CLASS XI

THEORY BASE OF ACCOUNTING

WORKSHEET 1

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 oh 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.

ACCOUNTING PRINCIPLES

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) informations 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. • B. 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. • B. 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. How ever, leased assets are shown in the books of lessee in accordance with this principle.