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Accounting concepts and conventions with examples pdf

In case where application of one accounting concept or principle leads to a conflict with another accounting concept or principle, accountants must consider what is best for the users of the financial information. An example of such a case would be the trade off between relevance and reliability. Information is more relevant if it is disclosed timely. However, it may take more time to gather reliable information. Whether reliability of information may be compromised to ensure relevance of information is a matter of judgment that ought to be considered in the interest of the users of the financial information. SlideShare utilise les cookies pour améliorer les fonctionnalités et les performances, et également pour vous montrer des publicités pertinentes. Si vous continuez à naviguer sur ce site, vous acceptez l'utilisation de cookies. Consultez notre Politique de confidentialité et nos Conditions d'utilisation pour en savoir plus. Accounting conventions are certain guidelines for complicated and unclear business transactions, though it is not compulsory or legally binding, however, these generally accepted principles maintain consistency in financial statements. While standardizing financial reporting process these conventions consider comparison, relevance, full disclosure of transactions, and application in financial statements. There are specific problems faced by accountants while making financial statements regarding certain business transactions, which are not entirely specified by accounting standards that are addressed by accounting conventions. It is referred to when; there is uncertainty in business transactions and when accounting standards fail to address such issues. Types of Accounting Convention #1 – Conservatism The accountant has to follow the conservatism principle of "playing safe" while preparing financial statements, considering all possible scenarios of loss while recording transactions. Two values occurred while logging assets, i.e., Market value and Book Value, in general, a lower value is considered since these conventions consider the worst-case scenario. There are specific points used for criticizing such a principle. In some instances, it's observed that secret reserves are being created by showing excess provision for bad debt and doubtful debts, depreciation, etc. And this affects the principle of true and fair status of financial conditions. #2 – Consistency Once a particular method is selected by the business while reporting process, it should be followed consistently in ensuing years. This principle is helpful for investors and analysts to read, understand, and compare the financial statements of the company. If the company wants to make a change in method, it should do so only with proper reasons to make specific changes. There are certain points, which criticize this principle, like considering certain items on a cost basis while others at market value void the principle of consistency in accounting. Still, accounting convention considers consistency in reporting methods over the years and not consistency with line items in comparison. Popular Course in this categoryAll in One Financial Analyst Bundle (250+ Courses, 40+ Projects)4.9 (1,067 ratings) 250+ Courses | 40+ Projects | 1000+ Hours | Full Lifetime Access | Certificate of Completion #3 – Full Disclosure Relevant and important information regarding the financial status of the company must be revealed in financial statements even after the application of the accounting convention. E.g., Contingent Liabilities, Law Suits against a business should be reported in adjoining notes in the financial statements of the company. #4 – Materiality Materiality Concept includes the impact of event or item and its relevance in financial statements. The accountant must report all such events and items that might influence the decision of investors or analysts. However, the information should be worthy of investigation and should have high value than the cost of preparation of statements. It means materiality allows an accountant to ignore certain principles when items are not material. For, E.g., Low-cost assets like stationery, cleaning supplies are charged under expense account instead of regular depreciating assets. Such issues have very little importance. Examples If Company built a plant worth \$250,000 10 years ago, it should remain as per book value even today. Revenues for the firm are recorded only after realization while Expense, loss, a contingent liability, is recorded as soon as it occurred. Importance Monetary Impact: Accounting considers only items and events with monetary value. Items such as Market leadership, management efficiency, skills are not considered in accounting as it does not directly reflect the financial impact on business. Different Entity: Accounting convention makes sure that private transactions of owners should not interfere in business transactions. Since businesses and owners are treated as two separate legal entities by law, this should be followed in business as well. Realization: Convention concentrates on the completed transaction. Transfer of ownership or sale of an asset or product should not be considered at the point of contract, but when the entire process completes. Understanding: There should be clarity of information in financial statements in a certain way that investors or analyst who reads them must understand such data. Comparison: Many Investors and analysts compare financial statements of the company with their peers to analyze performance over a period. They make sure any information reported is in a way that will make it easy for investors. Reliable: They make sure reliable information is segregated and reported in financial statements. Neutral: They state that the accountant should make financial statements with no stake in a company or a biased opinion. Advantages Credibility: Financial Statements prepared according to accounting standards and conventions are much more reliable and accurate. The following specific methods disclose relevant information. It increases the confidence of investors. Planning and Decision: It provides enough information regarding financial data. Easy to Compare: Accounting conventions makes sure that multiple companies report the transaction in the same manner as described. Thus making it easy for investors, creditors, analysts to compare the performance of peer groups of companies. Efficiency: Accounting standards and conventions provide efficiency in the reporting process, which makes it easier for an accountant. Even users of such financial statements benefitted as such standards are applicable and followed by all companies. Management Decisions: They help management to make certain important decisions that affect business. E.g., the Prudence concept makes sure revenues are recorded when realized, but liabilities and expenses are recorded as soon as they occurred. Reduce Fraud: It is guidelines for certain business transactions, which are fully explained by accounting standards. Accounting conventions, although not legally binding, make sure that financial statements provide relevant information in a particular manner. Reduce Wastage and Save Time: Accounting convention like materiality makes sure that financial statements record all items and events worth value. This convention helps the accountant to ignore certain principles and concentrate on relevant items. Disadvantages Uncertainty: Many accounting conventions don't wholly explain concepts or transactions, which are recorded in financial statements. They are thus making it easy for management to manipulate specific figures through the accountant, e.g., Provisions for bad debt, depreciation. Lacks Consistency in Different Line Items: Assets and income recorded at cost and when a transaction completes while liability and expenses are recorded as soon as it occurred. They operate with worst-case scenarios, which might not reflect actual information of the company. Manipulation: Although they are designed to avoid manipulation, many times, these conventions help the management of the business to manipulate specific financial data through the reporting process, which shows a different picture of a company's financial status. Estimates: Certain accounting estimate might not show a clear picture of the financial data of the company. Conclusion Accounting conventions are designed to resolve the issue of certain transactions through guidelines, which are not adequately addressed by accounting standards. These conventions help many companies while efficiently reporting their financial data. At the same time, it makes sure financial statements have all relevant information for the benefit of investors. Though these convention helps management to manipulate specific figures in financial statements, it also helps in the smoothening reporting process of a company. It makes sure relevant information is disclosed in financial data or adjoining notes. For an investor, it is essential to go through all the information before making any decision. Usage of these conventions reduces as accounting standards are developed over time and increase the level of details and answers questions. Recommended Articles This article has been a guide to what is Accounting Convention and its meaning. Here we discuss four types of accounting conventions and their examples and importance. You may learn more about Financing from the following articles – accounting concepts and conventions with examples pdf. accounting concepts and conventions with examples ppt. explain the accounting concepts and conventions with examples. difference between accounting concepts and conventions with examples. accounting principles concepts and conventions with examples. accounting principles concepts and conventions with examples pdf

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