Accounting Principles

I. What are the Principles of Accounting?

Accounting principles refer to the rules and guidelines followed by companies while reporting their financial data. Through these rules, experts can examine the financial data by standardizing accounting methods. These principles ensure that the quality of the financial information reported by companies is improved.

II. Principles of Accounting:

Following are the widely adopted principles in accounting:

1. Accrual Principle

It is one of the important accounting concepts and principles that mandate the recording of transactions in the time period in which they occur. It is regardless of the time when actual cash flows for the transactions are received. Through accrual principle, one can gain an accurate insight into the financial status of a business.

2. Consistency principle

According to this principle, when an organisation adopts a specific accounting method of reporting or documentation, then it should stay consistent with the method. The aim of this basic accounting principle is to make financial statements comparable across industries and companies.

3. Conservatism Principle

The Conservatism principle gives you a realistic perspective of unexpected situations. According to this principle, one should recognize expenses and liabilities at the early stages even if there is uncertainty about the outcome. However, the principle recognizes revenues and assets when there is an assurance of its receival. This principle can be applied to recognizing the estimates.

4. Cost Principle (historical Cost)

The Historical Cost principle is another name for the cost principle. Whenever a business acquires an asset, its initial value is recorded in its financial reports of the business. This value might not be improved in the market value of inflation. It is also not updated to reflect any depreciation or even appreciation. This value is known as the cost principle.

5. Economic Entity Principle

This principle is a basic of accounting that requires businesses to be treated as a separate financial and legal entity. This means that the recorded activities of the business entity must be kept separate from the recorded activities of the owner and other entities. These may include either a sole trader, limited liability partnership, or general partnership.

6. Matching Principle

The matching principle is a concept in accounting that states that companies must report their expenses and revenues simultaneously. The revenues and expenses are matched on income statement for a specific time period. It is a part of the accrual accounting method that provides an accurate representation of operations on the income statement. This principle is quite useful for investors as investors can match revenue and expenses to get a better sense of the finances of a business. Along with the income statement, there is a need to assess the cash flow statement as well.

7. Materiality Principle

As per the materiality principle, any item that may impact the decision-making process of an investor must be recorded. These details must be recorded in length in the financial statements using Generally Accepted Accounting Principles (GAAP). The material principle states that the accounting standard can be ignored if the end result is small.

8. Full Disclosure Principle

In the Full Disclosure principle, each piece of information should be included in the financial statement of an entity. This is necessary since it might affect the reader's perspective of understanding the statement. It is important to only disclose information about events that have a material impact on the financial position of an entity. As per the full disclosure principle, it may also include those items that cannot be quantified. Businesses are also liable to report existing accounting policies and any changes in them as well.

9. Going Concern Principle

Going concern concept is also known as the continuing concern concept. A company continues to be a going concern till the time the sale of assets does not hamper its operations. If a company is no longer a continuing concern, it needs to start reporting specific information on financial statements. Through this principle, accountants can make decisions related to which information should be reported on financial statements.

10. Monetary Unit Principle

According to this principle, business transactions should be recorded only when they can be expressed as currency. Accountants should avoid recording non-quantifiable entities in the financial accounts. Whenever a transaction or an event occurs, it is first converted into money. After that, it is recorded in the financial accounts of a business. It ensures that every accounting record is measurable in monetary terms by currencies.

11. Reliability Principle

This principle ensures that every transaction, business activity, event, etc is reliable when presented in the financial statement. Information should be associated with objective evidence and it can be checked, reviewed, and verified. This makes the information more reliable. Along with this, the information should be accurate and have a transparent representation. This makes the information reliable for its users. This principle ensures every financial statement and business accounting records are accurate.

12. Revenue Recognition Principle

Revenue recognition is a part of GAAP that identifies certain conditions in which the revenue is recognized. The revenue is recognized when a critical event has occurred. This principle uses the accrual method of accounting. According to this, revenues are recognized when realised and earned. It is a straightforward principle when revenue is recognized when customers make payments. Whenever the production takes longer, the accounting for revenue becomes more complicated.

13. Objectivity Principle

It refers to the concept of considering financial statements as solid evidence. These statements should not be biased or opinionated. While constructing financial statements, these statements should be helpful in evaluating the financial results, financial position and cash flow of an entity. This principle of accounting must be from the viewpoint of an auditor as well. In case an auditor is auditing a business that he has worked with, then the audit report might not be free from bias as per the relationship with the business owner.