

# Accounting assumptions, principles and constrains



Accounting Assumptions, Principles and Constrains The basic assumptions of accounting Basic accounting assumptions provide a foundation for recording the transactions and preparing the financial statements. They are considered as cornerstones of the foundation of accounting (Pratt, 2011) and they include Economic Entity which is the financial statements that presume that accounts often deal with a single organization. However, its application usually gets delicate when the involved parties want to cut down the financial statements to understand a particular product or division within the organization. The second assumption is going Concern that assumes that the economic entity has a significant past and future for purposes of recording costs of assets and inventory and decision making based on those costs in the present. Additionally, there are the Monetary Unit assumptions that keeps score with money, but it typically ignores inflation and deflation of currencies; the value and unit of currency are understood to be firm; otherwise, there is transaction with global divisions that uses other currencies besides the U. S. Dollar. Finally there is an accounting Periods assumption that assumes that the periodical accounting periods is applicable and accountants can stop to analyze financial statements.

### Accounting Principles

Historical Costs (assets and liabilities) characteristically report on the chronological cost and then adjusted to fair market value when the needs of reporting require it. However, the cost of assets went up some years thereby did not reflect what it is worth to other buyers or the cost of replacement. (Riahi-Belkaoui, 2005). Revenue Recognition is the recording of revenues when they are realized and earned. (Pratt, J. 2011). This is one of challenge that accrual-based accounting is trying to solve. Notably, receiving cash from <https://assignbuster.com/accounting-assumptions-principles-and-constrains/>

a sales order doesn't mean that everything has to earn the revenue especially when they are shipped. In other words, it is sometimes possible to sell goods or services without receiving cash. Therefore, Matching Expenses to Revenues means matching fixed cost of the revenues or recording profit in the income statement based on the best profit on revenues and expenses. This often leads to Full Disclosure where accountants record and report every bit of information in the numbers and footnotes of financial statements that fairly represent the activities of the business entity in that accounting period. This procedure is perfect; however, for decision-making it is expected to leave out or add things that are relevant to the decision being made.

### Accounting Constraints

In most cases, Cost and Benefit is often a Paradox since in every event there is a real cost of recording and reporting accounting information. Therefore, some very important events relevant to a business may fail to be disclosed because it was too expensive to gather required or relevant data and this often lead to a major accounting constrain. Therefore, there is a need to understand financial statements and add information to which we have access so as to make the best decisions. Another constraint is the Materiality – small financial events are very important as compared to large financial events for the typical, reasonable reader of financial statements (Pratt, J. 2011). However, the involved parties might differ in the decision making process considering financial statements are often understood differently by the accounting folks; some small financial event may fail to be disclosed even though it is very relevant to decision making processes. Finally, Industry Practice often leads to accounting constrains. Sizes and types of organizations often affect reporting financial activities. Some industries have

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special ways of distributing the products/services to customers; thus, it is never comprehensive for the all accountants to analyze and automobile manufacturer equally.

Nonetheless, an ideal accounting practice requires that the Generally Accepted Accounting Principles (GAAPs) be followed to the letter and the accounting assumptions be observed. This would facilitate systematic continuity and consistency of the financial records of various business entities. The related accounting constraints should also be addressed accordingly in order to avoid unnecessary shortcomings and erroneous actions.

#### Reference

Riahi-Belkaoui, A. (2005). Accounting theory. London: Thomson.

Pratt, J. (2011). Financial accounting in an economic context. Hoboken, NJ: Wiley.