

# Accounting concepts and conventions essay sample

[Business](#)



### 1. Define Accounting.

Ans: The American Institute of Certified Public Accountants (AICPA) defines Accounting as “ the art of recording, classifying and summarizing in a significant manner in terms of money, transactions and events which are, in part at least of a financial character, and interpreting the results thereof.”

### 2. What is GAAP?

Ans: Generally Accepted Accounting Principles - GAAP

The common set of accounting principles, standards and procedures that companies use to compile their financial statements. GAAP are a combination of authoritative standards (set by policy boards) and simply the commonly accepted ways of recording and reporting accounting information.

### 3. What are the types of accounts?

Ans: The business transactions can be grouped under three types of accounts:

\* Personal accounts

\* Real accounts

\* Nominal accounts

### 4. What is meant by book keeping?

Ans: Bookkeeping is the recording of financial transactions. Transactions include sales, purchases, income, and payments by an individual or organization. Bookkeeping is usually performed by a bookkeeper.

### 5. What are the stages of accounting cycle?

Ans: Steps in the Accounting Cycle

- \* Identify the Transaction
- \* Analyze the Transaction
- \* Journal Entries
- \* Post to Ledger
- \* Trial Balance
- \* Adjusting Entries
- \* Adjusted Trial Balance
- \* Financial Statements
- \* Closing Entries
- \* After-Closing Trial Balance.

6. What are Debit and Credit rules of double entry system? Ans: Debits are recorded on the left side of a T account in a ledger. Debits increase balances in asset accounts and expense accounts and decrease balances in liability accounts, revenue accounts, and capital accounts. Credits are recorded on the right side of a T account in a ledger. Credits increase balances in liability accounts, revenue accounts, and capital accounts, and decrease balances in asset accounts and expense accounts.

Debit accounts are asset and expense accounts that usually have debit balances, i. e. the total debits usually exceeds the total credits in each debit account. Credit accounts are revenue (income, gains) accounts and liability accounts that usually have credit balances. 7. What is accounting equation?

Ans: The equation that is the foundation of double entry accounting. The accounting equation displays that all assets are either financed by borrowing money or paying with the money of the company's shareholders. Thus, the

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accounting equation is:  $\text{Assets} = \text{Liabilities} + \text{Shareholder Equity}$ . 8. Who are the users of accounting information

Ans: Accounting, as an information system is very helpful to parties interested in it such as owners, management, creditors, employees, bankers, government and shareholders. Accounting directly or indirectly is of primary importance to proprietors and managers. The two main categories of users are (a) internal users (b) external users Internal users

Internal users comprise owners, management and employees who are interested in the accounting information relating to business. \* Owners, i. e. shareholders, partners and proprietors: they are the backbone of the business in the sense that they provide necessary funds for its smooth running, growth and development. There is always a keen desire on their part on profitability, increasing turnover, stable or rising dividend rate, sound financial position and constantly growing expanding business volume along with future earning potential and growth prospects. Such information needs of this group are satisfied through published accounts, annual report and other supplementary statements.

\* Management: management may consist of board of directors (i. e. top management) of the company, middle management and departmental heads or supervisors (lower level management), who are entrusted with the task of policy formulation, policy execution or implementation and overall supervision respectively. Accounting information, neither the objectives of enterprise can be laid down, nor the evaluation of performance becomes possible. The managerial tools such as production budget, sales budget and

cash budget and master budget are the offsprings of accounting statements and reports.

\* Employees: healthy industrial relations, i. e. employees (management) and employee (trade union) relation are a must for the prosperity and growth of the enterprise. This is possible only through properly motivated, satisfied labor force. Accounting information helps settle industrial disputes, avert compensation, more fringe benefits, better working conditions and so on.

#### External users

External users like creditors, investors, government, customers, researchers and foreigners are also helpful in accounting information due to the following reasons \* Creditors: trade creditors are those who supply goods on credit basis in anticipation that they will get their full payment on or before the due date. Usually they extend credit for a very short period and hence are keen to know whether or not the enterprise will be able to meet its financial commitments or obligations in time. Accounting statements help to determine a company's short-term solvency and liquidity position on which creditors can rely and review their credit policy or supply decisions.

\* Investors: the investor's decision of their investment depends upon three factors, i. e. safety of investment (principal), consistency in rate of return (dividend) and regularity of return. Their analysis covers past, present and future profitability, dividend policy and yield. Their decisions are also guided by viability of present projects, future prospects, growth and expansion plans. The accounting statements and annual reports provide necessary

information to substantiate their investment decisions. This group consists of banking, finance, mortgage, insurance companies and individuals.

\* Government agencies: government agencies include taxation authorities and regulatory bodies, such as ministry of trade and commerce, company law board, registrar of joint stock companies, security exchange board of India (SEBI). These agencies want to ensure whether all the rules pertaining to the preparation, presentation and disclosures have duly been complied with or not, thus making the accounting information available to various government agencies for different purposes. For example, income tax department shall be interested in making proper assessment of tax liability. While the regulatory agencies are concerned with the task of protecting and safeguarding the interest of investors and public at large. Government seekd information for framing business policies in the interests of the society and providing necessary direction to the business activity in accordance with national priorities and goals. The central structural organization uses this information for computing national income.

\* Customers: the public as customers is interested in accounting statements and reports with the object to know whether control is exercised on production, selling and distribution expenses, etc. as it affects the price of goods. Recently, customers protection association have been formed to exercise control on the business and industry and also to make them aware of ' social responsibility'.

\* Researchers: researchers while interpreting the financial statements may provide some startling facts and findings, which may be used by the

government to set its economic policy, or by regulatory agencies to take regulatory measures, and by management to review its own policies.

Therefore these statements are of much importance to scholars undertaking research in accounting theory as well as business affairs and practices.

\* Foreigners: foreigners are also keen on accounting information due to foreign collaboration like joint ventures, mergers and acquisitions of Indian companies with multi-national corporations.

\* Others: this is the residuary class which includes the rest of the users of accounting information, such as entrepreneurs, tax authorities, stock exchanges, media, political parties, etc. they are generally interested in the well-being and prosperity of business enterprises and their impact on social, economic, financial and business environment. Thus we can say that use of accounting information is so exhaustive that no one can be spared from its uses and benefits. 9. Explain all accounting concepts

Ans: The term “ concept” means an idea or thought. So, accounting concepts are the fundamental ideas or basic assumptions underlying the theory and practice of accounting. In other words accounting concepts are the broad working rules of accounting practices. They are developed over a period of time in responses to changing business environment. They are developed and accepted by the accounting profession.

There are a number of accounting concepts. The important accounting concepts are:

- 1) Money measurement concept
- 2) Separate entity concept

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- 3) Going-concern concept
- 4) Cost concept
- 5) Dual aspect concept
- 6) Accounting period concept
- 7) Objective evidence concept
- 8) Realization concept
- 9) Accrual concept
- 10) Matching concept

Money measurement concept:

In accounting, a record is made only of those transactions or events which can be measured and expressed in terms of money. Transactions or events which cannot be expressed in terms of money do not find place in the books of accounts though they may be very useful for the business. Separate entity concept, business entity concept, economic entity concept or accounting entity concept: In accounting, business is treated as separate entity from its owners. Accounts are prepared to give information about the business and not about those who own it. A distinction is made between business transactions and personal transactions. Without such a distinction, the affairs of the business will be mixed up with the private affairs of the proprietor and the true picture of the firm will not be available. The 'Business' and 'owner' are taken as two separate entities. The accountant is interested to record transactions relating to business only. The private transactions of the owner will be recorded separately and will have no bearing on the business transactions. All the transactions of the business are recorded in the books of



the business from the point of view of the business as an entity and even the proprietor is treated as a creditor to the extent of his capital.

Going-concern concept:

In accounting an enterprise is regarded as a going concern concept (i. e. a concern that will continue to operate for an indefinitely long period of time) there is neither the intension nor the necessity to wind up the concern in the foreseeable future. It may be noted that this concept does not mean permanent continuance of a business. All that it means is that a business enterprise will continue to operate for a fairly long period of time.

Cost concept:

According to this concept, an asset is ordinarily recorded in the books at the price at which it was acquired (i. e., at its cost price) and not on market price. This cost serves the basis for the accounting of this asset during the subsequent period. The ' cost' should not be confused with ' value'. It must be remembered that as the real worth of the assets changes from time to time, it does not mean that the value of such an asset is wrongly recorded in the books. Dual aspect concept:

Every business transactions always result in receiving of some benefit of some value and repaying of some other benefit of equal value. Every transaction is recorded on the basis of this concept.

Accounting period concept or periodicity of accounts:

According to this concept, the life of the business is divided into appropriate segments for studying the results shown by the business after each segment. It is supported by going concern concept. All the transactions are  
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recorded in the books of accounts on the assumption that profits on these transactions are to be ascertained for a specified period. This is known as accounting period concept. Objective evidence concept:

According to this concept all accounting transactions should be evidenced and supported by objective documents. These documents include invoices, contract, correspondence, vouchers, bills, passbooks, cheque etc. Realization concept:

This concept states that revenue from any business transaction should be included in the accounting records only when it is realized. The term realization means creation of legal right to receive money. Selling goods is realization, receiving order is not. Accrual concept:

The meaning of accrual is something that becomes due especially an amount of money that is yet to be paid or received at the end of the accounting period. It means that revenues are recognized when they become receivable. Though cash is received or not received and the expenses are recognized when they become payable though cash is paid or not paid.

Matching concept:

The matching concept states that the revenue and the expenses incurred to earn the revenues must belong to the same accounting period. So once the revenue is realized, the next step is to allocate it to the relevant accounting period. This can be done with the help of accrual concept. 10. Explain all the accounting conventions

Ans: An accounting convention refers to common practices which are universally followed in recording and presenting accounting information of the business entity. They are followed like customs, tradition, etc. in a society. The most important conventions which have been used for a long period are as follows: \* Convention of consistency.

\* Convention of full disclosure.

\* Convention of materiality.

\* Convention of conservatism.

Convention of consistency:

The convention of consistency means that same accounting principles should be used for preparing financial statements year after year. A meaningful conclusion can be drawn from financial statements of the same enterprise when there is comparison between them over a period of time. But this can be possible only when accounting policies and practices followed by the enterprise are uniform and consistent over a period of time. Convention of full disclosure:

This convention requires that all material and relevant facts concerning financial statements should be fully disclosed. Full disclosure means that there should be full, fair and adequate disclosure of accounting information. Adequate means sufficient set of information to be disclosed. Fair indicates an equitable treatment of users. Full refers to complete and detailed presentation of information. Thus, the convention of full disclosure suggests that every financial statement should fully disclose all relevant information.

Convention of materiality:

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The convention of materiality states that, to make financial statements meaningful, only material fact i. e. important and relevant information should be supplied to the users of accounting information. The question that arises here is what a material fact is. The materiality of a fact depends on its nature and the amount involved. Material fact means that the information of which will influence the decision of its user.

Convention of conservatism:

This convention is based on the principle that “ Anticipate no profit, but provide for all possible losses”. It provides guidance for recording transactions in the books of accounts. It is based on the policy of playing safe in regard to showing profit. The main objective of this convention is to show minimum profit. Profit should not be overstated. If profit shows more than actual, it may lead to distribution of dividend out of capital. This is not a fair policy and it will lead to the reduction in the capital of the enterprise. Thus, this convention clearly states that profit should not be recorded until it is realized. But if the business anticipates any loss in the near future, provision should be made in the books of accounts for the same.