

THEORETICAL FRAMEWORK

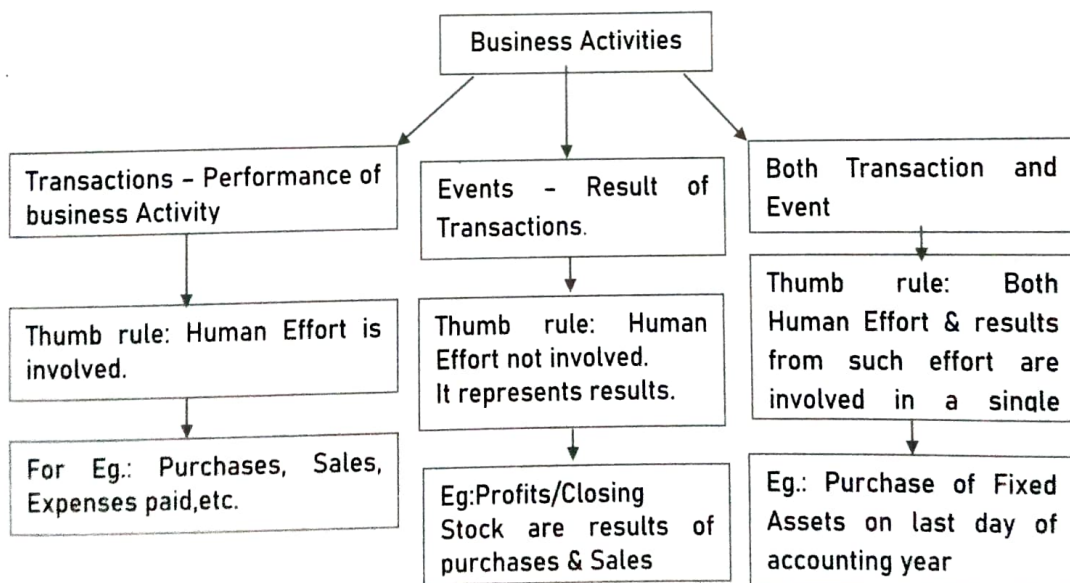
"One second, One minute, One hour, One day, One week, One month, One year and you are one year older. Make full use of your time."

MEANING AND SCOPE OF ACCOUNTING**MEANING OF ACCOUNTING**

- 1) As per the American Institute of Certified Public Accountants (AICPA) - Accounting is the art of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events which are in part at least of financial character, and interpreting the results thereof.
- 2) Accounting also involves analyzing and interpreting financial transactions and communicating the results to the persons interested in such information.
- 3) As per American Accounting Association- Accounting is the process of identifying, measuring and communicating economic information to permit informed judgments and decisions by the users of accounts.
- 4) Accounting is considered as an 'Information System', as the function of Accounting is to provide quantitative information, primarily financial in nature about the business organization.

TRANSACTIONS VS EVENTS, FINANCIAL VS NON- FINANCIAL

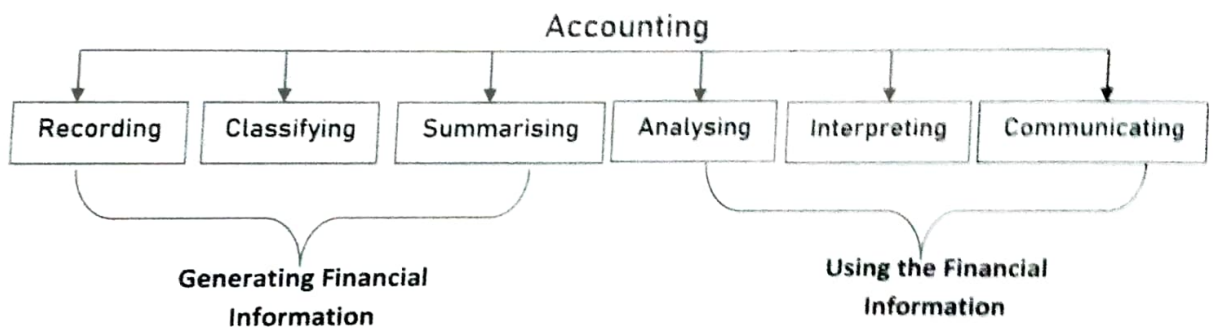
1. Transactions and Events: In a business or economic scenario.



2. Types of Transactions - 2 Types:

Types	Financial Transaction	Non - Financial Transaction
Meaning	When a business transaction involves a transfer of money or moneys' worth, then the transaction is called "Financial Transaction"	When a business transaction does not involve money or money's worth
Example	Purchase and Sale of goods, Payment of Expenses, Purchase of Assets, Goods lost by fire etc.	Quarrel between 2 Managers, Death of an employee etc.
Types	Cash and Credit Transaction	No such classification

ACCOUNTING PROCESS



Processes of Generating Financial Information (3 processes)

1. Recording:

Meaning	All business transactions which are of financial nature (i.e. expressed in terms of money) are recorded in the books of accounts.
Purpose	A businessman cannot keep in his memory all the business activities carried out by 'him. Hence, there is a need for keeping track of such activities in a separate record.
Basis of Recording	All transactions must be evidenced by supporting documents like Sales Invoice, Purchase Bill, Receipts, Pay Slip, etc. (These are called Vouchers)
Relevant A/cs Book	The Books in which primary entry is made is called "Journal", which is further sub-divided into several Subsidiary Books for Sales, Purchases, Cash & Bank, etc. according to the nature and size of the business.
Checkpoint	It is to be noted that Accounts is concerned with only FINANCIAL Transactions. Accounting will not record non-financial transactions in its books.
Example	<ul style="list-style-type: none"> • Salary paid to Manager will be recorded in the books of accounts. • But, good health of the Manager, even if it is of great use to the business, has no financial character and no economic value, and therefore, will not be considered in Accounting.

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2. Classifying:

Meaning	Classifying involves grouping transactions of a similar nature at one place, such that information will be compressed and presented in useable form.
Purpose	While the process of recording ensures that all financial transactions are recorded, one cannot make any observations unless all the transactions are grouped together under different categories.
Basis of Recording	Classification is based on the transactions recorded in the Journal / Subsidiary Books.
Relevant A/cs Book	The book containing the classified information of transactions is called 'Ledger'. Each page in the Ledger is called as "Folio". In each folio (Page No.), an individual Account Head and all transactions relating to that Account Head is recorded / posted.
Checkpoint	Ledger can be prepared only after the preparation of Journal / Subsidiary Books
Example	<ul style="list-style-type: none">• At recording stage, all transactions are normally recorded chronologically (i.e. date-wise).• Assuming a businessman made 10 sale transactions (out of which 6 are on credit), paid telephone charges. Rent etc., received payments from 3 debtors in a week, it is not possible to ascertain the exact position of each item unless they are grouped as "Sales A/c, Telephone Charges A/c, Rent A/c, Debtors A/c etc."

3. Summarizing:

Meaning	This involves presentation and preparation of the classified information in a manner useful to the internal and external users of Financial Statements.
Accounts Books	It involves preparation of Trial Balance, and Financial Statements there from, viz. (i) Profit and Loss Account (used to find out profits / losses for the business), (ii) Balance Sheet (used to ascertain the financial position), and (ii) Cash Flow Statement (used to determine the factors for increase or decrease in cash & bank balances)
Basis	Summarizing is based on the classified transactions presented in Ledger

Usage of Financial Information (generated through above 3 processes)

4. Analysing:

Meaning	Analysis involves methodical classification of data given in the Financial Statements.
Nature of process	Analysis is concerned with determining the relationship between the items in the Profit and Loss Account and Balance Sheet (i.e. Ratio Analysis). Thus, it provides the basis for interpretation. Further, analysis involves comparing current year figures with the previous year figures
Basis	Financial Statements generated above in summarizing.

5. Interpreting:

Meaning	Drawing observations from the items in the financial statements and also from relationships determined in analyzing process
Purpose	The recorded financial data is analysed and interpreted in the manner that will enable the data users to make a meaningful judgment about the financial condition and profitability of the business operation.

Nature of process	Financial Statements are interpreted to explain what had happened, why it had happened and what is likely to happen under specified conditions.
Basis	Financial Statements generated in summarizing process and relationships determined in Analyzing process.
Example	Assuming the NP ratio for 2023 is 20% on sales, whereas it was 15% in 2022. After analysing different ratios it was interpreted that the profit has increased mainly due to decrease in expenses & not due to increase in sales.

6. Communicating:

Meaning	It is concerned with the transmission of summarised, analysed and interpreted information to the end user to enable them to make rational decisions.
Modes	This is done through preparation and distribution of Accounting Reports, which includes Profit and Loss Account and Balance Sheet, additional information in the form of Accounting Ratios, Graphs, Diagrams, Funds Flow Statement, etc.

EVOLUTION OF ACCOUNTING AS SOCIAL SCIENCE

Accounting finds its roots as early as around 4000 BC, where Egyptians used some form of accounting for their treasuries. The in-charge of treasuries had to send day wise reports to their superiors known as Wazirs and monthly reports were sent to kings. Babylonia, known as the city of commerce, used accounting for business to identify the losses that took place due to frauds and lack of efficiency. Greece used accounting to divide the revenues received among treasuries, maintaining receipts, payments and balance of government financial transactions. Accounting practices in India could be traced back to a period where, Kautilya, a minister in Chandragupta's kingdom wrote a book named Arthashastra, which also described how accounting records had to be maintained.

In its oldest form, accounting aided the stewards to discharge their stewardship function. The wealthy men employed stewards to manage their property; the stewards in turn rendered an account periodically of their stewardship. This *'Stewardship Accounting'* was the root of financial accounting system.

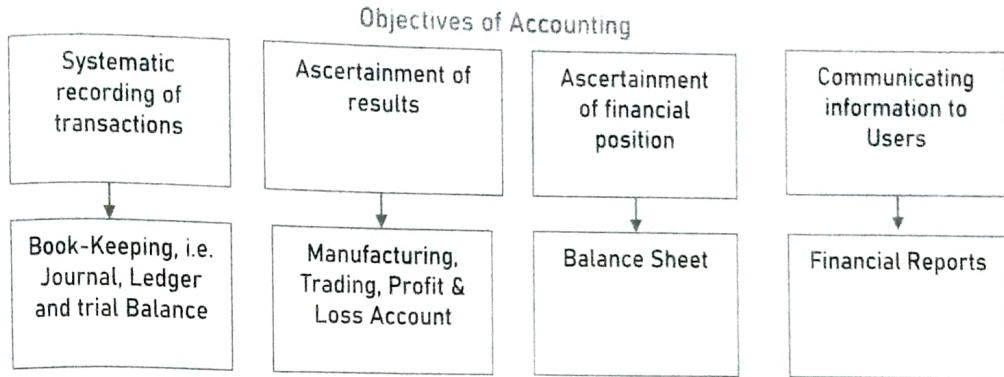
Social Science study man as a member of society; they concern about social processes and the results and consequences of social relationships. The usefulness of accounting to society as a whole is the fundamental criterion to treat it as a social science.

OBJECTIVES OF ACCOUNTING

1. To have a systematic record of all business transactions which are of financial nature.
2. To know the result of business operations for a particular period of time. If Revenue / Income exceeds the Expenses, then it is said that the business is running profitably, but if the Expenses exceed the Revenue, then the business is operating at a loss.
3. To know the financial position of the business. This will help answer questions like how much Assets and Liabilities that the business has on any date. The Balance sheet is a statement of assets & liabilities of the business at a particular point of time & helps in ascertaining the financial health of business.
4. To provide information to Users for decision making. Accounting, as the language of business, communicates the financial result of enterprises, to various Users. Accounting aims to meet the information needs of the decision maker and help them in rational decision making.

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5. To know the solvency position: Balance sheet also helps to know whether the business is solvent, i.e. ability to meet its liabilities in short run & in long run as and when they fall due.



FUNCTIONS OF ACCOUNTING

Measurement	Accounting measures the performance of the business entity and depicts its current financial position.
Forecasting	Accounting helps in forecasting future performance and financial position of enterprise using past data.
Decision-making	Accounting provides relevant information to the Users of accounts to aid rational decision-making.
Comparison & Evaluation	Accounting assesses performance achieved in relation to targets and discloses information which plays important role in comparing & evaluating financial results.
Control	Accounting identifies weaknesses in the operational system and provides feedback regarding effectiveness of measures to rectify such weaknesses.
Government Regulation & Taxation	Accounting provides necessary information to the Government, to exercise control on the entity as well as in collection of tax revenues.

BOOK-KEEPING – MEANING AND FEATURES

Meaning	It is an activity of recording and classifying the financial data relating to business operations in a significant and orderly manner.
Objective	<ul style="list-style-type: none"> Complete recording of transactions. Ascertainment of financial effect on the business.
Features	<ul style="list-style-type: none"> It is art of scientifically recording the transactions. Recording of transactions is restricted only to that of particular enterprise The recordings are made in a given set of books.
Advantages	<ul style="list-style-type: none"> From Financial Statements, financial information is readily available to Users Qualitative financial decisions can be taken, since information is reliable Valuable conclusions can be drawn on comparing books of different years of the same enterprise or comparing books of same period for different enterprises. Financial accounts of an enterprise are treated as evidence in a Court of Law.

BOOK-KEEPING V/S ACCOUNTING

Basis	Book-Keeping	Accounting
Scope	It is a process concerned with recording of transactions	It is a process concerned with summarising of the recorded transactions.
Stage	Book-Keeping is the primary stage. It constitutes as the base for accounting.	Accounting is the secondary stage. It constitutes as a language of the business.
Basic Objectives	To maintain systematic records of financial transactions	To ascertain net results of operations and financial position and to communicate information to the interested parties.
Financial position	Financial position of the business cannot be ascertained through book-keeping	Financial position of the business is ascertained based on the accounting reports
Financial Statements	Financial Statements do not form part of this process.	Financial statements are prepared on the basis of book-keeping records.
Managerial decision	Managerial decision cannot be taken with the help of these records.	Management can take decision on the basis of these records.
Sub-fields	There are no-sub fields for Book-Keeping	It has several sub-fields such as Financial Accounting, Management ,etc.

Note: In terms of scope, Book-Keeping < Accounting

SUB FIELDS OF ACCOUNTING

Financial Accounting	It covers the preparation and interpretation of financial statement (i.e. P&L Account and Balance Sheet) and communication thereof, to the user of accounts. It is historical in nature as it records transactions which has already occurred. It primarily helps in determination of the net result for an accounting period and the financial position as on a given date.
Management Accounting	It is used for internal reporting to the Management of a business unit. The different ways of grouping information and preparing reports as desired by the Managers for discharging their functions and referred to as Management Accounting.
Cost Accounting	It is the process of accounting for cost and determination of overall cost of the product or service. The study of the behavioural pattern of cost will enable to control cost.
Social Responsibility Accounting	It is concerned with accounting for social costs incurred by the enterprise and social benefits created.
Human Resource Accounting	It seeks to identify, qualify and report investments made in human resources of an organization that are not presently accounted under any conventional accounting practice.

USERS OF FINANCIAL INFORMATION

Users	Purpose
Management	For day-to-day decision-making and performance evaluation.
Investors	To analyze performance, profitability and financial position. Note: Prospective investors are interested in the track record of the company
Lenders	They are interested to know whether their loan-principal and interest will be paid back when due
Suppliers	To determine the credit worthiness of the Company.
Customers	To know general business viability before entering into long-term contracts and arrangements
Employees	To know stability, continuity & growth of the enterprises, and its ability to pay remuneration, retirement & Other benefits & to enhance career opportunities.
Government	To ensure prompt collection of Direct and Indirect Tax revenues & to evaluate performance and contribution to social objectives
Public at Large	To see whether the enterprise is making a reasonable/ substantial contribution to local economy, e.g. employment opportunities, patronage of local suppliers

RELATIONSHIP OF ACCOUNTING WITH OTHER DISCIPLINE

Auditing	Auditing process review the Financial Statements, which are the outcome of the accounting process. Thus, Auditor should have a through & sound knowledge of accounting Standards & GAAP of reviewing the Financial statement.
Economics	<ul style="list-style-type: none"> Economics uses the database provided by Accounting System, for developing decision-models and for rational decision-making on the use of scarce resources. Economic Theories have influenced the development of decision-making tools used in accounting. However, there are differences between the Economists' and Accountants concepts of Income, Capital and Valuation of assets
Law	<ul style="list-style-type: none"> Transactions and events are governed by the laws of the land like The Contract Act, Sale of Goods Act, Negotiable Instruments Act and Taxation Laws. The entity itself is governed by specific status like Partnership Act, Companies Act, Co-operative Societies Act, which have a bearing on maintenance of account books
Mathematics	<ul style="list-style-type: none"> Knowledge of arithmetic and algebra is a pre-requisite for accounting computation and measurement, e.g. Depreciation, Use of Interest and annuity tables, lease Rentals, Hire Purchase Installments etc. Ratios, Graphs & Operation Research Models have been widely used in accounting
Management	Management relies on accounting and other data for effective decision-making. Since an accountant plays an active role in management, he understands the data requirements, so the accounting System can be designed to serve management purpose.

Statistics

In accounting many ratios and financial calculations are based on statistical methods, which help in averaging them over a period of time. Thus, Statistics is helpful in development of accounting data and in their interpretation using Pie-charts, Graphs and Trend Curve Diagram etc.

LIMITATIONS OF ACCOUNTING

- 1 Accounting involves different assumptions and conventions on which it is based. These assumptions, by themselves become a limitation for accounting. Hence, Accounting is considered only as an art and not as pure science.
- 2 There are different accounting policies for the treatment of the same item, e.g. Depreciation, Valuation of Stocks, etc. This may not ensure comparability among financial statements of various firms.
- 3 Certain accounting estimates are based on the personal judgement of the accountant e.g. provision for doubtful debts, capital vs revenue expenditure, writing off intangible assets, etc. This may lead to the possibility of manipulation.
- 4 The financial position of the business as depicted by accounts is static and not dynamic i.e. it gives the position on a particular day on which it is prepared and does not predict future position.
- 5 Inflation effect is not considered in the general purpose financial statements i.e. Accounting ignores changes in some money factors.
- 6 The worth of an entity may be assessed by various factors but all cannot be measured in terms of money.
- 7 Accounting ignores the real assets which cannot be measured in terms of money, i.e., Employees. There is no generally accepted formula for the valuation of Human Resources in terms of money. Financial statements consider those assets which can be expressed in monetary terms.
- 8 There are occasions when accounting principles conflict with each other.

ROLE OF ACCOUNTANT IN THE SOCIETY

Areas of Service

Maintenance of Books of Accounts	An accountant is able to maintain a systematic record of financial transactions in order to establish the net result of the transactions entered into during a period and to state the financial position of the concern as at a particular date.
Statutory Audit	Every limited company is required to appoint a chartered accountant or a firm of chartered accountants as their auditor who are statutorily required to report each year whether in their opinion the balance sheet shows a true & fair view of the state of affairs on balance sheet date, and Profit & Loss A/c shows a true & fair view of profit or loss for the year.
Internal Audit	Now-a-days internal auditing has developed as a service to management. The internal auditor constructively contributes in improving the operational efficiency of the business through an independent review and appraisal of all business operations.

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Taxation	An accountant can handle taxation matters of a business or a person and he can represent that business or person before the tax authorities and settle the tax liability under the statute prevailing. He can also assist in avoiding or reducing tax burden by proper planning of tax affairs.
Management Accounting and Consultancy Services	Accountant provides management consultancy services in the areas of management information system, expenditure control and evaluation of appraisal techniques for new investments and divestments, working capital management, corporate planning etc.
Financial Advice	Some of the areas in which accountant can render financial advice are: <ul style="list-style-type: none">➤ Investments➤ Business Expansion➤ Insurance➤ Investigations➤ Pension schemes
Other Services	Secretarial Work, Share Registration Work, Company Formation, Receiverships, Liquidations, etc

Chartered Accountant in Industry

He works with the functional departments and translates the organisation's aims in terms of financial expectations.

A qualified accountant will be able to play an important role in performing important functions of a business relating to accounting, costing and budgetary control, estimating and treasury.

Chartered Accountant in Public Sector Enterprises

It is the duty of the accountants to prepare the accounts and reports of these public corporations in such a way that they enable the general public to know how far the items appearing in the various types of records and financial statements justify their existence.

Chartered Accountant in Framing Fiscal Policies

Accountants have a positive role to play in the determination of proper fiscal policies and advancement of trade, commerce and industry. They should develop new techniques and prepare themselves for new fields of service towards their commitment to the concept of the public goods and services.

Chartered Accountant and Economic Growth

In the present times accountants should conceive their duties as broadly as the conditions might require and do not restrict them to only literal compliance of the law. Their aim should be not to allow any individual to gain at the cost of the nation. Accountants have to accept a positive role and do their best to encourage efficiency in individual business units and encourage those social objectives which form the main foundation of a welfare state.

ACCOUNTING CONCEPTS, PRINCIPLES AND CONVENTIONS

Item	Descriptions
1. Accounting Assumptions	<p>(a) "Assumptions" refers to the Fundamental conditions based on which the entire accounting process is carried out.</p> <p>(b) In accounting there are 3 fundamental Accounting Assumptions.</p> <p>(c) For e.g. when a person started a particular business, we assume that the person started the business for continuing it to earn profits and not for closing it.</p>
2. Accounting Principles	<p>(a) Accounting Principles refers to the set of doctrines associated with the theory and procedures of accounting.</p> <p>(b) They serve as an explanation of currently practices and as a guide for selection of conventions or procedures where alternatives exist.</p> <p>(c) Accounting principles should be- (i) based on real assumptions, (ii) simpler and easily understandable, (iii) consistently followed, (iv) informational to the Users, and (v) able to reflect future predictions.</p>
3. Accounting Concepts	<p>(a) "Concept" means any idea or notion, which has universal application.</p> <p>(b) Accounting Concepts are the basic conditions which lay down the foundation for formulating the accounting principles.</p> <p>(c) They are clearly defined and supported by reasoning. Certain concepts are perceived, assumed & accepted in accounting to provide a unifying structure and internal logic to accounting process</p>
4. Accounting Conventions	<p>(a) Accounting Conventions are the general procedures emerging out of usage and practice of accounting principles.</p> <p>(b) Conventions may not have universal application.</p> <p>(c) Denote circumstances or traditions which guide the accountants while preparing the accounting statements.</p> <p>(d) Further, certain conventions may be changed over a period by Accounting Bodies like ICAI, to improve quality of financial statement.</p> <p>(e) Eg: In India, pedestrians walk on the left side and vehicles go on the right side of the road. This is traditionally accepted practice, and everybody follows it</p>

Concepts Vs Conventions:

- (a) Concepts are clearly defined & supported by reasoning while conventions may not be clearly defined.
- (b) Concepts support the principles whereas Conventions may contradict the principles

Note: Above terms Concepts, Principles & Conventions are sometimes used interchangeably

LIST OF ACCOUNTING ASSUMPTIONS / CONCEPTS / CONVENTIONS

1. Fundamental Accounting Assumptions: Only 3- (a) Going concern, (b) Consistency and (c) Accrual. (They are also considered as part of accounting concepts)

2 Accounting Concepts:

- | | |
|----------------------------------|------------------|
| 1. Business Entity | 6. Going Concern |
| 2. Money Measurement | 7. Cost |
| 3. Accounting Period/Periodicity | 8. Realization |
| 4. Accrual | 9. Dual Aspect |
| 5. Matching | 10. Consistency |

3 Accounting Conventions (a)Consistency (b)Full Disclosure (c)Conservatism (d)Materiality

FUNDAMENTAL ACCOUNTING ASSUMPTIONS

1. Going Concern:

- (a) The enterprise is normally viewed as Going Concern, i.e. Continuity in operation for the foreseeable future (endlessly)
- (b) It is assumed that the enterprise has neither the intention nor the necessity of liquidation or of reducing substantially its level of operations.

For Example: When we invest in shares of Reliance Company, we normally assume that the Company's operations will be continued. We do not expect the company to be closed.

Exception to Assumption: Joint Venture (Which is created for specific purpose/ period)

- (c) Going concern is also considered as one of the accounting concepts.
- (d) Based on Going Concern assumption becomes inappropriate (i.e. if the enterprise cannot be taken as a going concern) then assets should be valued at their Net Realizable Value. i.e. if the business is to be closed, then the assets must be valued at Market Values and not at cost.

2. Consistency:

- (a) *Meaning:* Accounting principles followed by the entity shall be consistent. i.e., the same over a period of time. Frequent changes in accounting policies will distort comparison.

Example: If one year, a particular payment is treated as expense, then the assumption is that the subsequent years also it shall be treated only as an expense.

- (b) Consistency is also considered as one of the accounting concepts.
- (c) *Exception:* As per Consistency Concept, a change in an accounting policy should be made only-
- If the adoption of a different accounting policy is required by Statute, or
 - For compliance with an Accounting Standard, or
 - If it is considered that the change would result in a more appropriate presentation of the Financial Statement of the enterprises.

3. Accrual:

- (a) Revenue and Costs are "accrued". i.e. recognized as they are earned or incurred and recorded in the financial Statement of the period to which they relate and not when money received or paid.

Example: If a sale for ₹ 10,000 is made on credit to a person in 2022 but the settlement is received in 2023. In this case ₹ 10,000 shall be treated as income in 2022 (in the year of accrual) and not in 2023. (year of receipt)

- (b) Accrual is also treated as one of the Accounting Concepts.

Disclosure Requirements

If the above assumptions are followed in preparing accounts	If the above assumptions are not followed
Separate disclosure is not required, since their acceptance and use are assumed	Disclosure is necessary, specifying that the general accounting assumptions are not followed.

ACCOUNTING CONCEPTS & CONVENTIONS

BUSINESS ENTITY

1. **Meaning:** The business enterprise is a separate identity and distinct from that of its Owners or Managers. The Owner of the business and the business as such is treated as two different persons.
2. **Impact of above concept:** All transactions are classified into - (a) Business Transactions, and (b) Personal Transactions. Business transactions are recorded in the books of accounts of the business. Owner's Personal transactions are recorded in his personal book of accounts and not in the books of the business.
3. **Example:**
 - (a) Mr. A is an owner of a CA firm "M/s A & Co." The profits arising from M/s A & Co. belong to Mr. A only. However, for accounting purpose, Mr. A is a different person and M/s A & Co. is a different person.
 - (b) Accounting will be done only for the transactions in which M/s A & Co. is involved and not for A's personal transactions.

MONEY MEASUREMENT

1. **Meaning:** Accounting data must be quantified so that data can be aggregated and hence summarized; hence, all transactions and events should be measured in terms of money. Transactions are recorded in books of account, in the ruling currency of the country where the books of accounts are prepared.
 2. **Common unit:** A common measuring unit in terms of money helps to (a) quantify data, and (b) enable determination of profit/loss and financial position. For Example the Rupee is the common unit of measurement for economic events and transactions in India. It is the legal tender used as the medium of exchange in market transactions.
 3. **Criticism of Money Measurement:**
 - (a) Value of Money erodes over a period of time. Future Cash Flows have a lower value than the Present Cash Flows. Hence money by itself is not a meaning full measurement base.
Example: One kg of Onion in 2022 was ₹ 40; But the same one kg of onion in 2023 is ₹ 80. This implies that the real value of money has gone down.
 - (b) Exchange value of a currency (e.g. Rupee) in relation to other currency is not constant over a time period. Hence, money does not provide a stable measurement yardstick.
 - (c) Many material transactions and events are not recorded in the books of accounts just because they cannot be measured in terms of money. E.g. appointment of new Chairman for the company.
 4. **Impact on Accounting:**
 - (a) As per Money Measurement Concept, only those transactions which are capable of being measured in terms of money are recorded in the books of accounts, that too in the ruling currency of the country. E.g. in Rupees in India, in Dollars in USA, in Pounds in UK.
 - (b) Transactions which are not in monetary terms, even if they affect the results of the business materially, are not recorded in the books of accounts.
- Note. Entity & Money Measurement Concepts are basic concepts on which the other procedural concepts depend.

PERIODICITY OR ACCOUNTING PERIOD

1. Need: As per the Going Concern Assumption, the enterprise has an indefinite life. However, it is necessary to sub-divide such indefinite period into smaller time units for (a) measurement of performance; (b) understanding the financial position of the enterprise and (c) control over operations. Such smaller and usable time-frame for reporting purpose is called Accounting Period.
2. Meaning:
 - (a) Hence, during the life-time of an entity, Financial Statement can be prepared in periodic intervals of time. The economic life of an enterprise is split into the periodic interval (being a financial year).
 - (b) As per Periodicity Concept, the financial Statements should be prepared after every accounting/ financial period, and not at the end of the life of the entity.
 - (c) Generally a period of 12 months (i.e. one year) is considered as the accounting period by most enterprises. In the corporate sector, Interim Financial Reporting is also prevalent. The length is also determined by the statute in certain cases.

Note: Normally the term "Financial Year" refers to the period for which the accounts are prepared. It is usually taken as the period from 1st April to 31st March of the next year.
3. Periodicity Concept facilitates in-
 - (a) Comparison of financial statements of different periods.
 - (b) Uniform and consistent accounting treatment for ascertaining the profit and assets of the business.
 - (c) Matching periodic revenue with expenses for getting correct result of the business operations.

ACCRUAL

1. Meaning: "Accrual" means recognition of revenue as they are earned and the cost as they are incurred and not when money is received or paid. This concept relates to measurement of income, identifying assets and liabilities.
2. Method: Under Accrual Concept, all transactions and events are recognized on mercantile basis, i.e., as they are earned or incurred, and recorded in the financial statement of the period to which they relate, and not when cash is actually received or paid.
3. As per Accrual Concept, Profits = Revenue Less Expenses
 - (a) Revenue = Gross Inflow of Cash, Receivables and other consideration arising in the course of ordinary activities of an enterprise from sale of goods, from rendering services, and from the use by others of enterprise's resources yielding interest, royalties and dividends.
 - (b) Expenses = Cost relating to the operations of an accounting period, or to the revenue earned during the period, or the benefits of which do not extend beyond that period.

MATCHING

1. Meaning:
 - (a) The performance of a business entity is measured with reference to a specific accounting period.
 - (b) Hence, to determine the profits for a particular period, Revenue earned in that period should be matched with the expenses incurred for earning such revenue.

2. Impact of Matching Concept: As per Matching Concept

$$\text{Periodic Profit} = \text{Periodic Revenue} - \text{Matched Expenses}$$

From the revenue of an accounting period such expenses are deducted which are expended to generate the revenue to determine profit of that period

3. Nature of Income / Expenses

Particular	Income	Expenses
Inclusions	Sales/Service rendered but money not received (Outstanding Income/Accrued Income)	Services received/ purchases made but money not paid (Outstanding Expenses/Sundry Creditors)
Exclusions	Advances received before sale/service is not income (Income received in advance)	Advance paid before purchases made/services received (Prepaid Expenses/Expenses paid in advance)

4. Impact: The Accrual Concept, together with Periodicity and Matching concepts, give rise to the recognition of (a) Prepaid Expenses (b) Outstanding Expenses (c) Income Receivable and (d) Income Received in advance.

COST

1. Meaning: As per Cost Concept, Value of asset as shown in balance sheet must be its Historical Cost, i.e. Acquisition Cost. This is the conventionally adopted measurement base for valuation of assets.
2. Significance/Merits:
 - (a) Historical Cost is objective and free from bias.
 - (b) Historical cost is easier to ascertain than Current Cost, Present Value etc.
 - (c) Historical Cost represents an actual figure/out flow of resources for acquiring the asset and does not reflect a hypothetical or notional figure.
3. Criticism: Historical Cost is criticized on the following grounds-
 - (a) Historical Cost does not reflect the true value of the assets particularly in an inflationary situation.
 - (b) Financial Statement prepared on the basis of cost concept loses comparability.
 - (c) Many assets (like Human Resources) do not have acquisition costs. Cost Concept fails to recognize such assets.

Note: Due to the above criticism, other measurement bases like Current Costs, Net Realizable Value, Present Value etc. are suggested.

REALISATION

1. Meaning: As per Realisation Concept, An asset is recorded at its Historical Cost and any change in its value should only be recognized when it is realized, i.e. at the time of its actual sale/disposal.
2. Concept: It emphasized that there is no certainty of income until a sale has been made and hence increase in value of the assets should not be taken into account unless it is actually realised.
3. Criticism: However, Realisation concept is criticized by arguing that if the value of an asset has been permanently changed, Profit or loss arising out of such change be considered to reflect true and fair financial position of the enterprise. Otherwise, accounting will become distorted and meaningless.

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4. Revaluation: So, fixed assets may be revalued periodically. However, selective revaluation of an asset may lead to unrepresentative or misleading amounts being reported in financial statements. Hence revaluation of assets should be done on a systematic basis. For example, all machineries shall be revalued rather than a single machinery.

Fair Value: Thus, the Realisation Concept is slowly being replaced by the recognition of assets at their fair market value (Fair value accounting concept). However, Accountants follow a more conservative path. They try to cover all probable losses but do not count probable gains.

DUAL ASPECT

1. Meaning: The Dual aspect concept is the core of double entry book-keeping
2. Basis: As per this concept, every transaction or event has two aspects, which have to be recorded in the books and the amounts of both the aspects are equal.
3. The possible combinations of the effect of each transaction is as under-

1st Aspect	2nd Aspect	Example
Increase in one asset	Decrease in another asset	Purchase of Machine by cash
Increase in asset	Increase in liability	Purchase of Machine on credit
Decrease in asset	Decrease in liability	Payment of Cash to Creditors
Increase in one liability	Decrease in another liability	Creditors paid from bank Overdraft

4. Significance: This concept give rise to the accounting equation: "CAPITAL + LIABILITIES + ASSETS". This equation can take many forms and some forms are given below

Equity (i.e. Capital) + Liabilities	=	Assets
Equity + Long term liabilities + Current liabilities	=	Fixed Assets + Current Assets
Equity + Long Term Liabilities	=	Fixed Assets + (Current Assets - Current Liabilities)
Equity + Long Term Liabilities	=	Fixed Assets + Working Capital
Equity	=	Fixed Assets + Working Capital - Long Term Liabilities

Note: Closing Capital = Opening capital (±) Profits/ (Losses) during the year (+) Additional Capital (-) Drawings (+) Interest on capital (-) Interest on drawings

Note: Capital is otherwise called Equity. Both the sides of equations shall always tally.

FULL DISCLOSURE

1. Meaning: As per this concept all the events and transactions which are relevant shall be disclosed in the books of accounts and the financial statement. The events may relate to the current or the subsequent accounting periods.
2. Purpose: The users of the financial statements must be aware of all relevant events and transactions to understand real position of the business.
3. Disclosure: It means that a statement describing the event/ transaction (including the amount involved) should be added to the financial statements as a note therein. (Disclosure is not same as accounting. Accounting means Accounting Entries will be passed, whereas in disclosure a mere statement is given Journal Entry not passed.)
Example: The legal suit filed against a company for violation of copyrights shall be disclosed as part of the financial statements though it cannot be measured accurately.

CONSERVATISM

1. Meaning.
 - (a) Conservatism or Prudence demands that unrealized profits and gain should not be recognized in the accounts. However, provision should be made for all actual and possible losses.
 - (b) The accountants should not anticipate income but should provide all possible losses.
2. Application of Conservatism Convention:
 - (a) Choice among different methods of valuation: If there is a choice between two methods of valuing an asset, the Accountant should choose a method which leads to the lesser value, e.g. Current Assets are valued at Cost or NRV, whichever is lower
 - (b) This concept prohibits Window Dressing. (It means manipulating the financial statements to make them attractive viz. inflating the profits, suppressing expenses, treating revenue expenditure as Capital expenditure etc.)
3. Advantages: This Concept has led to the following qualitative characteristics of Financial Statements - (a) Prudence, (b) Neutrality, and (c) Faithful representation of alternative values.

MATERIALITY

1. Meaning: As per Materiality Concept, all items having significant economic effect on the business should be disclosed in the financial statement.
2. Material items refer to the items in the financial statements the knowledge of which might influence the decision of the users of financial statement.
3. Factors: Materiality depends on the size and nature of the items or error, judged in the particular circumstances of its misstatement.
4. Advantage: Materiality provides a threshold or cut-off point for classifying the amounts into assets or expenses
5. Exception: This principle is an exception to the full disclosure principle.

SUBSTANCE OVER LEGAL FORM

1. Meaning: The accounting treatment and presentation in financial statements of transactions and events, should be governed by their substance and not merely by the legal form.
2. For Example.
 - (a) Sale of Land & Buildings without Registration: If the Firm has sold its land and Building, received consideration and handed over the possession to the buyer, it should be recorded as sale of land and building this recognition cannot be postponed for mere procedural formality pending e.g registration of sale deed.
 - (b) Hire Purchase-Considered as Sale: In case of an asset required on hire purchase, ownership is not transferred till last installment is paid. However, asset is shown in the books of the hire purchaser.

BASIS OF ACCOUNTING

1 Meaning: "Basis of Accounting" refers to the stage at which incomes and expenses are recorded in the books of accounts.

2 Types: There are 3 basis of Accounting- (a) Cash Basis (b) Accrual Basis and (c) Hybrid Basis

Cash Basis	Accrual Basis (Otherwise called as Mercantile Basis)
Profit = Cash received in normal course of business (-) Cash paid in normal course of business	Profit = Revenue (earned) (-) Expenses (incurred)
Cash Receipts of any year may relate to (a) previous year (b) current year or (c) future years. No distinction is drawn for calculating profits/surplus	When cash and revenue flow at different times, it is treated as under (a) Cash received before revenue is earned = Income Received in Advance = Liability. (b) Cash received after revenue is earned = Income Receivable = Assets
Cash payments of any year may relate to - (a) previous years, (b) current year or (c) future years. No distinction is drawn for calculating profits/surplus	When cash and expense are recognized at different times, it is treated as under- (a) Cash paid before expense is incurred= Prepaid expenses = Assets. (b) Cash paid after expense is incurred = Payables / Outstanding Liabilities = Liability
Companies Act, 2013 does not permit the use of cash basis of accounting	Companies Act 2013 specifically requires the use of accrual basis of accounting

Hybrid System or Modified Accrual System: In this method, the revenue is recognized on cash basis and expenses are recognized on Accrual Basis.

QUALITATIVE CHARACTERISTICS OF FINANCIAL STATEMENTS

Financial Statements are prepared to ascertain the operating results and the financial position of the business. They should have the following features:

Relevance	Information must be relevant to the decision-making needs of the users
Reliability	Information in financial statements must be reliable, i.e. (a) free from material error and bias, and (b) can be depended upon by the user to faithfully represent the correct position
Understandability	Financial statements must be understandable to users. However, the required information should not be excluded, just because it may be complex or difficult for the users to understand
Comparability	Information in financial statements should be comparable (both for inter-firm and intra-firm comparison) This is possible only when consistency concept is applied and accounting policies and changes therein are adequately disclosed

THEORETICAL FRAMEWORK

Materiality	All material information should be disclosed in the financial statements. Information is material if its misstatement (i.e. Omission/erroneous) could influence the economic decision of users.
Faithful Representation	Information must faithfully represent the transactions & events which it represents. It should represent the balance of assets and liabilities which can be used for analysis in good faith
Substance over form	The financial statement should reflect the substance of the transaction than the mere legal form thereof.
Neutrality	Information in financial statement must be free from bias, i.e. it should not influence the decision or judgment of the user, in order to achieve a pre-determined results or outcome.
Prudence	Prudence is the inclusion of a degree of caution in the exercise of the judgments needed in making the estimates required under conditions of uncertainty. Hence assets and incomes should not be over-stated, and liabilities and expenses should not be under-stated.
Disclosure	All material items must be fully, fairly and adequately disclosed in the financial statements. Fullness implies nothing material should be omitted. Fairness implies true and fair view of financial statements. Adequacy implies disclosure of proper details and in a sensible manner.
Completeness	Information in financial statements must be complete within the limitations set by materiality & cost. An omission can cause information to be misleading, unreliable and irrelevant