑦ Matching Principle

recognised → record

→ When an item of revenue is recognised as income [i.e. credited to P&L A/c] then expenses related to that revenue should also be recognis -ed [i.e. debited to P&L A/c]

Q. Depreciation is recorded because of matching principle

Accrual (+) Periodicity (+) Matching works together for Income Measurement

⑧ Cost Concept [Historical Cost Principle]:

→ According to this principle, fixed assets are recorded in the books at cost [ignore market value].

Realisation → वेचणी

⑨ Realisation Concept

→ It follows cost concept only.

→ Change in value of asset is recorded only when the business realises it.

(10) Materiality

→ Material means importance.

→ All the material items should be fully disclosed.

(11) Full Disclosure Principle

→ Everything has to be told to the users.

foot notes + not shown in B/S but in notes to accounts

→ Eg :- Contingent liabilities are shown as foot notes.

(12) Revenue Recognition

→ Revenue is recognised [recorded] when transaction takes place & obligation to receive is established, not when the actual receipt is received.

Imp (13) Dual Aspect Principle

→ Every transaction has two aspects [i.e. debit & credit]

→ Assets [Dr.] = Capital + Liabilities [Cr.].

Eg ① Find capital. Loan = ₹100,000, Creditors = ₹70,000, Machine = ₹1,10,000, Debtors = ₹80,000, Stock = ₹80000, Cash = ₹6000

→ Assets = Capital + Liabilities

[1,10,000 + 80000 + 80,000 + 6000] = Capital + [100000 + 70,000]

2,76,000 = Capital + 1,70,000

∴ Capital = ₹1,06,000

Eg ② Capital on 1^{st} April = ₹20,000
Capital on 31^{st} March = ₹26,000
Find Profit.

→ Profit = Closing Capital − Opening Capital.
= 26000 − 20000
∴ Profit = ₹6,000

Eg ③ Capital on 1^{st} April = ₹15,000
Drawings during the year = ₹8,000
Additional Capital = ₹7000
Capital on 31^{st} March = ₹25,000
Find Profit.

→ * Profit = ~~Clos~~ Closing capital + Drawings − Additional Capital − Opening capital.
= 25000 + 8000 − 7000 − 15000.
= 33,000 − 22,000
∴ Profit = ₹11,000

Eg ④ Find total Assets if, capital = ₹40,000, Creditors = ₹5000, Bills Payable = ₹3,000.

→ Assets = Capital + Liabilities
= 40000 + [5000 + 3000]
= 40000 + 8000
∴ Assets = ₹48000

Eg ⑤ Given one example of each of the following:-

	Given	Solution
(i)	↑A & ↓A	Purchase goods for cash [Stock (+), Cash (-)]
(ii)	↑A & ↑L	Purchase goods on credit [Stock (+), Creditor (+)]
(iii)	↑A & ↑Capital	Additional Capital introduced. [Cash (+), Capital (+)]
(iv)	↓A & ↓L	Payment to Creditor [Cash (-), Creditor (-)]
(v)	↓A & ↓Capital	Drawing [Cash (-), Capital (-)]
(x)	↑L & ↓L	Accepted Bills Payable from Creditor. [BP (+), Creditor (+)]
(vi)	↓L & ↑Capital	Conversion of loan into Capital. [Loan (-), Capital (+)]
(vii)	↑L & ↓Capital	Outstanding Expenses [Liability (+), Capital (-)]

(14) Conservatism

→ Do not anticipate profits but consider all prospective losses.

→ Eg. Provision for doubtful debts, Closing inventory is valued at cost or net realisable value whichever is low, etc.

* → For conversatism concept, there should be three qualitative ~~charachter~~ characteristics of financial statements, as below :-

(i) Prudence - judgment about the possible future losses which are to be guarded.

(ii) Neutrality - unbiased outlook [P = L]

(iii) Faithful - faithful representation of alternative values

* Financial Statements & Its Qualitative Characteristics.

(i) Understandability - financial statement should be easily understandable.

(ii) Relevance - financial statement must provide useful information to user.

(iii) Reliability - financial statement should be free from bias.

(iv) Comperrability – User can compare [i.e. intra firm comparison & inter firm comparison] financial statement.

(v) Materiality – Information is material if its misstatement could influence the economic decision of user.

(vi) Faithful representation – Everything should be of alternative values.

* (vii) Substance over from – It is necessary that transactions are accounted / recorded for & presented in accordance with their substance & economic reality & not merely their legal form.

(viii) Neutrality – unbiased outlook [P = L].

(ix) Prudence – judgment about the possible future losses which are to be guarded.

~~(x) Full & fair &~~
(x) Full, fair & adequate disclosure – Everything should be told to the users.

(xi) Completeness – Financial statement must be complete.