Chapter 1

Accounting Concepts & Conventions

Accounting Concepts are the assumptions on the basis of which financial statements of a business are prepared. The word concept means idea or notion. Concepts are the basic assumptions and conditions on which accounting principles are formed.

1. Entity concept : As per this concept the business is considered to have a separate identity apart from its owner. Only the business transactions are recorded in the books of Accounts. Personal transactions of the owner are recorded in his own personal books of Accounts. As per this concept the business is liable to pay to the owner the capital brought by him.

2. Money Measurement Concept : As per this concept only those transactions that can be measured in terms of money are to be recorded in the books of accounts.

3. Going concern concept : Accounting statements are prepared on the basis that the business will continue its activities in the near future. The valuation of the assets is done on this basis, as we assume that Assets are to be used in future & are not for resale. It is also assumed that business has indefinitely long life.

4. Periodicity Concept : This concept defines accounting period. A small period of time is chosen for measuring performance and looking at the financial position. Generally one year is taken as the standard period for measuring and appraising the financial position, which is called as Accounting year.

5. Matching Concept : As per this concept from the revenue of an accounting period such expenses are deducted which are incurred to earn that income. This helps to determine the correct profit or loss of that period.

6. Accrual concept : As per this concept the transactions are recorded in the books of Accounts when they occur & not when the money is paid or received. It means recording the expenses & incomes when they are incurred or earned irrespective whether it has been paid or received. Financial statements are prepared on the accrual basis as it informs the users not only of the past events but also the future obligations to pay and the sources to receive the money.

7. Cost Concept : The value of an asset is to be recorded on the basis of its purchase cost. If a tangible asset is acquired free of cost, then the transaction is recorded at value of 1 to make te record available as per disclosure principle. ₹

8. Realisation Concept : Any change in value of an asset is to be recorded only when the business realises it. This concept follows the cost concept .i.e. if there is an anticipation of a decrease in the value of an asset it will be recorded but if there is an anticipation of an increase in the value of an asset it will be recorded only when the money is received for the same.

9. Conservatism Concept (Prudence) : This concept implies that the accountant should not anticipate income but provide for all possible losses. This concept puts a guard against all possible losses. Valuation of stock at cost or market price whichever is less , Providing R.D.D. and R.F.D.D. are examples of conservatism.

10. Consistency Concept : In order to compare the financial statements of different years it is necessary to maintain consistency in the accounting policies followed by the business. Valuation of stock at cost or market price whichever is less is an exception to this rule.

Accounting policies should be changed when there is compliance of law or in accordance with the accounting standards. A proper accounting policy should be consistently followed w.r.t. stock valuation, Depreciation and investment valuation.

11. Convention Of Disclosure:-
Interpretation: The convention of disclosure means that information of material nature must be fully or properly disclosed in the financial statement. Unless there is a clear disclosure of various information's the financial statement will be useless. Sometimes the information may not be material but its effect in future years may be material, then the same is to be properly disclosed.
Example:
1. Contingent liabilities.
2. Events subsequent to balance sheet date.
3. Accounting method and policies adopted by a concern, change in them if any.
4. Difference in the cost value and market value of investment, stock, etc.

12. Materiality Concept:. This principle permits other concepts to be ignored if the effect of that concept is not material. This principle is an exception to the rule of full disclosure. According to this concept only those items having a significant effect on the business should be disclosed in the financial statements. Judgement of materiality depends upon the common sense and discretion of the accountant. Materiality depends upon not only the amount of the item but also on the size of the business , nature / level of information , level of person making the decision etc.

13. Dual aspect concept : This concept implies double entry book keeping i.e. for every debit there is a credit. Every transaction affects two aspects.

Increase in one asset / liability	Decrease in another asset / liability
Increase in one asset / liability	Increase in liability / asset
Decrease in one asset / liability	Increase in another asset / liability
Decrease in asset / liability	Decrease in liability / asset

* Accrual, periodicity and matching are the three procedural conventions for income measurement and recording of assets
* Primary Quality of financial statements are reliability and relevance.
* Going concern, Cost and Realisation concepts help in valuation
* Entity and Money measurement concepts are viewed as basic concepts.

14. Objective Evidence: This concept / convention means all transaction should be supported by documentary evidence. It can be verified. These evidences behind the business transactions should be objective and represent factual information's without bias towards either side. E.g. bill, voucher, pass book, Agreement etc.
Fundamental Accounting Assumptions :

(a) Going Concern : Assumption that an enterprise will continue operations for the foreseeable future. It has indefinitely long life.

(b) Consistency : The accounting policies are followed consistently.

(c) Accrual : Transactions and other events are recognized when they occur they are recorded in the accounting records and reported in the financial statements of the periods to which they relate.