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Lecture 03: Accounting principles

1_ The meaning of accounting principles:

Accounting principles are the common guidelines and rules related to accounting transactions that are followed to prepare financial statements successfully. These principles are the founding guidelines for preparing and recording financials for proper analysis. These accounting principles are also known as Generally Accepted Accounting Principles or GAAP.

2_ The importance of accounting principles:

The main purpose of accounting principles is to guarantee that a business's financial recordings and statements are consistent and to the point. Accurate knowledge of accounting principles makes it easy for investors to extract and analyze necessary information from financial statements. There are several reasons why accounting principles are important when recording financial data:

_ accounting principles can help record consistent, standardized and accurate data. This helps stakeholders compare financial performance over the years and with different companies.

_ Accounting principles can help detect errors, increasing the accuracy of the data recorded.

_ Accounting principles can also ensure that the data recorded is in compliance with the law of the country and can be used in case of legal issues or actions.

_ The accounting principles allow investors to analyze and tally significant information to make financial decisions.

_ This concept determines the expenses, income, liabilities, profit, assets and losses for financial reporting.

3_ Types of accounting principles:

Accrual principle:

The company should record accounting transactions in the same period it happens, not when the cash flow was earned. For example, let's say that a company has sold products on credit. As per the accrual principle, the sales should be recorded during the period, not when the money would be collected.

Consistency Principle:

This consistency principle is the accounting principle that requires an entity to apply the same accounting policies, methods, and standards for reporting its financial statements. The principle states that once a company has decided on an accounting principle. It can not be changed unless it leads to more accurate financial reporting.

Conservatism principle:

Conservatism principle is one of the main accounting principles which records future possible loses but not future gains or revenues. According to the conservatism principle businesses should record any future uncertain loses but not record future gains until they become certain.

Matching Principle:

The matching principle states that any expenses and the revenues incurred should be recognized in the same period. The guide acknowledges that an effect and cause relationship exists between revenues and expenditures. The purpose of matching expenses with revenues is to associate cost of assets and revenues to its benefits.

Cost Principle:

The cost principle states that any asset acquired by a company must be recorded in financial records at its original cash value rather than its market value. The assets recorded value will not fluctuate along with inflation or changes in market value.

Materiality principle:

This principle suggests that only significant information should be included in financial statements, while immaterial information can be omitted.

Revenue Recognition Principle:

Relate to the accrual principle; the revenue recognition principle says that a company should record revenue when a sale has been made, or when a service is given not when the related cash will be received. If there is doubt whether the customer will pay for amounts owe then allowance for doubtful debt should be maintained for the amount which company considers is not going to be realized.

Objectivity Principle:

According to the objectivity principle, financial information must be reliable and free of prejudice. It emphasizes the need to rely on objective evidence rather than human judgments to ensure the trustworthiness of financial data.