

# ACCOUNTING CONCEPTS

Accounting employees follow concepts commonly accepted by the profession as guides for reporting and interpreting accounting information.

## Accounting Period Cycle

*Changes in financial information are reported for a specific period of time in the form of financial statements.*

- \* accounting records are summarized and reported to business owners and managers depending on the needs of the business (1, 3, 6, or 12 months).
- \* for tax purposes every business prepares financial statements at the end of each year.

## Adequate Disclosure

*Financial statements contain all information necessary to understand a business' financial condition.*

- \* accurate and up-to-date financial information about a business is needed by owners, managers, lenders, and investors. All important financial information must be adequately and completely disclosed on financial statements.

## Business Entity

*Financial information is recorded and reported separately from the owner's personal financial information.*

- \* a business' financial records and reports must not be mixed with an owner's personal records and reports.
- \* the business exists separately from its owner.

## Consistent Reporting

*The same accounting procedures are followed in the same way in each accounting period.*

- makes
- \* accounting information recorded and reported differently each accounting period comparisons and decisions from one accounting period to another impossible.
  - \* unless a change is necessary to make information more easily understood, accounting information is reported in a consistent way for each accounting period.

## Going Concern

*Financial statements are prepared with the expectation that a business will remain in operation indefinitely.*

- \* a business is expected to continue indefinitely even if the owner retires or sells the business.

- \* if a business is sold, the new owner is expected to continue the business' operations.

### **Historical Cost**

*The actual amount paid for merchandise or other items bought is recorded.*

- \* the actual amount paid for an item in a business transaction is the historical cost and the amount recorded in the financial records.

### **Matching Expenses with Revenue**

*Revenue from business activities and expenses associated with earning that revenue are recorded in the same accounting period.*

- \* matching expenses with revenue gives a true picture of business operations for an accounting period, therefore, all revenue earned as a result of business operations and all expenses incurred in producing the revenue must be reported in the same period.

### **Materiality**

*Business activities creating dollar amounts large enough to affect business decisions should be recorded and reported as separate items in accounting records and financial statements.*

- \* how amounts of business transactions are recorded and reported depending on the amount involved and the relative importance of the time needed to make business decisions.
- \* large amounts are generally recorded separately. (\$20,000 computer)
- \* small amounts are generally combined with other amounts. (\$20 desk lamp)

### **Objective Evidence**

*A source document is prepared for each transaction.*

- \* only business transactions that actually occur are recorded and the amounts must be accurate and true.
- \* one way to check the accuracy of accounting records is to check the original business papers containing details (check, sales invoice, receipt).
- \* every entry must be supported by a business paper that can be verified.

### **Realization of Revenue**

*Revenue is recorded at the time goods or services are sold.*

- \* regardless of when cash is actually received, the sale amount is recorded in the accounting records at the time of sale.

### **Unit of Measurement**

*Business transactions are stated in numbers that have common values – that is, using a common unit of measurement.*

- \* useful nonfinancial information may also be recorded to describe the nature of a business transaction.

\* all transactions are recorded in a common unit of measurement – the dollar.