INDIAN SCHOOL DARSAIT

DEPARTMENT OF COMMERCE

Sub.: Accountancy	Theory Base of Accounting	Worksheet : 3
Date of Worksheet: 23/04/2017		Prepared by: Joseph Martin Cherian
Name of Student:		Roll Number:
Class and Div. XI C & D		

3rd Chapter

BASIC PRINCIPLES/CONCEPTS OF ACCOUNTING

1.	**ENTITY CONCEPT** • Business is considered as a separate entity different from that of the owner. • All transactions are analyzed from the point of view of business only • Distinction is made only to differentiate the private transactions of the owner from that of the business. • This principle is applicable to all forms of business organizations.
2.	**GOING CONCERN CONCEPT** • Business is said to be having an indefinite life. • On the basis of the assumption transactions are classified into capital and revenue items. • If this assumption is not made people will not enter into long-term contracts as they fear that the business can wind up at any time.
3.	**MONEY MEASUREMENT CONCEPT** • Only transactions that are measured in terms of money are recorded in the books of accounts. • Non-monetary transactions like quality of a product, labour unrest, competent management, even though are important are not recorded in the book of accounts.
4.	**ACCOUNTING PERIOD CONCEPT** • For the purpose of reporting the entire life of a firm is divided into time intervals. Each time interval is known as accounting period. • It is usually for a year. • The accounting year can be a calendar year, fiscal year or natural year.

5.	**REVENUE PRINCIPLE** • Revenue is the amount, which as a result of operations is added to the capital. • It is realized when the goods have been transferred or the services have been rendered to a customer. • It can be realized on the basis of (1) sales (2) cash (3) production
6.	**EXPENSE PRINCIPLE** • Expense is the cost of the use of things or services for the purpose generating revenue. • It is useful for the purpose of estimating profits or losses. Because only expenses are matched with revenue. • It is recognized when assets or services are used to produce revenue during a period.
7.	**MATCHING PRINCIPLE** • This principle indicates the procedures / rules to be followed while matching revenue and expenditure. • Revenue should be matched with the expense if the benefit is likely to accrue in the same year. Otherwise it should not be matched. • Certain expenses are shown in the P/L a/c and certain expenses are shown in the B/S due to operation of matching principle.
8.	**FULL DISCLOSURE PRINCIPLE** • All material (significant) information should be disclosed in financial statements. • Assets, expenses & revenues should be clearly stated along with their methods of valuation and grouping. • The legal requirements if any must also be followed. • Examples. : a] stating the methods of valuation of stock (b) stating contingent liability (c) stating the method of depreciation.
9.	**VERIFIABLE OBJECTIVE PRINCIPLE** • All accounting transactions should be supported and evidenced by business documents (like voucher, cash memos, invoices etc.,)

	• Such documents help in conducting audit. • This principle also states that accounting should be free from personal bias of the person who is recording the transactions.
10.	**DUAL ASPECT PRINCIPLES** • Every business transaction has two-fold aspect as it affects two parties. • Every financial transaction involves (a) yielding of a benefit and (b) giving of that benefit. Every debit has a corresponding credit. • That is why it is always said that ASSETS = LIABILITIES + CAPITAL. Hence any increase or decrease in total assets must simultaneously produce a corresponding increase or decrease in total equities.
11.	**HISTORICAL COST** • All business transactions must be recorded in the books of accounts at Their monetary cost of acquisition. • The balance of assets and liabilities is carried forward from year to year at its acquisition cost, irrespective of increase or decrease in the market value of assets. • The use of Historical cost provides verifiable and objective Accounting information.

MODIFYING PRINCIPLES

12.	**MATERIALITY** • Accounting statements should disclose all items, which are material enough to affect evaluations or decisions. • Only those transactions, which are significant from the point of view of income determination, should be recorded. • Insignificant matters can be ignored.
13.	**CONSISTENCY** • Accounting procedures or practices should remain the same from one year to another. • This will enable the business to compare it results from year to year. • If any change of method is effected it should be disclosed in that year's financial

	statement.
14.	**CONSERVATISM (PRUDENCE)** • "ANTICIPATE NO PROFIT BUT PROVIDE FOR ALL POSSIBLE LOSSES" • Valuing stock at cost or market price whichever is lower, providing for bad and doubtful debts are the examples of the application of this principle. • This principle tries to prevent window dressing (painting a better picture of the business when it actually not)
15.	**TIMELINESS** • IT MEANS APPROPRIATE RECORDING OF TRANSACTIONS AT APPROPRIATE TIME. • All accounting information's must be made available at the earliest time possible • The delay in recording might encourage fraud, embezzlement manipulation. • BETTER TO HAVE LEES INFORMATION IN TIME RATHER THAN MORE RELIABLE INFORMATION VERY LATE.
16.	**INDUSTRY PRACTICE (VARIATIONS IN ACCOUNTING PRACTICES)** • Each industry has to adopt accounting assumptions, basic principles and practice that are prevailing in that industry. • Even though they are not in consonance with the established principles and assumptions it is accepted as industry practice. • Example: (a) valuing stock at market price instead of cost or market price whichever is lower.
17.	**SUBSTANCE OVER FORM** • Accounting Must communicate the material use and substantial information to all those who are directly or indirectly interested in its information. • Transactions and events recorded in the books should be governed by substance of such transaction or event and not the legality of such transaction. • Example: In the case of financial lease the lessee has no legal right on the leased assets. However, leased assets are shown in the books of lessee in accordance with this principle.

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