Financial Accounting

According to **American Institute of Certified Public Accountant Committee**:- Accounting is the art of recording, classifying and summarising in a significant manner and in terms of money, transactions and events which are in part at least of a financial character and interpreting the result thereof.

Accounting Concepts:

1. Separate Entity Concept- According to this concept, a business is treated as a separate entity distinct from its owners and all economic proprietors.

2. Money Measurement Concept- Only these transactions are recorded in accounting which is capable of being expressed in terms of money.

3. Going Concern Concept- As per the concept it is assumed that the business will continue to exist for a long period in the future.

4. Accounting Period Concept: As the business is intended to continue indefinitely for a long period, the time results of the business operations can be ascertained only when the business is completely warned up. But ascertainment of profit after a very long period will be of little use to the manager, investors and others because it will be too late to take corrective steps at a time. The users of financial statements need to know the results of the business at frequent intervals. Thus, the entire life of the firm is divided into time intervals

for the measurement of profits of the business. Twelve month period is usually adopted for this purpose because it takes care of all the seasonalities or the fluctuations, if any, in the twelve month period.

5. Cost Concept: A fundamental assumption of accounting closely related to the going concern concept is that an asset is recorded in the books at the price paid to acquire it and that the cost is the bases of all subsequent accounting for the asset. It does not mean that the assets well always be shown at but it means that cost becomes basis for all future accounting for asset.

6. Dual Aspect Concept: This is the basic assumption of accounting. According to this every financial transaction involves two aspects:

a.) Yielding of benefits

b.) The giving of that benefit. Thus, every debit must have a corresponding credit and vice versa.

7. Matching Concepts: The determination of profit of a particular accounting period is essentially a process of matching the revenue recognised during the period and the cost to be allocated to the period to obtain the revenue.

8. Realisation Concept: According to this concept, revenue is considered as being earned on the date at which it is realised i.e. the date when the property in goods passes to the buyer and he becomes legally liable to pay.

9. Objectivity Concept: According to their concept, every entry in accounting records should be supported by some objective evidence objectively connects reliability, truthfulness and verifiability which mean that there is some evidence in ascertaining the correctness of the information reported.

10. Accrual Concept: The essence of the accrual concept is that revenue is recognised when it is realised, that is when sale is complete or services are given and it is immaterial whether cash is received or not.

Accounting Conventions/ Principles

1. Principle of Matching of Cost and Revenue –

According to this principle in determining the net profit from business operations, all costs which are applicable to revenue. Accordingly, for matching costs with revenue, first revenues should be recognised and then costs incurred for generating that revenue should be recognised.

2. Principle of Full Disclosure –

These principles require that all significant information relating to the economic affairs of the enterprise should be completely disclosed.

3. Dual Aspect Principle –

According to this principle, every business transaction is recorded as having a dual respect. There are two sides of every transaction. If one account is debited, any other account is credited. This system of recording transactions based as this principle is called as “Double Entry Systems”. It is because of this principle the two side of balance sheet are always equal.

4. Principle of Consistency –

This principle states that accounting principles and methods should remain consist from one year to year in order to enable the management to compare the results of the two periods and draw important conclusions about the working of the enterprise.

5. Principle of Conservatism –

According to this principle, all anticipated losses should be recorded in the books of accounts, but all anticipated or unrealised gains should be ignored. In other words, conservatism is the policy of playing safe. Provision is made for all known liabilities and losses even though the amount cannot be determined with certainty. Likewise, when there are different alternatives for recording a transaction, the one having least favourable intermediate effect on profits or capital should be adopted. For Eg.

a.) closing stock is valued at the cost price or market price whichever less is.

b.) Provisions for doubtful debts are created in anticipation of bad debts.

6. Principles of Timeliness –

This principle requires that the fundamental statements should be prepared quickly at the end of the accounting period and made available to the management and other external users at the earliest possible time. Financial statements provide useful reformation to their basis.