



Subject : Business Finance II

Accounting Concepts

Accounting Concepts

- Accounting standards are based on concepts and conventions which have gradually come together and evolved over many years since bookkeeping and accountancy came into being.

Cost Concept

- Under that concept, non-current assets generally appear in the statement of financial position at their original cost less depreciation to date, subject to a possible impairment write-down.
- The cost concept is being gradually phased out to provide more scope for realism in the financial statements. For example, tangible non-current assets such as property, plant and equipment can be shown at **their fair value** rather than their **historical costs**.

Money Measurement

- Accounting statements restrict themselves to matters which can be **measured objectively in money terms**.
- Excludes such items as the values of the company's customer base, its workforce and its brand names

Business Entity Concept

- Affairs of the business are kept separate from those of the owners.
- This is perfectly valid in the case of a limited company, which has its own legal identity. It would, however, also apply to sole traders and partnerships where the business does not have a separate legal form.

Realisation Concept

- Income is recognised as and when it is 'earned'. It is not, therefore, necessary to wait until the customer settles his or her bill. This avoids the fluctuations in reported income which might arise if everything was accounted for on a cash basis.
- May also create the impression that the business is performing well when, in fact, it is in danger of running out of cash.

Accrual concept

- Expenses are recognised as and when they are incurred, regardless of whether the amount has been paid.
- Again, this avoids the random allocation of costs to periods depending on whether the bill happens to have been paid or not

Matching concept

- Income and expenses which relate to each other should be matched together and dealt with in the same statement of profit or loss.

Dual Aspect concept

- Dual aspect concept recognises that every transaction or adjustment will affect two figures. For example, the purchase of inventory for cash will increase the asset of inventory and reduce the asset of cash.
- This concept forms the basis for the **double entry bookkeeping** system

Materiality

- There is very little point in making minute adjustments which have no real effect on the overall picture portrayed by the financial statements.
- Accountants might report rough approximations for certain costs rather than waste time calculating more precise figures.

Prudence

- lowest reasonable figure should be stated for profit or for any of the assets. The highest reasonable figure should be stated for any liabilities.
- This means that there is very little danger of the figures lulling anybody into a false sense of security by overstating the company's strengths.
- To be applied in **situations of uncertainty**

Going Concern Concept

- Assumed that a business will continue indefinitely in its present form
- ***To support the cost concept of accounting***

Consistency

- Figures published by the company should be comparable from one year to the next.
- Accounting policies should not, therefore, be changed from one year to the next unless there is a very good reason for doing so. Any changes should be highlighted and their impact explained, which may involve restating prior year figures in the accounts.

Thank You