ACCOUNTINGCONCEPTSANDCONVENTIONS

Accountingconcepts:

The term ‘concept’ is used to denote accounting postulates, i.e., basic assumptions orconditions upon the edifice of which the accounting super-structure is based. The following arethe commonaccountingconcepts adoptedbymanybusinessconcerns.

1. BusinessEntityConcept

2.MoneyMeasurementConcept3.GoingConcernConcept

4.DualAspectConcept

5.PeriodicityConcept 6.HistoricalCostConcept

7. MatchingConcept 8.RealisationConcept

9.AccrualConcept 10.ObjectiveEvidenceConcept

i) **Business Entity Concept:** A business unit is an organization of persons establishedto accomplish an economic goal. Business entity concept implies that the business unit isseparate and distinct from the persons who provide the required capital to it. This conceptcan be expressed through an accounting equation, viz., Assets = Liabilities + Capital. Theequation clearly shows that the business itself owns the assets and in turn owes to variousclaimants. It is worth mentioning here that the business entity concept as applied inaccountingforsoletradingunitsisdifferentfrom thelegal concept.Theexpenses,income, assets and liabilities not related to the sole proprietorship business are excludedfromaccounting.However,asoleproprietorispersonallyliableandrequiredtoutilize non-business assets or private assets also to settle the business creditors as per law. Thus,in the case of sole proprietorship, business and non-business assets and liabilities aretreated alike in the eyes of law. In the case of a partnership, firm, for paying the businessliabilities the business assets are used first and it any surplus remains thereafter, it can beused for paying off the private liabilities of each partner. Similarly, the private assets arefirst used to pay off the private liabilities of partners and if any surplus remains, it istreated as part of the firm's property and is used for paying the firm's liabilities. In thecaseofacompany,itsexistencedoesnot depend onthelifespanofanyshareholder.

ii) **Money Measurement Concept:** In accounting all events and transactions are recodein terms of money. Money is considered as a common denominator, by means of whichvarious facts, events and transactions about a business can be expressed in terms ofnumbers. In other words, facts, events and transactions which cannot be expressed inmonetary terms are not recorded in accounting. Hence, the accounting does not give acomplete picture of all the transactions of a business unit. This concept does not also takecareoftheeffectsofinflationbecauseitassumesastablevalueformeasuring.

iii) **GoingConcernConcept:**Underthisconcept,thetransactionsarerecordedassuming that the business will exist for a longer period of time, i.e., a business unit isconsidered to be a going concern and not a liquidated one. Keeping this in view, thesuppliersandothercompaniesenterintobusinesstransactionswiththebusinessunit.Thisassumptionsupportstheconceptofvaluingtheassetsathistoricalcostorreplacement cost. This concept also supports the treatment of prepaid expenses as assets,althoughtheymaybepracticallyunsaleable.

iv) **DualAspectConcept:**Accordingtothisbasicconceptofaccounting,everytransaction has a two-fold aspect, viz., 1.Giving certain benefits and 2. Receiving certainbenefits.Thebasicprincipleofdoubleentrysystemisthateverydebithasacorresponding and equal amount of credit. This is the underlying assumption of thisconcept. The accounting equation viz., Assets = Capital + Liabilities or Capital = Assets -Liabilities, will further clarify this concept, i.e., at any point of time the total assets of thebusiness unit are equal to its total liabilities. Liabilities here relate both to the outsidersandthe owners.Liabilitiestothe ownersare consideredas capital.

v) **PeriodicityConcept:**Underthisconcept,thelifeofthebusinessissegmentedinto different periods and accordingly the result of each period is ascertained. Though the business isassumed to be continuing in future (as per going concern concept), the measurement of incomeand studying the financial position of the business for a shorter and definite period will help intaking corrective steps at the appropriate time. Each segmented period is called “accountingperiod” and the same is normally a year. The businessman has to analyse and evaluate the resultsascertained periodically. At the end of an accounting period, an Income Statement is prepared toascertain the profit or loss made during that accounting period and Balance Sheet is preparedwhich depicts the financial position of the business as on the last day of that period. During thecourseofpreparationofthesestatementscapitalrevenueitemsaretobenecessarilydistinguished.

i) **Historical Cost Concept**: According to this concept, the transactions are recordedin the books of account with the respective amounts involved. For example, if an asset ispurchases, it is entered in the accounting record at the price paid to acquire the same andthat cost is considered to be the base for all future accounting. It means that the asset isrecorded at cost at the time of purchase but it may be methodically reduced in its value bywayofchargingdepreciation.However,inthelightofinflationaryconditions,theapplication ofthisconceptisconsideredhighlyirrelevantforjudgingthefinancialpositionofthebusiness.

ii) **Matching Concept**: The essence of the matching concept lies in the view that allcosts which are associated to a particular period should be compared with the revenuesassociatedtothe same periodtoobtain thenetincome of thebusiness.Underthisconcept,theaccountingperiodconceptisrelevantanditisthisconcept(matchingconcept)whichnecessitatedtheprovisionsofdifferentadjustmentsforrecordingoutstandingexpenses,prepaidexpenses,outstandingincomes,incomesreceivedinadvance, etc., during the course of preparing the financial statements at the end of theaccountingperiod.

iii) **Realisation Concept:** This concept assumes or recognizes revenue when a sale ismade. Sale is considered to be complete when the ownership and property are transferredfrom the seller to the buyer and the consideration is paid in full. However, there are twoexceptionstothisconcept,viz.,1.Hirepurchasesystemwheretheownershipistransferredtothebuyerwhenthelastinstalmentispaidand2.Contractaccounts,in which the contractor is liable to pay only when the whole contract is completed, the profitiscalculatedonthebasisofworkcertifiedeachyear.

iv) **Accrual Concept:**According to this conceptthe revenueis recognized on itsrealization and not on its actual receipt. Similarly the costs are recognized when they areincurred and not when payment is made. This assumption makes it necessary to givecertain adjustments in the preparation of income statement regarding revenues and costs.But under cash accounting system, the revenues and costs are recognized only when theyare actually received or paid. Hence, the combination of both cash and accrual system ispreferable togetridofthelimitationsofeachsystem.

v) **Objective Evidence Concept:** This concept ensures that all accounting must bebased on objective evidence, i.e., every transaction recorded in the books of account musthave a verifiable document in support of its, existence. Only then, the transactions can beverified by the auditors and declared as true or otherwise. The verifiable evidence for thetransactions should be free from the personal bias,*i.e.,* it should be objective in natureand not subjective. However, in reality the subjectivity cannot be avoided in the aspectslikeprovisionforbadanddoubtfuldebts,provisionfordepreciation,valuationofinventory,etc.,andtheaccountantsarerequiredtodisclosetheregulationsfollowed.

AccountingConventions

The following conventions are to be followed to have a clear and meaningful informationanddatainaccounting:

i) **Consistency:** The convention of consistency refers to the state of accounting rules,concepts, principles, practices and conventions being observed and applied constantly,i.e., from one year to another there should not be any change. If consistency is there, theresults and performance of one period can he compared easily and meaningfully with theother. It also prevents personal bias as the persons involved have to follow the consistentrules,principles,conceptsandconventions.Thisconvention,however,doesnotcompletely ignore changes. It admits changes wherever indispensable and adds to theimprovedandmoderntechniques ofaccounting.

ii) **Disclosure:**Theconventionofdisclosurestressestheimportanceofprovidingaccurate, full and reliable information and data in the financial statements which is ofmaterialinteresttotheusersandreadersofsuchstatements.Thisconventionisgiven duelegalemphasisbytheCompaniesAct,1956byprescribingformatsforthep reparation of financial statements. However, the term disclosure does not mean allinformation that one desires to get should be included in accounting statements. It isenoughifsufficientinformation, whichisofmaterialinteresttotheusers,isincluded.

iii) **Conservatism:**Intheprevailingpresentdayuncertainties,theconventio nofconservatism has its own importance. This convention follows the policy of caution orplaying safe. It takes into account all possible losses but not the possible profits or gains.A view opposed to this convention is that there is the possibility of creation of secretreserves when conservatism is excessively applied, which is directly opposed to theconvention of full disclosure. Thus, the convention of conservatism should be appliedverycautiously.