**An I International CBSE Finger Print School**

**Coimbatore**

# Theory Base of Accounting

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Theory Base of Accounting concepts are fundamentally the basic ideas holding the theory base of accounting and therefore, can be regarded as general working practices for all accounting activities. These concepts are mentioned below:

* **Business Entity Concept**: The concept of business entity says that a business is a separate entity from its owners. Therefore, for the [objective of accounting](https://byjus.com/commerce/class-11-accountancy-chapter-1-introduction-to-accounting/), the firm and its owners are considered as 2 distinct persons. Hence, when an owner brings in capital into the firm, it is considered as a liability of the business.
* **Money Measurement Concept**: The concept of money measurement associates to such transactions of a business, which can be recorded in terms of money in the books of accounts. The records are to be kept in monetary units alone and not in physical. All the assets are consequently shown in monetary terms for accounting purposes.
* **Going Concern Concept**: Going concern concept says that a firm will take on its business for an unlimited period of time and would not be converted into cash at any pre-decided timeframe.
* **Accounting Period Concept**: Accounting period is the timeframe at the end of which, the [financial statements](https://byjus.com/commerce/financial-statements-of-a-company/) of a business are prepared, to evaluate its profits and losses, and to learn the status of its assets and liabilities. This is required for the smooth availability of data to the users of the accounting information in a convenient manner.
* **Cost Concept**: Cost concept requires that all the assets must be recorded in the books of accounts at the price at which they were bought, which involves the cost incurred for transportation, installation and acquisition. The cost concept is traditional in nature as a particular amount concerning the asset is paid on the date of purchase and does not change year after year.

## Fundamental Accounting Assumption:

* Fundamental accounting assumptions are the assumptions which are presumed to have been followed while preparing the books of accounts.
* If they are not followed, then reasons should be disclosed for not following them.

There are 3 basic Accounting Assumptions:

### Going Concern Assumption

* The concept of going concern assumes that a business firm would continue and carry out its operations for a foreseeable future.
* There is no intention to close down the business, not any necessity to scale down its business activities.
* The business firm will not dissolve until it is required by the law.
* Because of this difference between capital expenditure (gives long term benefit to the business) and revenue expenditure (its benefit is taken in the same accounting year) is made.
* Example-if fixed asset is purchased, then its cost is spread over its useful life and its total cost is not treated as an expense in the year of purchase.

### Consistency Assumption

* According to this assumption, accounting policies and practices once selected and adopted are followed every year.
* They should be applied consistently over the period of time.
* It helps in the comparative study of financial statement of the current year with that of the previous year.
* It eliminates the factor of personal bias.
* Previous policies can be changed if:
  + Required by law or accounting standards
  + It will result in a more meaningful presentation.
* Changes should be disclosed.

### Accrual Basis Assumption

* Revenue and expenses are recognised in the period in which they occur rather than when they are received or paid.
* It is an important concept because it recognises the assets, liabilities, incomes and expenses only when transactions related to it are entered into.
* Profit is recognised when the sale of goods & services has been made, and obligation is transferred to the customer to pay in return.
* Similarly, Expense is also recognised when goods and services are purchased, and obligation is created to pay for them.

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| **Multiple Choice Questions** |
| Q.1- Which of the following is not fundamental accounting assumptions? |
| a. Going concern  b. Consistency  c. Accrual  d. Business Entity |
| Q.2-\_\_\_\_\_\_\_ assumption means neither any intention to close down the business nor any necessity. |
| a. Accrual  b. Going Concern  c. Matching  d. Consistency |