**Accounting Concepts**

These are the ground rules that must be applied when preparing financial statements. There are four main concepts that are generally acceptable.

1. ***The Going-Concern Concept***

* It is assumed that the business for which accounts are prepared is solvent and viable.
* The business is regarded as capable of operation into the future.

1. **The Accruals Concept (matching)**

* All income and expenditure for a particular period of time has to be included in the accounts whether it has been received, paid or not.
* Note: rent due at the end of the year must be included in this year’s accounts as it’s owed for this year.
* Rent prepaid must not be included in this year’s account as the payment refers to next year.

1. ***The Consistency Concept***

* If a business has used an accounting method for the treatment of a particular item, then it is assumed that it will continue to use this method in the future, e.g. straight line depreciation.
* This enables a business to compare like with like.
* Any change in accounting method must be disclosed.

1. ***The Prudence Concept***

* Revenue and profits included in the accounts only when they are realized (or when there is reasonable certainty of realizing them).
* Costs are included when there is a reasonable possibility of incurring them.
* Caution must be exercised so as not to overstate profits or understate losses.

**Other Key Accounting Concepts**

***The Entity Concept***

* Accounting records reflect the financial activities of a specific business or organization, and not of its owners or employees.
* The business is distinct from the owner. The capital of the business is owed to the owners.

***The Double-Entry Principle***

For every debit entry in the books, there must be a corresponding credit entry.

Every transaction has a twofold effect, e.g. purchase of an asset by cash, cash account decreases(cr) and asset increases(dr).

***The Realisation Concept***

* It is assumed that profit is earned when goods or services pass to the consumer and not when they are paid for.

***The Historical Cost Convention***

* All assets are recorded in the balance sheet at their cost price and not at their market value.

**The Materiality Concept**

* Relevant minor profits and losses may be ignored, but the major ones should be fully disclosed.
* The materiality of the item is usually left to the judgment of the accountant.

***Money Measurement Concept***

* The accounting process records only those activities that can be expressed in monetary terms.
* Accounts do not show the number of employees, target market, etc.

***Objectivity***

* This means that the accounts are prepared without any personal bias on the part of the accountant that compiles them. All figures should be independently backed up with documents such as invoices and receipts.

**Bases and Policies**

**Accounting Bases**

* These are the assumptions, methods and procedures used for applying the basic concepts to the accounts, e.g. a base for dealing with depreciation of fixed assets may to use straight line *method.*

**Accounting Policies**

* These are the accounting bases selected – base becomes policy - and consistently followed, by the management of an organization in preparing and reporting the financial statement.
* Accounting policies deal specifically with matters such as depreciation methods, amortization of goodwill, and stock pricing.
* Accounting policies must be disclosed in the annual financial statements by way of a note.