Generally Accepted Accounting Principles for SSC

Generally Accepted Accounting Principles form the base of accounting. For SSC CGL Exam, it is very important to prepare Financial Awareness and General Awareness topics. By preparing these topics, you can assure good score in less efforts. Read these notes to learn about Generally Accepted Accounting Principles for SSC CGL Tier II exam. Once you are done reading, you can download this article as PDF!

Generally Accepted Accounting Principles

- Generally Accepted Accounting Principles are rules governing accounting.
- These are broad concepts and detailed practices in accounting, including all the conventions, rules, and procedures that make up accepted accounting practice at a given time.
- The primary objective of Generally Accepted Accounting Principles is to provide information useful for making investment and lending decisions.
- Accountants have agreed to apply a common set of measurement principles (a common language) to record information for financial statements. Accountants follow these professional guidelines.

Basic Concepts of Generally Accepted Accounting Principles

1. Separate Business Entity - Generally Accepted Accounting Principles

- Accounting entity is an organization that stands apart as a separate economic unit.

- In accounting we make a distinction between business and the owner.
- All the books of accounts record day to day financial transactions from the view point of the business rather than from that of the owner.
- It is only for accounting purpose that partnerships and sole proprietorship are treated as separate from the owner(s), though law does not make such distinction.
- Business entity concept is applied to make it possible for the owners to assess the performance of their business and performance of those who manage the enterprise.

2. Money Measurement - Generally Accepted Accounting Principles

- In accounting, only those business transactions are recorded which can be expressed in terms of money.
- As money is accepted not only as a medium of exchange but also as a store of value, it has very important advantage since number of assets and equities, which are otherwise different, can be measured and expressed in terms of a common denominator.

3. Dual Aspect - Generally Accepted Accounting Principles

- Financial accounting records all the transactions and events involving financial element. Each of such transactions requires two aspects to be recorded.
- The recognition of two aspects of every transaction is known as a dual aspect analysis.
- According to this concept every business transaction has dual effect.
- According to this system the total amount debited always equals the total amount credited.
- It follows from 'dual aspect concept' that at any point in time owners' equity and liabilities for any accounting entity will be equal to assets owned by that entity.

Accounting Equation -

Assets = Liabilities + Owners Equity
Owners' Equity = Assets - Liabilities

- 'Owners' Equity' denotes the resources supplied by owners of the entity.
- 'Liabilities' denote the claim of outside parties such as creditors, debenture-holders, bank against the assets of the business.
- Assets are the resources owned by a business.

4. Going Concern - Generally Accepted Accounting Principles

- Accounting assumes that the business entity will continue to operate for a long time in the future unless there is good evidence to the contrary.
- The enterprise is viewed as a going concern, that is, as continuing in operations, at least in the foreseeable future.
- If the accountant has good reasons to believe that the business, or some part of it is going to be liquidated or that it will cease to operate (say within six-month or a year), then the resources could be reported at their current values.
- If this concept is not followed, International Accounting Standard requires the disclosure of the fact in the financial statements together with reasons.

5. Accounting Period - Generally Accepted Accounting Principles

- This concept requires that the life of business should be divided into appropriate segments for studying financial results shown by enterprise after each segment.
- The results of operations of a specific enterprise can be known precisely only after the business has ceased to operate, its assets have been sold off and liabilities paid off, the knowledge of the results periodically is also necessary.
- This concept poses difficulty for the process of allocation of long term costs.

- Short term reports are of vital importance to owners, management, creditors and other interested parties.

6. Cost Concept- Generally Accepted Accounting Principles

- Term ‘assets’ denotes the resources land building, machinery etc. owned by a business, the money values that are assigned to assets are derived from the cost concept.
- According to this concept, an asset is ordinarily entered on the accounting records at the price paid to acquire it.
- Assets are recorded at their original purchase price and this cost is the basis for all subsequent accounting for business.
- The cost concept does not mean that all assets remain on the accounting records at their original cost for all times to come.
- The cost concept meets all three basic norms of relevance, objectivity and feasibility.

7. The Matching Concept- Generally Accepted Accounting Principles

- This concept is based on accounting period concept. In reality we match revenues and expenses during accounting periods.
- Matching is the entire process of periodic earnings measurement, often described as a process of matching expenses with revenues.
- Income made by the enterprise during a period can be measured only when revenue earned during a period is compared with the expenditure incurred for earning that revenue.
- Revenue is the total amount realized from the sale of goods or provision of services together with earnings from interest, dividend, and other items of income.
- Expenses are cost incurred in connection with the earnings of revenues.

8. Accrual Concept - Generally Accepted Accounting Principles

- Accrual concept makes a distinction between the receipt of cash and the right to receive it, and the payment of cash and the legal obligation to pay it.
- Accrual principle tries to evaluate every transaction in terms of its impact on the owner's equity.
- The essence of the accrual concept is that net income arises from events that change the owner's equity in a specified period and that these are not necessarily the same as change in the cash position of the business. Thus, it helps in proper measurement of income.

9. Realization Concept - Generally Accepted Accounting Principles

- According to Realization concept, revenue is recognized when sale is made. Sale is considered to be made at the point when the property in goods passes to the buyer and he becomes legally liable to pay.
- This implies that revenue is generally realized when goods are delivered or services are rendered.
- In case of long run construction contracts revenue is often recognized on the basis of a proportionate or partial completion method.

10. Convention of Materiality - Generally Accepted Accounting Principles

- Materiality concept states that items of small significance need not be given strict theoretically correct treatment. In fact, there are many events in business which are insignificant in nature.
- The cost of recording and showing in financial statement such events may not be well justified by the utility derived from that information.

- It should be noted that an item material for one party may be immaterial for another.
- There are no hard and fast rules to draw the line between material and immaterial events and hence, it is a matter of judgment and common sense.

11. Convention of Conservatism - Generally Accepted Accounting Principles

- This rule means that an accountant should record lowest possible value for assets and revenues, and the highest possible value for liabilities and expenses.
- According to this concept, revenues or gains should be recognized only when they are realized in the form of cash or assets (i.e. debts) the ultimate cash realization of which can be assessed with reasonable certainty.
- Provision must be made for all known liabilities, expenses and losses, Probable losses regarding all contingencies should also be provided for,
    - Anticipate no profits but provide for all possible losses
    - Policy of 'Caution' and 'Playing Safe'
    - Policy of safeguarding against possible losses in world of uncertainty

12. Convention of consistency - Generally Accepted Accounting Principles

- The convention of consistency requires that once a firm decided on certain accounting policies and methods and has used these for some time, it should continue to follow the same methods or procedures for all subsequent similar events and transactions unless it has a sound reason to do otherwise.
- The application of the principle of consistency is necessary for the purpose of comparison.

To sum up, Generally Accepted Accounting Principles are guidelines for systematic approach to business operations.

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