Accounting principles

- Accounting principles refer to the rules and actions adopted by the accountants globally for recording accounting transactions. These are classified into two categories:
  - Accounting concepts
  - Accounting conventions
- Accounting concepts include the assumptions and conditions on which the science of accounting is based.
- Accounting conventions include the customs and traditions that assists the accountants in preparing accounting statements.

Accounting Period Concept

- To know the financial performance and position of the business, a business owner is required to prepare financial statements at the end of a specific period.
  Therefore, the period for which such financial statements are maintained is termed as 'accounting period'.
  So, to take important financial decisions, a business owner needs to maintain proper financial statements.

Conservatism Concept

- The Conservatism Concept of Accounting states that a business owner should preferably understate rather than overstate his business's net income.
- This means that profits should not be recorded until they are realized. However, all losses, including the ones that have less chances of occurring, should be recorded in the books of accounts.
- Thus, such a policy helps in dealing with business uncertainties and protects the interests of its creditors.

Realization Concept

- As per this concept, revenues arising on account of sale of goods or services rendered must be recorded only when they are realized.
- Typically, a business would realize revenues at the time of selling goods or rendering of services. This means that a business would realize revenues only when the legal right to receive such revenues arise.

Matching Concept

- This concept of accounting states that expenses incurred in a particular accounting period should match with the revenues generated during the same period.
- This means expenses incurred during a particular period should be deducted from revenue earned during the same period.

Consistency Concept

- The financial statements help in evaluating the performance of a business only when such results can be compared over a period of time.
- Therefore, to make such comparisons possible, businesses need to follow uniform and consistent accounting policies over a period of time.

Materiality Concept

- Materiality concept states that events that are trivial and have an insignificant impact on the books of accounts can be ignored. Whereas, the material facts that reasonably influence the decisions of the stakeholders of your business must be recorded.

Historical Cost Concept

- As per this concept, all assets are required to be recorded at their historical cost. This means that assets need to be recorded at their purchase price in books of accounts. Such a price includes the cost of (i) acquisition, (ii) transportation, (iii) installation and (iv) making the asset ready to use.

Money Measurement Concept

- According to this concept, transactions that can be expressed in terms of money only are recorded in the books of accounts.
- Transactions or happenings that cannot be expressed in monetary terms are not recorded in accounting statements.
- Furthermore, transactions are recorded in terms of monetary units and not in terms of units of physical quantity.

Dual Aspect Concept

- This concept states that every transaction has a dual affect and should be recorded in two separate accounts. The dual accounting concept is the foundation for recording transactions in books of accounts. Such a concept is expressed in terms of the following accounting equation: Assets = Liabilities + Capital.
- As per this equation, the assets of a business are always equal to the claims of owners and outsiders. The claim of owners is termed as capital (owner's equity). Whereas, the claims of outsiders are called liabilities (creditors equity). Now, the dual effect of every transaction impacts this equation in such a way that both sides are equal at all times.
- The Double Entry System of Accounting is based on this Principle of Duality.

Going Concern Concept

- This accounting principle assumes that a business will continue to exist long enough to carry out its objectives and commitments and will not liquidate in the foreseeable future.

Accounting conventions

- **Conservatism:** Playing it safe is both an accounting principle and convention. It tells accountants to err on the side of caution when providing estimates for assets and liabilities. That means that when two values of a transaction are available, the lower one should be favored. The general concept is to factor in the worst-case scenario of a firm’s financial future.
- **Consistency**: A company should apply the same accounting principles across different accounting cycles. Once it chooses a method it is urged to stick with it in the future, unless it has a good reason to do otherwise. Without this convention, investors' ability to compare and assess how the company performs from one period to the next is made much more challenging.

Accounting Conventions contd.

- **Full disclosure**: Information considered potentially important and relevant must be revealed, regardless of whether it is detrimental to the company.
- **Materiality:** Like full disclosure, this convention urges companies to lay all their cards on the table. If an item or event is material, in other words important, it should be disclosed. The idea here is that any information that could influence the decision of a person looking at the financial statement must be included.