LESSON-3 ACCOUNTING CONVENTIONS AND STANDARDS

SUMMARY

Accounting conventions are common practices which are followed in recording and presenting accounting information of business.

Accounting Conventions help in comparing accounting data of different business units or of the same unit for different periods. These have been developed over the years. The most important conventions which have been used for a long period are

- **Convention of Consistency.**
- **Convention of Full Disclosure.**
- **Convention of Materiality.**
- **Convention of Conservatism.**

Convention of consistency

Convention of consistency states that the same accounting methods should be adopted every year in preparing financial statements.

There are three types of consistency namely :

- Vertical consistency (Same organisation)
- Horizontal consistency (Time basis)
- Dimensional consistency (Two organisations in the same trade)

Significance

- It facilitates comparative analysis of the financial statements.
- It ensures uniformity in charging depreciation on fixed assets and valuation of closing stock.

Convention of Full Disclosure

Convention of full disclosure states that all material and relevant facts relating to financial statements should be fully disclosed. Full disclosure means that there should be full, fair and adequate disclosure of accounting information. **Adequate** means sufficient set of information to be disclosed. **Fair** indicates an equitable treatment of users. **Full** refers to complete and detailed presentation of information.

Significance

- It helps in meaningful comparison of financial statements of the different business units.
- This can also help in the comparison of financial statements of different years of the same business unit.
- This convention is of great help to investor and shareholder for making investment decisions.
- The convention of full disclosure presents reliable information.

Convention of Materiality

Convention of materiality states that, to make financial statements more meaningful only significant information should be shown in the financial statements. The convention of materiality states that, to make financial statements meaningful, only material facts i.e. important and relevant information should be supplied to the users of accounting information.

Significance

- It helps in minimising the errors of calculation.
- It helps in making financial statements more meaningful.
- It saves time and resources.

Convention of conservatism

Convention of conservatism states that, profit should not berecorded until it is realised. But if business anticipates any loss in near future provision should be made in the books of account.

This convention is based on the principle that **"Anticipate no profit, but provide for all possible losses"**. It provides guidance for recording transactions in the books of accounts. It is based on the policy of playing safe in regard to showing profit. The main objective of this convention is to show minimum profit.

Significance

It helps in ascertaining actual profit.

It is useful in the situation of uncertainties and doubts.

It helps in maintaining the capital of the enterprise.

GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP) AND ACCOUNTING STANDARDS

Generally Accepted Accounting Principles (GAAP) refer to the rules or guidelines adopted for recording and reporting of business transactions of financial statements. These principles have evolved over a long period of time on the basis of past experiences, usages or customs, etc.

Generally accepted accounting principles refer to the rules or guidelines adopted for recording and reporting of business transactions in order to bring uniformity in the preparation and presentation of financial statements.

ACTIVITY

Visit a number of business units and enquire from the accountants how do they deal with the following while preparing the accounts:

1. Valuation of the stock at the end of the accounting period.
2. At what intervals do they close their account books?