

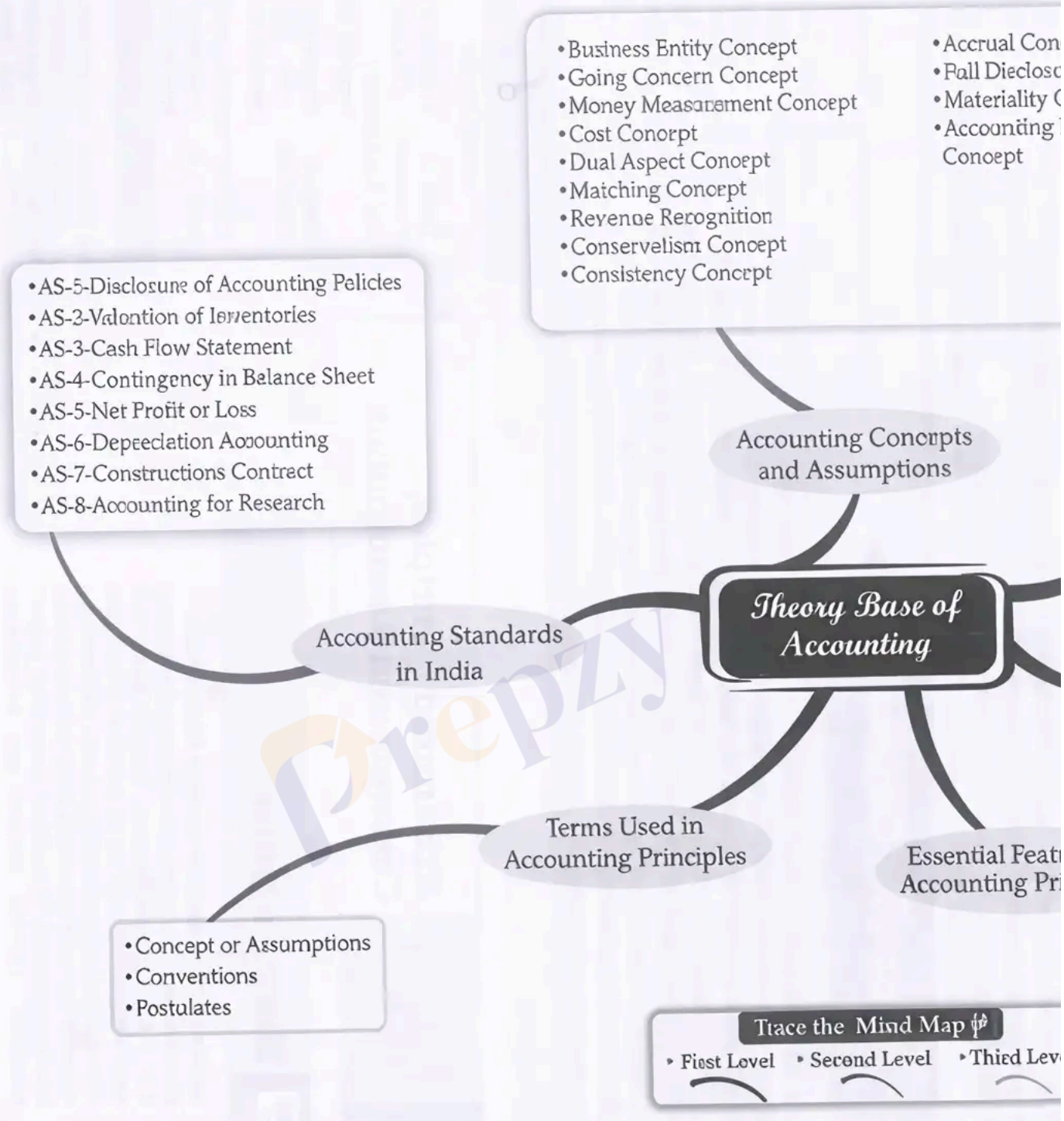
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Revision Notes

► Basic or Fundamental Accounting Assumptions :

The financial statements, comprising the Trading Account, Profit & Loss Account, Balance Sheet and Cash Flow Statement, that are prepared for companies and persons. It is essential that the published information is based on defined principles, concrete concepts, and conventions.

Accounting principles are the basic guidelines that provide standards for accounting practices and procedures to be followed, so that the financial statements are prepared on the basis of which financial statements are prepared.



This mind map outlines the "Theory Base of Accounting," organizing key concepts, principles, standards, and the importance of accounting rules and practices.

Financial statements are prepared based on accounting conventions, which are a set of practices followed over time. Accounting concepts (Accepted Accounting Principles). The fundamental accounting assumptions are:

1. Consistency assumption :

Accounting practices selected and adopted should be applied consistently year after year to ensure meaningful study of business performance.

2. Going concern assumption :

The enterprise is assumed to have an indefinite life with no intention to liquidate or significantly scale down operations.

3. Accrual assumption :

Revenue and expenses are recognized when earned or incurred, not when cash is received or paid.

Accounting Principles / Basic Accounting Concepts :

1. Business Entity Principle :

The business is a separate entity from its owner. Business transactions are recorded separately from the personal transactions of the owner.

Example: When the owner invests money, the business receives cash and owes that amount to the owner.

2. Money Measurement Principle :

Only transactions measurable in terms of money are recorded. Non-monetary factors like customer satisfaction cannot be recorded.

3. Accounting Period Principle :

The indefinite life of a business is divided into accounting periods (usually one year) to measure performance and calculate profit or loss.

In India, accounting years are either Calendar Year (1 Jan – 31 Dec) or Fiscal Year (1 Apr – 31 Mar).

4. Principle of Full Disclosure :

All material facts affecting business profitability must be disclosed in financial statements, whether legally required or not.

5. Materiality Principle :

Only items significant enough to influence decision-making are disclosed. For example, small purchases like pencils are expenses, while

6. Conservatism or Prudence Principle :

Anticipate and provide for possible losses but not for anticipated gains. Examples include valuing closing stock at cost or market price (lower of the two).

7. Cost Concept :

Assets are recorded at their historical cost, including acquisition and installation costs.

8. Matching Principle of Revenue and Expenses :

Revenues and related expenses must be matched in the same accounting period to determine accurate profit.

9. Dual Aspect Principle :

Every transaction affects at least two accounts, maintaining the accounting equation: **Assets = Liabilities + Capital**.

10. Revenue Recognition Principle :

Revenue is recognized when the earning process is complete, the amount is measurable, and realization in cash or receivable is established.

11. Objectivity Concept :

Accounting entries must be supported by unbiased documentary evidence to ensure reliability.

12. Going Concern Concept :

Assumes business will continue indefinitely, allowing assets to be recorded at cost and depreciated over their useful life.

13. Consistency Concept :

Accounting policies should be applied consistently over time to allow meaningful comparisons. Changes must be disclosed with their effects.

Key Words

- ▶ **Accounting Concepts** : Necessary assumptions and basic theoretical ideas fundamental to accounting practice.
- ▶ **Convention** : Customs or traditions guiding preparation of accounting statements.
- ▶ **Postulates** : Basic assumptions accepted universally.
- ▶ **Revenue Recognition Concept** : Standard for recognizing revenues.

Accounting Standards and GST

Revision Notes

- ▶ **Accounting Standards**

History:

Accounting Standards were developed to standardize diverse accounting policies and ensure transparency, consistency, comparability. The International Accounting Standards Committee (IASC), now International Financial Reporting Board (IFRB), was formed in 1973 to formulate and improve these standards.

Meaning:

Accounting Standards are guidelines issued by the accounting organization of a country (e.g., Institute of Chartered Accountants of India) for accounting practices.

Purpose:

Accounting Standards help in:

- Comparing financial statements easily, improving reliability.
- Providing standard accounting policies, valuation norms, and disclosure requirements.
- Reducing creative accounting for favorable presentation.

Benefits:

- Eliminates variations in accounting treatments.
- Discloses important information not statutorily required.
- Facilitates comparison of financial statements nationally and internationally.
- Assists auditors in auditing accounts.
- Builds confidence among users of accounting information.

Limitations:

- Difficulty in choosing among alternative treatments.
- Rigid adherence may reduce flexibility.
- Cannot override prevailing laws; legal requirements prevail.

► Indian Accounting Standards

The Institute of Chartered Accountants of India (ICAI) formed the Accounting Standards Board (ASB) in 1977 to harmonize accounting practices, consulting stakeholders, finalizing drafts, and issuing standards under ICAI authority.

► **GST** : Goods and Services Tax is a comprehensive indirect tax levied on supply of goods and services except petroleum and alcohol for

Characteristics of GST :

- Comprehensive indirect tax replacing earlier indirect taxes except customs duty.
- Value-added tax with input tax credit.
- GST paid is an asset, not a cost.
- Uniform GST rates across states.

Advantages of GST :

- Creates a common national market.
- Simplifies business by single indirect tax registration.
- Reduces cost by removing cascading effect.
- Simplifies indirect tax regime with fewer rates.
- Improves tax management.
- Makes goods cheaper.
- Attracts Foreign Direct Investment (FDI).
- Boosts Gross Domestic Product (GDP).
- Reduces cash economy.

Key Words

► **Accounting Standards** : Guidelines issued by accounting organizations for financial statement preparation.

► **GDP** : Gross Domestic Product.

System and Basis of Accounting

Revision Notes

► Systems of Accounting :

Transactions may be recorded under two systems:

(i) **Double Entry System** :

Every transaction has two aspects: debit and credit. Both are recorded, ensuring the sum of debits equals credits. This system is scientific.

Advantages of Double Entry System :

- Complete record of transactions.
- Scientific method.
- Ensures arithmetical accuracy.
- Facilitates timely financial statements.
- Helps detect errors and frauds.
- Facilitates decision making through comparisons.

Disadvantages :

- Complexity in adjustments for outstanding and prepaid expenses.
- Requires more judgment and estimates.
- Less suitable for non-profit or cash-based organizations.

(ii) Single Entry System :

Only one aspect of transactions is recorded, leading to incomplete records. No trial balance can be prepared, making final accounts im

Basis of Accounting :

Transactions may be recorded on either:

(i) Cash Basis of Accounting :

Transactions are recorded when cash is received or paid. Revenue and expenses are recognized only on actual cash flow. No adjustmer

Advantages :

- Simple accounting without adjustments.
- Objective with minimal estimates.
- Suitable for cash-based and non-profit organizations.

Disadvantages :

- Not recognized under Companies Act.
 - Does not give true and fair view due to lack of adjustments.
 - Does not distinguish capital and revenue expenditure.
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(ii) Accrual Basis of Accounting :

Income is recorded when earned and expenses when incurred, regardless of cash flow. Adjustments for outstanding, prepaid, accrued, c

Advantages :

- Gives true and fair view of profit and financial position.
- More scientific and widely used.
- Recognized under Companies Act.
- Distinguishes capital and revenue expenditure.

Disadvantages :

- More complex due to adjustments.
- Subjective estimates may be required.
- Profit and financial position determination is not straightforward.