

Chapter 2: Theory Base of Accounting

Meaning of Accounting Principles

Accounting principles are the basic rules and guidelines that help in recording and reporting financial transactions consistently and logically.

Need for Accounting Principles

To bring uniformity and consistency

To make financial statements understandable and comparable

To ensure transparency and reliability

To maintain faith of users (investors, creditors, government, etc.)

1.Basic Terms

✅ Accounting Concepts

Accounting concepts are the fundamental assumptions or conditions on which accounting is based.

Major Accounting Concepts:

* Business Entity Concept

Business and owner are separate entities.

Transactions are recorded from the business's point of view.

* Money Measurement Concept

Only transactions measurable in money are recorded.

* Going Concern Concept

Assumes the business will continue indefinitely.

* Accounting Period Concept

Life of business is divided into periods (usually a year) to measure performance.

* Cost Concept

Assets are recorded at their original purchase price (cost), not market value.

* Dual Aspect Concept

Every transaction has two aspects: debit and credit.

Equation: Assets = Liabilities + Capital

* Revenue Recognition (Realisation) Concept

Revenue is recorded when realised, not necessarily when cash is received.

* Matching Concept

Expenses should be matched with revenues of the same accounting period.

* Full Disclosure Concept

All material information must be disclosed in financial statements.

* Consistency Concept

Same accounting policies should be followed every year.

2. Accounting Conventions

Accounting conventions are customary practices developed over time.

Common Conventions:

* Conservatism (Prudence)

Anticipate losses, not profits.

Record lower asset value and higher liabilities.

* Materiality

Only significant information is recorded.

* Consistency

Once a method is adopted, continue using it unless a change is justified.

* Disclosure

All relevant information should be clearly presented.

3.System of Accounting

* Cash Basis of Accounting

Transactions recorded only when cash is received or paid.

* Accrual Basis of Accounting

Transactions recorded when they occur, not when cash is exchanged.

✅ Key Takeaways

Accounting concepts and conventions form the theoretical foundation of accounting.

They help ensure objectivity, reliability, and uniformity.

A strong understanding of theory base is essential before learning journal entries, ledger, and financial statements.