St. Lawrence High School

A Jesuit Christian Minority Institution

Study Material 8

Sub: ACCOUNTANCY Class 11

Chapter: Unit 2: Theory Base of Accounting Date: 25/07/2020

Topic: Fundamental Accounting Assumptions & Principles 1

Fundamental Accounting Assumptions

Accounting assumptions are those broad concepts that develop generally accepted accounting principles, i.e., upon which accounting is based. These assumptions are the rules of the game and they have been developed from common accounting practice. These assumptions are discussed below:

Going Concern Concept:

In most cases, it is not possible to determine in advance the length of life of a business unit, and so an assumption must be made. Accounting is based on the assumption that the business unit will be operating for as long as possible. When a business is started except for a terminable venture, it is assumed that the business will not dissolved in the near future. From the accountant's standpoint, Profit & Loss Account and Balance Sheet are drawn up on the assumption that the business will continue functioning in the foreseeable future. The accounting system provides a continuous record of the performance of the business throughout its existence.

This concept assumes that the business unit will continue operating under the same economic conditions and in the same general environment. But, it does not that the business unit will be profitable as long as it exists. This concept relates to the future which is, by definition, uncertain. Therefore, this concept does not imply that the business will continue forever.

Consistency:

Accounting principles are not static or unchanging. It is possible to adopt a variety of principles and procedures for business transactions. An accountant is often faced with choice of methods of dealing with certain items, e.g., depreciation of fixed assets, valuation of closing stock etc. Having made his choice, he should follow it consistently so that the figures of one accounting period may be comparable with those for another. Therefore, whatever accounting method a business unit decides to adopt, a consistent approach has to be followed.

Though consistency is important for good accounting practice, this does not mean that changes cannot be made in the business unit's accounts. In the event of any change a note must be attached along with the accounting statements indicating the alteration(s).

Accrual:

Any increase in the owner's equity is called revenue and, any decrease in it is called an expense. Income is the excess of revenue over expenses. In calculating profit for any financial period expenses and revenues are matched in a more realistic way, i.e., they concern the same goods and the same time period. The accrual concept is an accounting system which recognizes the revenues and expenses as they are earned or incurred, respectively, without regard to the date of receipt or payment. This concept is one of the consequences of the periodicity concept. In the preparation of Profit & Loss Account for an accounting period, revenues and expenses are recognized as they are earned or incurred respectively, and not when cash is received or paid. The earning of revenue and the expense incurred for earning it, can be accurately related to specific time periods, but the receipts and payments may not be related to the period under consideration. This concept requires proper apportionment of expenses to time period by the inclusion of prepayments and accrual in a Balance Sheet.

Accounting Principles

A generally accepted set of rules can provide uniformity in the accounting system, the accounting procedure and presentation of accounting results. In developing the structure of accounting theory and relate the theory to accounting practices, the accounting profession has agreed to take for granted certain basic concepts. These concepts are regarded as accounting principles. Different accounting principles are discussed below:

Accounting Entity:

According to entity concept, business is considered separate and distinct from the owners of the enterprise. This concept starts with the fact that the business unit is a separate entity with its own identity. We must, for the purpose of bookkeeping, keep the owner and the business quite separate. Only those economic events which affect the business unit are recorded. Assuming that the business unit is a separate entity, accounting records are kept only from the point of view of business unit not the owners.

Advantages:

1. This concept stress the importance of the business unit.
2. This concept can be applied for any form of business organization.
3. It is the basis of double entry system of bookkeeping.
4. It helps in separating out the business transactions from the personal transactions of the owners
5. This concept can be applied along with proprietary concept and fund concept.
6. It is possible to measure how successful or otherwise the business has been in terms of profit or loss.

Disadvantages:

1. Accounting is done from the viewpoint of the business unit, which is an artificial person.
2. This concept sometimes coincides with the legal fact.
3. To some extent, present accounting practice is not based on this concept.
4. The owners cannot be identified with the existence of the business unit.

5. This concept does not stress the importance of the proprietor(s).
6. It is not concerned with increase of wealth of the owner(s).

Money Measurement:

Money is the medium of exchange. It provides a uniform way to measure the value of goods and services. It makes exchange more efficient. Finally, money is a store of value. Money is one form in which wealth can be maintained. The accounting system uses money as its basic unit of measurement. All business transactions are recorded in terms of money. This is because of money is a useful way of converting accounting data into a common unit. Most of the resources of a business can be expressed in terms of money value.

Problems under this principle:

1. The concept assumes stability in the value of money.
2. Many factors of vital importance to the business are outside the purview of accounting.

Prepared by
Pralay Kabi