Basic Understanding of Accounting Principles, Accounting Concepts and Accounting Convention

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Accounting Principles

Accounting principles are the rules that have emerged from the use of basic accounting concepts. These rules have evolved over a long period of time; they represent the collective wisdom of accounting history. Adherence to these rules ensures that accounting records are maintained on more or less the same basis by all business units and can, therefore, be relied upon and used for comparison. So, to achieve that purpose, standards were invented that were uniform, scientific and easily adaptable for all. These standards are known as accounting principles. Accounting principles may be defined as those rules of action or conduct which are adopted by the accountants universally while recording accounting transactions. It is necessary to frame or make certain uniform standards which are acceptable universally. These standards are termed as "Accounting Principles".

Had there been no Accounting principles, every business would be preparing its financial statements in its own distinguished manner. Number of different formats in financial statements would be presented for the same financial information. Businesses themselves would find it hard to evaluate their performance, compare their competitor's financial statements or approach each other for raising funds, supplying goods, etc. Financial data and statements would be useless in evaluating businesses, as there would be no common format or principle followed when preparing the financial statements. Hence, in absence of Accounting principles, the situation would be disastrous. That's why accounting principles are needed to provide a form of standardisation and uniform reporting of financial statements and accounting practices.

These principles, which serve as the rules for accounting for financial transactions and preparing financial statements, are known as the "*Generally Accepted Accounting Principles,*" or GAAP. The Generally Accepted Accounting Principles (GAAP) ensure that financial statements are accurate and consistent in recording and tracking financial records uniformly and globally. The accounting principles and concepts have global acceptance and bring an acceptable format and accounting uniformity when preparing financial statements. The authorities and regulators in each country, like India, USA, UK, etc., have different GAAP procedures in accounting. However, the objectives, fundamentals and core accounting principles of all GAAP procedures are identical. They set up

certain protocols, accounting concepts and standards, that all businesses and companies should and are expected to follow when accounting. This helps get efficient reports and accurate financial statements when viewing an organisation's reports or statements like the Balance Sheet or Profit and Loss Statements.

The application of the principles by accountants ensures that financial statements are both informative and reliable. It ensures that common practices and conventions are followed, and that the common rules and procedures are complied with. This observance of accounting principles has helped developed a widely understood grammar and vocabulary for recording financial statements. They are a body of doctrines commonly associated with the theory and procedures of accounting. They are serving as an explanation of current practices and as a guide for selection of conventions or procedures where alternatives exist.

Accounting principles are accepted as such if they are (1) objective; (2) usable in practical situations; (3) reliable; (4) feasible (they can be applied without incurring high costs); and (5) comprehensible to those with a basic knowledge of finance.

Accounting Concepts

The term 'concepts' includes those basic assumptions or conditions on which the science of accounting is based.

1. Business entity concept: A business and its owner should be treated separately as far as their financial transactions are concerned.

2. Money measurement concept: Only business transactions that can be expressed in terms of money are recorded in accounting, though records of other types of transactions may be kept separately.

3. Dual aspect concept: For every credit, a corresponding debit is made. The recording of a transaction is complete only with this dual aspect.

4. Going concern concept: In accounting, a business is expected to continue for a fairly long time and carry out its commitments and obligations. This assumes that the business will not be forced to stop functioning and liquidate its assets at "fire-sale" prices.

5. Cost concept: The fixed assets of a business are recorded on the basis of their original cost in the first year of accounting. Subsequently, these assets are recorded minus depreciation. No rise or fall in market price is taken into account. The concept applies only to fixed assets.

6. Accounting year concept: Each business chooses a specific time period to complete a cycle of the accounting process—for example, monthly, quarterly, or annually—as per a fiscal or a calendar year. This is called the accounting periodicity.

7. Matching concept: This principle dictates that for every entry of revenue recorded in a given accounting period, an equal expense entry has to be recorded for correctly calculating profit or loss in a given period. This is done to give an accurate value of the profit earned in the specified accounting period.

8. Realisation concept: According to this concept, profit is recognised only when it is earned. An advance or fee paid is not considered a profit until the goods or services have been delivered to the buyer.

Therefore, Accounting Concepts are basic assumptions on which accounting records are based. They are the things that one assumes but, in certain cases, that may not be correct.

Accounting Conventions

The term 'conventions' includes those customs or traditions which guide the accountant while communicating the accounting information. An accounting convention means a set of traditions, practices and customs that guide the firm in its preparations when readying its accounting statements. The accounting conventions are a result of derived practice and usage.

There are four main conventions in practice in accounting, as follows :

1. Conservatism : is the convention by which, when two values of a transaction are available, the lower-value transaction is recorded. By this convention, profit should never be overestimated, and there should always be a provision for losses. In other words, this convention implies that all prospective losses have already happened, and all prospective profits are not accounted for until they are thoroughly and finally earned.

2. Consistency : prescribes the use of the same accounting principles from one period of an accounting cycle to the next, so that the same standards are applied to calculate profit and loss.

3. Materiality : means that all material facts should be recorded in accounting. Accountants should record important data and leave out insignificant information. The non-material item may be merged with other items or ignored completely when the value and impact are very small.

4. Full disclosure : entails the revelation of all information, both favourable and detrimental to a business enterprise, and which are of material value to creditors and debtors. It states that accounting should be conducted and prepared openly and transparently. All material information on transactions is clearly and fully disclosed.

Conclusion

The principle of accounting follows standard account principles to bring about uniformity and standardisation in the accounting of financial transactions and the reporting in financial statements.

Accounting principles involve both accounting concepts and accounting conventions. Accounting conventions and concepts are both a part of accounting principles though dependent on each other in explaining accounting principles.

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