1 ACCOUNTING PRINCIPLES, CONCEPTS AND CONVENTIONS

THIS CHAPTER INCLUDES

- Definition of Accounting
- Objectives of Accounting
- Function of Accounting
- Book-Keeping
- Accounting Cycle
- Accounting - Classification
- Basis of Accounting
- Basic Accounting Terms
- Accounting Principles
- Accounting Concepts and Conventions

CHAPTER AT A GLANCE

S. No.	Topic	Important Highlights
1.	**Definition**	As per the definition of American Institute of Certified Public Accountants- Accounting is "the art of recording, classifying and summarizing 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 results thereof".
2.	**Characteristics (attributes) of Accounting**	(i) Accounting records transactions and events which are of financial nature. (ii) Accounting is an art. (iii) It involves the following activities: recording, classifying and summarizing

		(iv) Accounting helps in determining the financial position of an enterprise by analysing and interpreting the summarized records and communicating them to users. (v) Accounting information can be manipulated and thus cannot be considered as the true test of performance. (vi) It records transactions in terms of money.
3.	**Objectives of Accounting**	(i) Maintaining accounting records (ii) Ascertaining profit/loss of the enterprise (iii) Ascertaining the financial position of the enterprise (iv) Providing accounting information to the users.
4.	**Functions of Accounting**	(i) Maintaining systematic records (ii) Protecting and controlling business properties (iii) Ascertaining the operational profit/loss (iv) Ascertaining financial position (v) Facilitating rational decision making.
5.	**Advantages of Accounting**	(i) Provides financial information about the business to interested parties (ii) Helps in comparison of financial results • Comparison of its own results of different years • Comparison of financial results with other firms in the industry (iii) Helps in decision making

		(iv) Accounting information can be used as an evidence in legal & Taxation matter (v) Helps in valuation of the business (vi) Provide information to interested parties
6.	**Disadvantages (Limitations of Accounting)**	(i) Accounting ignores non monetary transactions (ii) Accounting information is sometimes based on estimates which may be unrealistic (iii) Window Dressing may lead to faulty results. (iv) Accounting ignores the effect of price level changes as the recordings are done at historical costs. Fixed assets recorded at historical cost. (v) Accounting information can be manipulated and thus can not be considered as the true test of performance. i.e. it may be biased. Money as measurement unit changes in value. (vi) Accounting Information may be biased. Accounting Information is not without personal influence or bias of accountant.
7.	**Book-Keeping**	• Book keeping is a branch of knowledge that educates us how the financial records are maintained. Due to clerical in nature it is done by junior employees. • It is concerned with recording financial data of the business in a significant and orderly manner.

		• It is meant to show the effect of all the transactions made during the accounting period on the financial position of the business. • Book keeping is a clerical work which covers procedural aspects of accounting work and includes record keeping function. It is science and art both. • Book keeping is mechanical and repetitive.
8.	**Accounting Cycle**	**Steps/Phases of Accounting Cycle:** **(i) Recording of Transaction:** As soon as a transaction happens it is at first recorded in subsidiary book. **(ii) Journal:** The transactions are recorded in Journal chronologically. **(iii) Ledger:** All journals are posted into ledger chronologically and in a classified manner. **(iv) Trial Balance:** After taking all the ledger account closing balances, a Trial Balance is prepared at the end of the period for the preparations of financial statements. **(v) Adjustment Entries:** All the adjustments entries are to be recorded properly and adjusted accordingly before preparing financial statements. **(vi) Adjusted Trial Balance:** An adjusted Trial Balance may also be prepared. **(vii) Closing Entries:** All the nominal accounts are to be closed by the transferring to Trading Account and Profit and Loss Account.

		(viii) Financial Statements: Financial statement can now be easily prepared which will exhibit the true financial position and operating results.
9.	**Basis of Accounting**	**(i) Accrual Basis of Accounting** Accrual Basis of Accounting is a method of recording transactions by which revenue, costs, assets and liabilities are reflected in the accounts for the period in which they accrue. This basis includes consideration relating to deferrals, allocations, depreciation and amortization. This basis is also referred to as mercantile basis of accounting. **(ii) Cash Basis of Accounting** Cash Basis of Accounting is a method of recording transactions by which revenues, costs, assets and liabilities are reflected in the accounts for the period in which actual receipts or actual payments are made.
10.	**Accounting Principles**	**Generally Accepted Accounting Principles** A widely accepted set of rules, conventions, standards, and procedures for reporting financial information, as established by the Financial Accounting Standards Board are called Generally Accepted Accounting Principles (GAAP). These are the common set of accounting principles, standards and procedures that companies use to compile their financial statements.

11.	**Accounting Concepts**	**1. Going Concern Concept** • It is on this concept that a clear distinction made between assets and expenditure. • This concept assumes that business shall continue for an indefinite period. • The proprietor has no intention to close it in the near future and would be able to meet its obligations according to plan. • Due to this concept : (i) Assets are valued at cost and then depreciated every year. (ii) Expenses and incomes are classified into capital and revenue. **2. Business Entity Concept** • According to this concept, business and its owners are separate entities. • The owner is treated as the creditor of the company to the extent of capital contributed by him. • All transactions of the business are recorded in the books of business from the point of view of business. • This concept keeps the personal affairs of the owner away from the business affairs. • Income or profit is the property of the business unless distributed among the owners. **3. Money Measurement Concept** • As per this concept, only those transactions which can be expressed in terms of money can be recorded.

- Transactions and events which cannot be expressed in terms of money, even if they affect the business, are not recorded in the books.
- Income or profit is the property of the business unless distributed among the owners.

  Example: Death of the director, disputes within the organisation, strikes, etc. may affect the working and profits of the business, but are not recorded in books of accounts.
- Measuring unit for money is the currency of the ruling country.

  Note: Entity and money measurement are considered as the basic concepts on which other procedural concepts depend.

4. Cost concept

- According to this concept, the value at which the various assets shall be recorded in the books shall be the historical cost or acquisition cost.
- This concept says that the assets shall be recorded at cost at the time of its purchase and its value shall be reduced systematically by charging depreciation.
- This concept helps to keep the statements free from personal bias or judgements.
- This concept is not beneficial for new investors as they are more interested in knowing the present worth of the business rather than its historical cost.

		5. Dual Aspect Concept • According to this concept, every transaction has two aspects a debit aspect and a credit aspect. • Due to these two aspects, the total amount debited is always equal to the total amount credited (i.e. total assets are equal to total liabilities) **Note: Concept of Accounting Equation :** Accounting equation is based on the dual aspect concept. **Assets:** These are the resources owned by the business. **Liabilities:** These are the claims against the assets. Liability to owners — capital Liability to outsiders — liabilities. **6. Realisation concept** • According to this concept, revenue is recognized only when sale is made. • This concepts says that any change in the value of an asset is to be recorded only when business realises it. • This concept prevents business firms from inflating their profits by showing expected incomes. (which have not yet materialised) • E.g. An increase in the value of asset cannot be considered as a profit until and unless the asset is sold and profit is realised. **Note :** Going concern + Cost Concept + Realization Concept = Valuation criteria

		7. Accrual concept • It is fundamental to the usefulness of financial accounting information. • According to this concept, a transaction should be recorded at the time when it takes place and not when the cash is realised. • Every transaction and event effects, one or more or all the three aspects, assets, liabilities and capital. • They have their impact on both the profit & loss A/c and Balance Sheet. • This concept implies that income should be measured as a difference between revenue and expenditure. **8. Accounting Period Concept** • This is also known as the concept of periodicity. • According to this principle, the life of an enterprise is broken into smaller periods (generally one year) know as accounting period. • The main objective of this concept is to know the performance of the enterprise at regular intervals. • Accounting period is an interval of time at the end of which the income or revenue statement and balance sheet are prepared in order to show the results of the operations. **9. Matching concept/ Revenue match concept** • Based on accounting period concept • As per this concept, expenses of a period should be matched with the revenues of that period.

		• It says, the cost incurred to earn the revenue should be recognized as expenses in the period when revenue is recognized. • Matching principle requires that all revenues earned during an accounting year, whether received or not and all cost incurred, whether paid or not, have to be taken into account while preparing Profit/Loss Account. In the same manner all amounts received or paid during the current year but pertaining to the previous year or the next year should be excluded from current year's revenue and cost. • The term matching means appropriate association of related revenues and expenses.
12.	**Accounting Conventions**	**1. Consistency** • According to this convention, accounting practices once selected and adopted should be applied consistently year after year. • This convention helps in comparison of financial statements. • Consistency does not mean that accounting principles once adopted can never be changed. They can be changed, if the change is desirable. **Example:** If a company follows written down value method of depreciation, it shall continue to follow year after year.

		2. Disclosure • This is also known as the "Full disclosure" principle. • According to this convention, all significant information should be fully and fairly disclosed in the financial statements. • Ensuring this convention increases the relevance and reliability of financial statements. The companies act make ample provision for disclosure of essential information. **3. Conservatism** • The concept of conservatism states that we should not anticipate a profit but should provide for all possible losses while preparing financial statements. • It enables the financial statements to show a realistic picture of the state of affairs of the enterprise. • This convention understates the assets and overestimates the liabilities. • Financial statement are usually drawn up on a conservative basis. • Choice between two method of valuing an asset the accountant should choose a method which leads to lesser value. **Example:** Valuing stock at lower of cost or market value, making provision for doubtful debts in anticipation of debts becoming bad, are done to comply with the convention of conservatism.

		4. Materiality • According to the convention of materiality, accountant should record only those items which are material and ignore all insignificant items. • An item is said to be material if it is likely to influence the decision of the users. (like investors etc.) • Judgement of materiality depends from organisation to organisation and on the basis of professional experience and judgement.

OBJECTIVE QUESTIONS

2007 - June [1] (a) In each of the following one of them is correct. Indicate the correct answer :

(iii) When the concept of conservation is applied to the Balance Sheet, it results in
(a) Overstatement of Capital
(b) Understatement of Capital
(c) Overstatement of Assets
(d) Understatement of Assets **(2 marks)**

Answer:

(d) Understatement of Assets

2007 - Dec [1] (b) State with reasons whether the following are true or false:

(i) Furniture for a furniture dealer is stock in trade.
(viii) Dual concept of accounting is not strictly followed in the case of Single entry system. **(1 × 2 = 2 marks)**

Answer:

(i) True
(viii) True

2008 - June [2] (j) Hybrid system of Account is a mixture of __________ and __________.

(k) _________ Liability is not reflected in Liability side of a Balance Sheet but shown as a ____________ to the Balance Sheet.

(2 × 2 = 4 marks)

Answer:

(j) Hybrid system of Account is a mixture of ***Cash system*** and ***Mercantile System.***

(k) ***Contingent*** Liability is not reflected in Liability side of a Balance Sheet but shown as a ***Foot Note*** to the Balance Sheet.

2008 - Dec [1] (a) In each of the following, one of them is correct. Indicate the correct answer :

(vii) The recognition that every transaction has two sides to it, is the leading principle of
(a) Accrual Concept
(b) Realisation Concept
(c) Dual Aspect Concept
(d) Matching Concept **(1 mark)**

(b) Fill in the blanks:

(iii) Effects of an event must be recognized in the same accounting period as per _______ concept.

(iv) Contingent Liability is a _______ item to the Balance Sheet.

(1 × 2 = 2 marks)

Answer:

(a) (vii) **(c)** Dual Aspect Concept
(b) (iii) Matching
(iv) Foot Note

2009 - June [1] (b) Fill in the blanks :

(iii) The ________discount is never entered in the books of accounts.

(1 mark)

Answer:
Trade

2009 - Dec [1] (b) Fill in the blanks:

(ii) Effects of an event must be recognised in the same accounting period in which they are entered as per _________ concept. **(1 mark)**

Answer:
Matching

2010 - June [1] (b) Fill up the banks:

(i) Debtor is a person who _____ money to the business.

(ii) Every debit has a _______ credit. **(1 × 2 = 2 marks)**

Answer:

(i) Owes

(ii) Corresponding

2010 - Dec [1] (c) State the reasons whether the following statements are **True** of **False:**

(No marks shall be awarded if reason is not given)

(i) Prudence is a concept to recognize realized losses and not profits.

(vii) Contingent liability is an unascertained liability but its amount and due date are determinate. **(2 × 2 = 4 marks)**

Answer:

(i) **False:** Prudence is a concept to recognize anticipated losses but not anticipated profits.

(vii) **False:** Contingent liability is an unascertained liability and its amount and due date are indeterminate.

2010 - Dec [2] (a) Give one word or phrase that describe the following:

(i) Making provision for doubtful debts is an application of which Accounting Principle?

(ii) Accounting of a small calculator as an expense and not as an asset is an application of which Accounting Principle?

(iii) Appending notes to the financial statements is an application of which Accounting Principle? **(½ × 3 = 1.5 marks)**

Answer:

(i) Prudence

(ii) Materiality

(iii) Full Disclosure

2011 - June [1] (a) In each of the following one of the alternatives is correct, indicate the correct one:

(i) The convention that states that the accounting practice should be followed consistently over the years

(a) Consistency

(b) Conservation

(c) Materiality

(d) Disclosure

(viii) Claims against the company not acknowledged as debts are

(a) Contingent liability

(b) Current liability

(c) Secured loan

(d) Unsecured loan **(1 × 2 = 2 marks)**

(b) Fill in the blanks :

(vi) According to____________concept all the personal income and expenditure of the owner of a business should be separated from business income and expenditures. **(1 mark)**

Answer:

(a) (i) **(a)** The consistency

(viii) **(a)** Contingent liability

(b) (vi) Separate Entity

2011 - Dec [1] (c) State with reasons whether the following statement is True or False:

(v) Capital is treated as internal liability. **(2 marks)**

Answer:

True: AS it is the contribution by the owners of company.

2012 - June [1] (b) Fill in the blanks :

(ii) Closing stock is valued at cost or net realizable value, whichever is less, is based on _________ concept.

(iii) The _________ discount is never entered in the books of accounts.

(1 × 2 = 2 marks)

(c) State with reasons whether the following statement is True or False:

(ii) Prudence is the concept to anticipate and recognize losses.

(2 marks)

Answer:

(b) (ii) Conservatism

(iii) Trade

(c) (ii) **True:** Profits are not anticipated but losses are provided as a matter of conservatism. The exercise of prudence in selection of accounting policies is to ensure that (i) profits and assets are not overstated (ii) losses and liabilities are not understated.

2012 - June [5] (a) In each of the following one of the alternatives is correct, indicate the correct one :

(i) Which method of costing is used for determination of costs for printing industry?

(a) Process Costing

(b) Operating Costing

(c) Batch Costing

(d) Job Costing **(1 mark)**

Answer:

(d) Job Costing

2012 - Dec [1] (c) State whether the following statements are 'True' or 'False':

(v) A sale is recognised when goods are sent to customer.

(vii) A business transaction is always recorded in terms of money.

(1 × 2 = 2 marks)

Answer:

(v) False

(vii) True

QUESTIONS AND ANSWERS OF SEPTEMBER 2014

1. Which of the following concepts, if violated, would make comparison of financial statements over a period of time difficult?
   (a) Cost concept
   (b) Consistency concept
   (c) Accounting period concept
   (d) Accrual concept **(1 mark)**
   Answer: (b)
2. Conservatism concept does not require
   (a) Making provision for doubtful debts
   (b) Valuing stock at lower of cost or net realisable value
   (c) Creating provision for discount on creditors
   (d) Making provision for an unfavourable legal suit **(1 mark)**
   Answer: (c)
3. As per duality concept or accounting equivalence concept, which of the following is correct?
   (a) All increase in liabilities and increase in assets represent sources of funds
   (b) All decrease in liabilities and decrease in assets represent sources of funds
   (c) All increase in liabilities and decrease in assets represent sources of funds
   (d) All increase in liabilities and increase in assets represent uses of funds **(1 mark)**
   Answer: (c)

QUESTIONS AND ANSWERS OF DECEMBER 2014

1. This is more of a convention than a concept, it proposes that while accounting for various transactions, only those which may have material effect on profitability or financial status of the business should have special consideration for reporting, this concept is known as

(a) Concept of Consistency
(b) Concept of Conservation
(c) Concept of Materiality
(d) Concept of Disclosure **(1 mark)**

Answer: (c)

2. Recording of Fixed Assets at cost ensures adherence of
   (a) Conservatism Concept
   (b) Going Concern Concept
   (c) Cost Concept
   (d) Both (a) and (b) above **(1 mark)**

   Answer: (c)

QUESTIONS AND ANSWERS OF MARCH 2015

1. Human resources will not appear in the balance sheet according to ______ concept.
   (a) Accrual
   (b) Going concern
   (c) Money measurement concept
   (d) None **(1 mark)**

   Answer: (c)

2. The ____ concept means that similar items in a set of accounts should be given similar accounting treatment and it should be applied from one period to another.
   (a) Going Concern
   (b) Prudence
   (c) Consistency
   (d) Materiality **(1 mark)**

   Answer: (c)

3. 'A Limited' purchased goods of ₹ 10,00,000, and sold 90% of goods and remaining goods market value is ₹ 90,000, and closing stock is 10%, but he recorded ₹ 90,000 and not ₹ 1,00,000. Which concept does he follows:

(a) Materiality concept
(b) Cost concept
(c) Entity concept
(d) Conservatism concept **(1 mark)**

Answer: (d)

QUESTIONS AND ANSWERS OF JUNE 2015

1. Omission of Paise and showing the round figures in financial statements is based on:
   (a) Conservatism Concept
   (b) Consistency Concept
   (c) Materiality Concept
   (d) Realization Concept. **(1 mark)**

   Answer: (c)

QUESTIONS AND ANSWERS OF SEPTEMBER 2015

1. Assets are held in the business for the purpose of:
   (a) Re-sale
   (b) Conversion into cash
   (c) Earning reverse
   (d) None of the above. **(1 mark)**

   Answer: (c)
2. It is essential to standardize the accounting principles and policies in order to insure:
   (a) Transparency
   (b) Consistency
   (c) Comparability
   (d) All of the above. **(1 mark)**

   Answer: (d)

3. In the financial statement, contingent liability is:
   (a) Recognized
   (b) Not Recognized
   (c) Adjusted
   (d) None of the above. **(1 mark)**

   Answer: (b)

QUESTIONS AND ANSWERS OF DECEMBER 2015

1. Rohan purchased goods for ₹ 25,00,000 and sold 4/5th of the goods amounting ₹ 18,00,000 and met expenses amounting ₹ 2,50,000 during the year, 2013. He counted net profit as ₹ 3,50,000 which accounting concept was followed by him?
   (a) Entity
   (b) Periodicity
   (c) Matching
   (d) Conservation. **(1 mark)**

   Answer: (c)
2. The determination of expenses for an accounting period is based on the principle of:
   (a) Objectivity
   (b) Materiality
   (c) Matching
   (d) Periodicity. **(1 mark)**

   Answer: (c)
3. The concepts of Conservation in balance sheet results in:
   (a) Increase in Cash
   (b) Decrease in Cash
   (c) Decrease in assets
   (d) No change in assets. **(1 mark)**

   Answer: (a)

QUESTIONS AND ANSWERS OF MARCH 2016

1. If the going concern concept is no longer valid, which of the following is true?
   (a) All prepaid assets would be completely written-off immediately.
   (b) Potal contributed capital and retained earnings would remain unchanged.
   (c) Intangible assets would continue to be carried at net amortized historical cost.
   (d) Land held as an investment would be valued at its realizable value.
   (1 mark)

   Answer : (d)
2. Under which of the following concepts are shareholders created as creditors for the amount they paid on the shares they subscribed to ?
   (a) Cost concept
   (b) Duality concept
   (c) Business entity concept
   (d) Since the shareholders own the business, they are not treated as creditors. **(1 mark)**

   Answer : (c)
3. Which of the following is not a contingent liability ?
   (a) Claims against the company not acknowledged as debts
   (b) Debts included on debtors which are doubtful in nature
   (c) Uncalled liability on partly paid shares
   (d) Arrears of cumulative fixed dividends. **(1 mark)**

   Answer : (b)
4. Which of the following is not a contingent liability:
   (a) Debts included in sundry debtors which are doubtful in nature
   (b) Uncalled liability on partly paid shares
   (c) Claims against the company not acknowledged as debts
   (d) Arrears of fixed cumulative dividend. **(1 mark)**

   Answer : (a)

5. The concept of conservatism will have the effect off:
   (a) Overstatement of Assets
   (b) Understatement of Assets
   (c) Overstatement of Liabilities
   (d) Understatement of Liabilities. **(1 mark)**

   Answer : (b)

QUESTIONS AND ANSWERS OF JUNE 2016

1. Recording of Fixed Assets at cost ensure adherence of:
   (a) Conservatism concept
   (b) Going concern concept
   (c) Cost concept
   (d) Both (a) and (b) above. **(1 mark)**

   Answer: (c)
2. Accounting is a / an _____.
   (a) Science
   (b) Art
   (c) Subject matter of sociology
   (d) Subject matter philosophy. **(1 mark)**

   Answer: (b)

QUESTIONS AND ANSWERS OF DECEMBER 2016

1. Choose the correct answer from the given four alternatives:
   (iv) Accounting does not record non-financial transactions because of ______.
   (a) entity concept
   (b) accrual concept
   (c) measurement concept
   (d) going concept **(1 mark)**

Answer:

(c) measurement concept

2. State whether the following statement is True or False:
   (i) "Going concern concept" means that the business is assumed to exist for an indefinite period. **(1 mark)**

Answer:

True

4. Fill in the blanks:
   (i) Cash discount is allowed to encourage prompt payment by the _________.
   (ii) Closing stock is valued at cost or net realisable value, whichever is less. This is based on __________concept in accounting.
   (iv) _______is to be disclosed by way of a note to the financial statements. **(1 × 3 = 3 marks)**

Answer:

(i) Debtors
(ii) Conservatism
(iv) Contingent liability

QUESTIONS OF JUNE 2017

1. (a) Choose the correct answer from the given four alternatives:
   (i) The determination of expenses for an accounting period is based on the concept of
      (a) Objectivity
      (b) Materiality
      (c) Matching
      (d) Periodicity **(1 mark)**
   (ii) Decrease in the amount of creditors results in
      (a) increase in cash
      (b) decrease in cash
      (c) increase in assets
      (d) no change in assets **(1 mark)**

(iii) Accounting does not record non-financial transactions because of
   (a) Entity Concept
   (b) Accrual Concept
   (c) Cost Concept
   (d) Money Measurement Concept **(1 mark)**

(iv) Income tax of the sole trader paid is shown
   (a) Debited to P & L Account
   (b) Debited to Trading Account
   (c) Debited to his Capital Account
   (d) None of the above **(1 mark)**

(b) State whether the following statements are True or False:
   (i) Capital is equal to Asset - Liability.
   (vii) Fixed assets are kept in the business for use over a longer period.
   (viii) Ownership expressed in terms of money called Capital Account.
(1 mark each)

DESCRIPTIVE QUESTIONS

2008 - Dec [2] (b) Define Contingent Liabilities. **(3 marks)**

Answer :

It represents a potential obligation that could be created depending on the outcome of an event. E.g. if any supplier files a legal suit it will not be accepted as admitted liability till the verdict of the court of law is received. From the date of legal suit till the date of final verdict, this claim is shown as contingent liabilities, which is not recorded in the books of accounts, but disclosed by way of foot note under the liabilities side of the Balance Sheet. Some of examples are :

(i) Claims against the company not acknowledged as debt.
(ii) Uncalled liabilities on shares partly paid.
(iii) Arrears of fixed cumulative dividend.
(iv) Other money for which the company is contingently liable.

2012 - June [3] (c) Recognize the accounting concept in the following :

(i) The transactions are recorded at their original cost.

(ii) The business will run for an indefinite period.

(iii) Every transaction has two effects to be recorded in the books of accounts.

(iv) Accounting treatment once decided should be followed period after period. **(1 × 4 = 4 marks)**

Answer :

Accounting Concept:

(i) Historical Cost concept

(ii) Going Concern concept

(iii) Dual aspect concept

(iv) Consistency concept

TOPIC NOT YET ASKED BUT EQUALLY IMPORTANT FOR EXAMINATION

SHORT NOTES

Q.1. Write short note on :
Going concern concept

Answer :

Going Concern Concept : This is the basic accounting concept anticipating the activities of the business entity will operate for the foreseeable future. This is also based on the basic hope of the business to continue and prosper in the years of its existence. On the basis of this concept assets and liabilities are accounted for on historical cost basis and not at market value on disposal. The Companies Act now requires the directors to prepare the accounts based on this concept and to report the same in their directors responsibility statement.

Q.2. Write short note on :
Historical cost concept

Answer :

Historical cost refers to the cost at time of acquisition. Historical cost forms the basis of many accounting valuations. This concept is an idea about the basis on which assets should be valued in the account that was paid for them. In other words, an asset is ordinarily recorded at its cost and this cost becomes the basis for subsequent accounting for that asset. This concept provides uniformity in accounting records under conditions of stable prices. But, under conditions of inflation, there will be an overstatement of the net profit.

DESCRIPTIVE QUESTIONS

Q.1. Discuss in brief any four concepts of Accounting.

Answer :

Concepts of accounting :

(i) **Going concern concept:** The accounts are prepared on the basis that the business of an enterprise is to continue for a long time and as such the assets other than current assets are valued at historical cost and not at their realisable value.

(ii) **Consistency concept:** The accounting treatment of like items is consistently applied from one period to subsequent periods.

(iii) **Accrual concept:** Income and expenses are recorded in the books as and when they are earned or incurred without considering the time of actual receipt or payments.

(iv) **Prudence concept:** A business should not take into cognisance of any income or profit till there is reasonable certainty, but should provide on anticipation of a loss fully irrespective of their difference in time of actual happening of such loss.

(v) **Dual aspect concept:** Every transaction entered has a double effect while entries are recorded in the accounts.

(vi) **Money measurement concept:** An event is recorded on money terms and not based on many other economic factors.

(vii) **Realisation concept:** Profits and gains are recognised only when there is a legal right to receive them.

(viii) **Business Entity concept:** Business activities would be separated from personal activity of a businessman.