FUNDAMENTAL ACCOUNTING ASSUMPTIONS

Going concern assumption

- According to this assumption, it is assumed that business shall continue for a foreseeable future and there is no intention to close the business.
- It is because of this concept that a distinction is made between capital and revenue expenditure.
- On the basis of this concept, total cost of fixed asset is not treated as expense in the year of purchase.

Consistency assumption

- According to this assumption policies once adopted should be applied consistently year after year.
- This concept helps in better understanding of accounting information and more meaningful comparison.
- This concept is important when alternative accounting practices are available. For e.g. method of depreciation i.e. WDV and SLM both are acceptable.
- Policies can be changed if change is required by law or accounting standard or the change will result in more meaningful presentation.

Accrual assumption

- As per this assumption a transaction is to be recorded when it takes place and not when the settlement in money takes place.
- Under this concept profit is regarded as earned when goods or services are sold to a customer who accepts an obligation to pay.
- For e.g. if goods sold in February and payment is received in April then sales should be recorded in the month of February even if payment is not received.

ACCOUNTING PRINCIPLES

1. Business entity principle
- According to this principle business is separate from owners. Therefore business transactions are recorded from the point of view of business and owners.
- Owners are considered creditors of the business to the extent of capital invested.
- This principle is applicable to every form of enterprise including sole proprietorship.

2. Money measurement principle
- According to this concept only those transactions and events which can be measured in terms of money are recorded in books of accounts.
- Transactions and events that cannot be measured in terms of money are not recorded in books of accounts. E.g. honesty, hardwork, dedication etc. This is one of the drawback of accounting.
- This principle considers value of money as static.
- If an enterprise has 5 cars, 2 buildings, and 100 chairs etc. these cannot be added. These will be shown in money terms.
Accounting period principle

- As per this principle, life of an enterprise is broken into smaller periods so that its performance can be measured regularly.
- One may argue that financial statements of the enterprise should be prepared at the end of its life but it is impossible to do so as number of users of financial statements need information for their purpose. e.g. government for tax, management or decision making etc.
- In view of the above, life of business broken into smaller periods is termed as accounting period.

Full disclosure principle

- As per this principle, there should be complete and understandable reporting of economic information so that users of financial statements can take informed decision.
- All material and significant information should be disclosed to maintain good accounting practices.
- Disclosure of material information will help in better understanding and more ever money disclosures are required by companies act, 2013.
- Whether information should be disclosed or not is dependent on materiality of information.

Materiality principle

- As per this concept every material item or event should be disclosed separately so that user of the financial statement can take informed decision.
- Whether an item is material or not is dependent on the nature and amount.
- An item may be material for one enterprise and may not be material for another enterprise e.g. repair expense of one lakh may be material for enterprise having turnover of five lakh but may not be material for enterprise having turnover of fifty crores.

Prudence or conservatism principle

- As per this principle, do not anticipate a profit but provide for all possible losses.
- This concept ensures presentation of a realistic picture of the enterprise and not a painted picture.
- This concept has a drawback that it may be used to create secret reserves.
- Valuation of stock at cost or NRV whichever is less is an application of prudence concept.

Cost concept or historical cost principle

- According to this concept, an asset is recorded in books of accounts at a price paid for it.
- At the time of purchase asset is recorded at its cost and depreciated thereafter.
- Market value of an asset may be different with its book value.
- This concept brings objectivity in financial statements.

Matching concept or matching principle
• As per this concept, revenues of the period should be matched with expenses of that period to determine correct profit.
• As per this concept, payment or receipt is not relevant. What matters is occurrence of a transaction and matching of cost and revenue.
• This concept gives rise to outstanding expenses, prepaid expenses, advance income, accrued income etc.
• This concept should be followed to have true and fair view.

Dual aspect or duality principle

• As per this principle, every transaction has two aspects i.e. debit and credit.
• In short, every debit has a credit in one or more accounts and vice versa.
• E.g. Ravi started business with a capital of one lakh or one hand asset of the business is increased by one lakh and on the other hand business has a liability towards owner to the extent of capital.

Revenue recognition concept

• According to this concept, revenue is considered to be realised when a transaction takes place and the obligation to receive the amount has been established.
• It is to be noted that recognition of revenue and receipt of an account are two different aspects. E.g. if sale took place in February and payment is received in May then sales will be considered of February.

Verifiable objective concept

• As per this concept, accounting should be free from personal bias.
• In other words, all accounting transactions should be evidenced by supporting documents.
• E.g. are cash, invoice, cheque, receipt etc.

Accounting standards

Accounting standards are set of guidelines issued by ICAI that have followed for preparation and presentation of financial statements.

Nature of accounting standards:

• These are the guidelines which provide framework.
• It brings uniformity and ensures transparency, consistency, and comparability.
• These are made taking into consideration laws of the country and business environment.
• These are mandatory in nature.
• They are flexible in a way, alternatives are available.

Objectives of accounting

• Minimise diverse/different accounting policies.
• Promote better understanding of financial statements.
• Ensures comparison of financial statements.
- Enhance reliability.

**Advantages/utility of accounting standards**

- It provides the norms on the basis of which financial statement should be prepared.
- It ensures uniformity which leads to meaningful comparison of financial statements.
- It enhances reliability of the financial statements.
- It helps auditors in auditing the accounts.