

# [Accounting concepts and principles essay sample](https://assignbuster.com/accounting-concepts-and-principles-essay-sample/)

These are rules and principles of accounting that are essential and should be followed by any organization in preparation of all accounts and financial statements. The following are accounting concepts and policies that must be applied in preparation of account statements, Entity Concept, according to this concept, the owner of the business or proprietor must be separate and distinct from the business or enterprise. Therefore business is treated as a separate unit. Moreover, business transactions must be recorded in financial books as well, so as to keep an exact record for an organization or an entity (B. Krishna, 2010). Example; assuming that am a CPA and I received $900 bill for utilities. I paid the whole amount using my business account. $600 is to be considered a withdrawal because only $300 (1/3rd) related to business and the other $600 was for domestic purpose. It is also known as business entity.

Money Measurement, under this concept, each of those occasions/truths or exchanges happening inside a book keeping period which bring out about the changes of money related position of business or an organization and are measurable in monetary terms, must be recorded in the financial accounts (B. Krishna, 2010). In other words, any event or facts that have direct effect to the business but cannot be measured in monetary terms cannot be included in monetary terms. For example I am a financial manager of a particular organization and due to an accident occurred upon me I could not attend the organizations duties for a long period of time as a result to a great loss this can never be recorded in financial statements.

Matching concept, with a specific end goal to achieve precise net wage figure, the costs acquired to gain the incomes perceived amid the bookkeeping period, ought to be perceived in that time period and not in the following or previous. This is called matching standard. On the premise of this idea, wage articulation arranged salaries emerge when the income pay surpasses the income costs. In straightforward words cost is the expense of gaining income (B. Krishna, 2010).

As indicated by this idea, matching of costs with income is focused around gathering arrangement of bookkeeping, income is earned when merchandise or administrations are sold, and costs are perceived when money is paid, as well as when administrations or resources are sold have been utilized to create such income inside a bookkeeping period.

Keeping in mind the end goal to gauge the net pay enough, incomes and costs must be allotted to the proper bookkeeping period and this issue is understood by applying matching change. Example A company pays $20000 per month to 5 of its doctors, monthly sales are $500000, $100000 worth of salaries should be matched with $500000 of revenue generated

Prudence concept, under this premise, the impacts of exchanges and different occasions are perceived when they happen as opposed to when cash is gotten or paid. They are recorded in the bookkeeping records and reported in the monetary articulations of the periods to which they relate.

There fore credit deals and acknowledge buys are recorded as they happen and not just once installment has been influenced (K. Everingham; E. Kleynhans, 2007). Bookkeeping benchmarks entirely oblige bookkeeping on accumulation premise. However there is an option called money premise of bookkeeping, under money premise occasions are recorded focused around their hidden money streams or out streams. Money premise is typically utilized while get ready budgetary articulations for assessment purposes. Example an airline sells its tickets days or even weeks before the flight is made, but it does not record the payments as revenue, because the event on which the revenue is based has not occurred yet.

Going concern, according to going concern, the operations of the bookkeeping element will proceed for the predictable future. This suggests that the pay articulations and asset reports are drafted on the premise that there is no proposition or need to exchange the substance or to curtail operations fundamentally. Henceforth liquidation or constrained deal qualities are not fused in the money related proclamations, unless the going concern supposition is invalid. In the occasion of unforeseeable liquidation, then again it can be normal that extensive misfortunes will emerge on the distinction between convey qualities and liquidation qualities, and the going concern suspicion would be invalid (K. Everingham; E. Kleynhans, 2007).

The operations of the bookkeeping element will proceed for the predictable future. The status of going concern is essential in light of the fact that if the organization is going concern it needs to follow the generally accepted accounting standards. The inspectors of the organization figure out if the organization is going concern or not at the date of the budgetary proclamations. Example a bank is in a serious financial troubles and the government of the country is not willing to bail out. The board of directors has passed a resolution to liquidate the business. Therefore, the bank is not going concern, another example is that, A merchandising company has a current ratio below 0. 5, a creditor $1000000 demanded payment which the company could not make, the creditor requested the court to liquidate the business and recover his debts and the court grants the order. Due to that reason, a company is no longer going concern. Consistency, The idea of consistency, implies that bookkeeping techniques once received must be connected reliably in future.

Likewise same routines and procedures must be utilized for comparable situations, it suggests that, a business must forgo transforming its bookkeeping arrangements unless on sensible grounds. On the off chance that for any legitimate reason the bookkeeping strategy is changed, a business must uncover the way of progress, the explanations behind the change and its impacts on the things of budgetary articulations. Consistency idea is critical due to the need similarity that is, it empowers financial specialists and different clients of monetary explanations to effectively and accurately look at the money related articulations of the organization. It is very important that, the accountant to be consistent in applying principles and procedures to similar situations, because inconsistency in reporting can cause misleading interpretations as a result to wrong conclusion (M. Hanif, 2000).

Example Adil’s company has been using declining balance method for its IT equipment, according to consistency concept, it should continue to use declining balance method in respect of its IT equipment in the following periods, if the Adil’s company wants to change it to another depreciation method, like straight line method, it must provide in its financial report, the reason for the change, the nature of the change and the effects of the change on items such as accumulated depreciation. Historical concept, Alludes to the expense at the time of securing. Since accounting is essentially the recording of past happening, accountants utilize the securing cost as the most target estimation as it is upheld by the proof of exchange. It is basic idea of accounting, which is focused around authentic record of the exchanges. Case in the event that I acquired a machinery for $95000, it will show up in the books at that figure without considering the market estimation of that machine at some other purpose of time.

Dual aspect concept, otherwise called duality Principle, is a principal tradition of bookkeeping that requires the distinguishment of all parts of a bookkeeping exchange. Double entry idea is the basic premise for twofold passage accounting framework. Duality principle follows the system of double entry where by for every debit entry there must be credit at the same time, this implies that in any business transaction concern there are two sides, on which one is receiving of benefit another is giving of that benefit. According to (M. Unnibhavi, 2005) “ There will be a double entry for every transaction, that is for every debit there must be corresponding credit, this is the principle of double entry which in other words, known as the dual aspect’’. Example I bought a car, for this transaction I suppose to debit car account and credit cash account this is a practical meaning of dual aspect principle.

Accrual concept, this principle implies that, business transactions are recorded when they happen rather than when payment is made or received. This concept is also known as accrual basis of accounting, it is most essential to the value of financial accounting data. Example, an airline sells tickets days or even weeks before the flight is made, but it does not record the payment as revenue because the event on which revenue is concerned has not happen yet. Accounting standard entirely oblige accounting on accrual premise. However there is an option called cash premise of accounting where by the occasions are recorded focused around their hidden money streams or surges, this is normally utilized for tax purposes.

Time interval concept, a business plans to proceed in long haul, it is constantly useful to record for their execution and position focused around time period in light of the fact that it gives opportune input and aides in settling on convenient choice. Under time period assumption, we plan money related articulations quarterly, half yearly or every year. The wage articulation gives us an understanding into the execution of the organization for a time of time. Example Hassan company prepares income statement and statement of financial position at each end of the year to check the financial position of the business and to determine the revenue and expense of the company respectively.

Separate determination concept, holds that every part of any classification of assets or liabilities ought to be esteemed independently when touching base at aggregate to be demonstrated in the records for the category. Example the estimation of each one stock thing ought to be ascertained exclusively at the lower of expense and net feasible worth, and these qualities ought to then be totaled to a give the stock figure that will show up in the records.

Substance over form, by considering this idea, representing business exchange and different occasions, we gauge and report the economic effect of an occasion rather than its authoritative document. Substance over form is basic for solid budgetary reporting. It is somewhat pertinent if there should arise an occurrence of income distinguishment, deal and buy understanding. Example If company A and B swap their inventories, they will not be allowed to record sales because no sales occurred even if they have entered into valid enforceable contracts.

On preparation of financial statements and report for any business organization, accounting concepts and policies are of more much important and thus must be taken into account so as to evaluate the performance of company or organization and its position as well. It should be noted that any accounting report and statement must consider accounting concepts and policies with the apparent reason of easing the evaluation of the business concern to outsiders like investors and the like.

Below are the sets of financial statements of Mr. Adil’s company limited

The following are the sets of financial statements report of Mr. Adil’s company as on 31st December 2010.   
Adil Company ltd   
Income statement for the year ending 31st december2010.   
$ $ Sales 391, 400 Less: Returns inwards (2110) 389, 290 Less: cost of goods sold:

Opening inventory 72, 410 Add: Purchases 254, 810   
Carriage inwards 760   
255, 570   
Less: Returns outwards (1’240) 254, 330   
Less: Closing inventory(89, 404) 164, 926 237, 336 Gross Profit 151, 954 Less: Expenses:

Carriage outwards 2, 850 Motor expenses 1, 490 Rent 8, 200 Telephone charges 680 Wages and Salaries 39600 Insurance 745 Office expenses 392 Sundry expenses 216   
54, 173 Net profit 97, 781

Non current Asset $ $ Van 5, 650 Office equipment 7, 470 13120 Current Assets

Inventory(31. 12. 2010) 89, 404 Account receivable 38, 100 Cash at bank 4, 420 Cash in hand 112 132, 036 Less: Current liabilities

Account payable (26, 300) 105, 736 118, 856

Financed by:   
Capital 49, 675 Add: Net profit 97, 781 147, 456 Less: Drawings (28, 600) 118, 856   
The above Accounting statement of Adil company ltd which reported on the given date witness the application of Accounting c0ncepts and principles as follows; Money measurement concept, it is obvious that, all accounting transactions and events must be reported and recorded in the books of accounts in monetary manner. Like wise, from the above income statement and statement of financial position it evidence that, on preparation of any report relating to accounting must take into account this important concept.

Going concern concept, since the concept assumes that the business will continue for a long time on its operation for at least twelve months after the end of reporting period, the above statements shows that the company sounds since it is able to pay its current obligations, there fore we expect to proceed with business on the next accounting period.

Dual aspect concept, as the business contains two aspects, which are assets, and liabilities and these two aspects are equal to each other by the claims against tem When Assets= capital + liabilities, from Adil company, 145156= 145156, this is the evidence for dual aspect on the report.

Historical concept, The Company of Adil ltd shows Assets at cost price. This concept is of apparent to any business to evaluate the value of an asset on cost regardless the market price.

Trade discounts are motivating forces for client to buy an item. They may be new client rebates, amount rebates, close out markdown, and numerous more. Whatever the sort they outline to allure a client to buy more, to buy this to buy now. They often times offered at the time of procurement case when products are obtained in mass or to hold unwavering clients. Cash discounts, is the amount of the reduction of the sum to be paid (F. Wood, A. Sangster, 2012). Business lean toward it if their clients pay their record rapidly. A business may acknowledge a littler aggregate in full settlement, if installment is made inside a certain time of time. On expansion to that, it is still called money rebate regardless of the possibility that record is paid with check or by immediate move into the financial balance.

The rate of money markdown is typically expressed as a rate. Full subtle elements of the percent permitted, and the period inside which installment is to be made, are cited on all business records by the dealer. A common period amid which rebate may be permitted is one month from the date of unique exchange. Further to that, cash discount involves two main categories, which are discount allowed and discount received. Discount allowed, is a cash discount allowed by a business to its customers when they pay their accounts quickly while discount received, is a cash discount received by a business from its suppliers when it pays what it owes them quickly.

On the off chance that you have ever bought anything by phone, by letter or over web, you have presumably been charged for ‘ postage and bundling’. At the point when products are conveyed by suppliers or sent to clients, the expense of transporting merchandise is regularly extra charge to the buyer. In accounting, this charge is called ‘ carriage’ There are two main types of carriage in accounting as distinguished below Carriage inwards, is a category of carriage levied for delivery of goods bought. At the point when merchandise are bought, the expense of carriage inwards might either be incorporated as shrouded piece of the price tag, or be charged independently. Case in point, your business was purchasing precisely the same products from two suppliers.

One supplier may offer them for $10 not charges anything for carriage. An alternate supplier may offer the products for $9, however you would need to pay $1 to a dispatch for carriage inwards, that is, and aggregate expense of $10. In both cases, the same merchandise cost you the same aggregate sum. It would not be fitting to forget the expense of carriage inwards from the “ less expensive” supplier in the count of terrible benefit, as the genuine expense to you having the products accessible for resale in $10.

Carriage inwards is always added to the cost of purchases in the trading account. While, carriage outwards, is charged on goods sent out by a business to its customers. Carriage outwards is not piece of offering cost of the merchandise. Clients could come and gather the products themselves, in which case there would be no carriage outwards cost for the vender to pay or to energize clients. Carriage outwards is commonly entered in the profit and loss account section of income statement. It is never involved in the calculation of gross profit. Since it is an expense to the business it always decreases the net profit of the business.

There are two main methods of calculating depreciation. Upon the whole process of calculating depreciation, we must take these two methods into consideration. The following are the two main methods of computing depreciation

Strait line method, under this method the number of years is estimated; this is the useful life of an asset. The cost is then divided by the number of years. This gives the depreciation charge for each year. Straight-line strategy is thought to be most regular system for devaluation of benefits. To register the measure of yearly devaluation cost utilizing the straight line obliges the beginning expense of the advantages less its rescue quality and it assessed valuable life. In alternative words, straight-line depreciation is computed with the useful of the following formula: Annual depreciation= cost- salvage value

Estimated useful life   
While, reducing balance method of depreciation, under this method, a fixed percentage for depreciation is deducted from the cost in the first year. In the second and later years the same percentage is taken of reduced balance (that is, cost less depreciation already charged). This method is known as the diminishing balance method or the diminishing debit balance method.

The basic formula used to find the percentage to apply with this method is:   
r = 1-n (s/c)

Where by:   
n = number of years   
s = the net residual value   
c = cost of the asset   
r= the rate of deprecation to be applied.

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