6.8 ACCOUNTING PRINCIPLES & POLICIES

6.8.1 ACCOUNTING PRINCIPLES

ACCRUALS (MATCHING) - Costs must be matched against related income of the same period.

BUSINESS ENTITY & OWNERSHIP - Know that a distinction is made b/w the financial transactions of a & B & those of its owners.

CONSISTENCY - The same accounting treatment should be applied to similar items at all times.

DUALITY - Every transaction has a 2-fold aspect.

GOING CONCERN - Accounting assumes that a business will continue to operate indefinitely.

MONEY MEASUREMENTS - Financial statements only include items which can be expressed in monetary terms.
PRUDENCE - Profits should not be overstated by ignoring foreseeable losses or that revenue should not be recorded before it is earned.

REALISATION - Know that revenue is recognised as being earned when legal liability to pay is incurred by the customer (i.e. when ownership of goods passes to the customer).

6.8.2 ACCOUNTING PRINCIPLES

COMPATIBILITY - Recognise that a financial report can only be compared with reports for other periods if similarities & differences can be identified.

RELEVANCE - Financial info is relevant only if it affects the B decisions.

RELIABILITY - Financial info is reliable only if it can be depended upon to represent actual events & is free from error & bias.
UNDERSTANDIBILITY: A financial report must be capable of being understood by the users of that report.

* Valuing the inventories on the basis of "lower of cost & net realisable value" is an example of the principle of Prudence.

* Credit sales were recorded at the time of sale rather than when payment was received. An example of Realisation.

* No entries were made for expenses paid by the owner for running his personal motor expenses. It is known as an example of Business Entity.

* An example of Accruals/Matching is when an accrued expense is included in the income statement.

Q. How does reducing the value of inventory fit an accounting principle of Prudence? It avoids inventory/profits/current assets to be overstated.

Q. How does reducing the value of inventory be an application of accruals (matching)? The loss arising from the damage is recorded in the same year as the damage occurred.