DEPARTMENT OF COMMERCE
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CORE CONCEPT OF

FINANCIAL ACCOUNTING

1. What is Business Entity Concept & Money Measurement Concept? Briefly explain.
2. Point out the accounting concepts?
3. What do you understand by accounting conventions? Please explain.
4. Illustrate the Conservatism?
5. Point out the Dual Aspect Concept & Going Concern Concept.
6. What do you mean by Accrual Concept?
7. Briefly illustrate the Consistency & Full Disclosure of Accounts?

Accounting Concepts And Conventions

Accounting Concepts

- Separate Business Entity Concept
- Money Measurement Concept
- Dual Aspect Concept
- Going Concern Concept
- Accounting Period Concept
- Cost Concept
- The Matching Concept
- Accrual Concept
- Realization Concept

Accounting Conventions

- Convention of full disclosure
- Convention of Materiality
- Convention of Conservatism
- Convention of consistency

i) Business Entity Concept: A business unit is an organization of persons established to accomplish an economic goal. Business entity concept implies that the business unit is separate and distinct from the persons who provide the required capital to it. This concept can be expressed through an accounting equation, viz., Assets = Liabilities + Capital. The equation clearly shows that the business itself owns the assets and in turn owes to various claim

ii) Money Measurement Concept: In accounting all events and transactions are recode in terms of money. Money is considered as a common denominator, by means of which various facts, events and transactions about a business can be expressed in terms of numbers. In other words, facts, events and transactions which cannot be expressed in monetary terms are not recorded in accounting.

iii) Going Concern Concept: Under this concept, the transactions are recorded assuming that the business will exist for a longer period of time, i.e., a business unit is considered to be a going concern and not a liquidated one. Keeping this in view, the suppliers and other companies enter into business transactions with the business unit. This assumption supports the concept of valuing the assets at historical cost or replacement cost.

iv) Dual Aspect Concept: According to this basic concept of accounting, every transaction has a two-fold aspect, Viz., 1.giving certain benefits and 2. Receiving certain benefits. The basic principle of double entry system is that every debit has a corresponding and equal amount of credit.

V) Periodicity Concept: Under this concept, the life of the business is segmented into different periods and accordingly the result of each period is ascertained. Every businessman wants to know the profit or loss of a business so that as per the requirement of it own and end-users so that account may be prepare for three month, six month, one year or two year and also it can be prepare as per the nature of account like, construction work, sugar mills, woolen industries etc

vi) Historical Cost Concept: According to this concept, the transactions are recorded in the books of account with the respective amounts involved. For example, if an asset is purchases, it is entered in the accounting record at the price paid to acquire the same and that cost is considered to be the base for all future accounting. It means that the asset is recorded at cost at the time of purchase but it may be methodically reduced in its value by way of charging depreciation.

vii) Matching Concept: The essence of the matching concept lies in the view that all costs which are associated to a particular period should be compared with the revenues associated to the same period to obtain the net income of the business. Under this concept, the accounting period concept is relevant and it is this concept (matching concept) which necessitated the provisions of different adjustments for recording outstanding expenses, prepaid expenses, outstanding incomes, incomes received in advance, etc., during the course of preparing the financial statements at the end of the accounting period.

viii) Realization Concept: This concept assumes or recognizes revenue when a sale is made. Sale is considered to be complete when the ownership and property are transferred from the seller to the buyer and the consideration is paid in full.

ix) Accrual Concept: Accrual concept ensure that the profit or loss shown is on the basis of full facts relating to all the expenses and income. Accrual refers to those expenses and income which have not been derived in terms of cash. The income pay in advance, the out standing expenses these terms are not entered into cash book because there is no flow of cash .in these transaction as they are only the obligation to receive and pay

x) Objective Evidence Concept: This concept ensures that all accounting must be based on objective evidence, i.e., every transaction recorded in the books of account must have a verifiable document in support of its, existence like cash receipts, cash memo, invoice bills etc. Only then, the transactions can be verified by the auditors and declared as true or otherwise. The verifiable evidence for the transactions should be free from the personal bias,

Accounting Conventions

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, the results and performance of one period can he compared easily and meaningfully with the other. It also prevents personal bias as the persons involved have to follow the consistent rules, principles, concepts and conventions. This convention, however, does not completely ignore changes. It admits changes wherever indispensable and adds to the improved and modern techniques of accounting.

ii) Full Disclosure of Accounts: The convention of disclosure stresses the importance of providing accurate, full and reliable information and data in the financial statements which is of material interest to the users and readers of such statements. This convention is given due legal emphasis by the Companies Act, 1956 by prescribing formats for the preparation of financial statements. However, the term disclosure does not mean all information that one desires to get should be included in accounting statements. It is enough if sufficient information, which is of material interest to the users, is included.

iii) Conservatism: In the prevailing present day uncertainties, the convention of conservatism has its own importance. This convention follows the policy of caution or playing 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 secret reserves when conservatism is excessively applied, which is directly opposed to the convention of full disclosure. Thus, the convention of conservatism should be applied very cautiously.

Accounting Equation

As indicated earlier, every business transaction has two aspects. One aspect is debited other aspect is credited. Both the aspects have to be recorded in accounts appropriately. American Accountants have derived the rules of debit and credit through a 'novel' medium, i.e., accounting equation. The equation is as follows:

Assets = Equities

The equation is based on the principle that accounting deals with property and rights to property and the sum of the properties owned is equal to the sum of the rights to the properties. The properties owned by a business are called assets and the rights to properties are known as liabilities or equities of the business. Equities can be subdivided into equity of the owners which is known as capital and equity of creditors who represent the debts of the business know as liabilities. These equities may also be called internal equity and external equity. Internal equity represents the owner's equity in the assets and external represents he outsider's interest in the asset. Based on the bifurcation of equity, the accounting equation can be restated as follows:

Assets = Liabilities + Capital

(Or)

Capital = Assets – Liabilities

(Or)

Liabilities = Assets – Capital.

The equation is fundamental in the sense that it gives a foundation to the double entry book-keeping system. This equation holds good for all transaction and events and at all periods of time since every transaction and events has two aspects.