

3.1 Fundamental Accounting Principles

JMC Jayasekera Management Centre (Pvt) Ltd



Accounting Concepts

Sandeepa Jayasekera - JMC

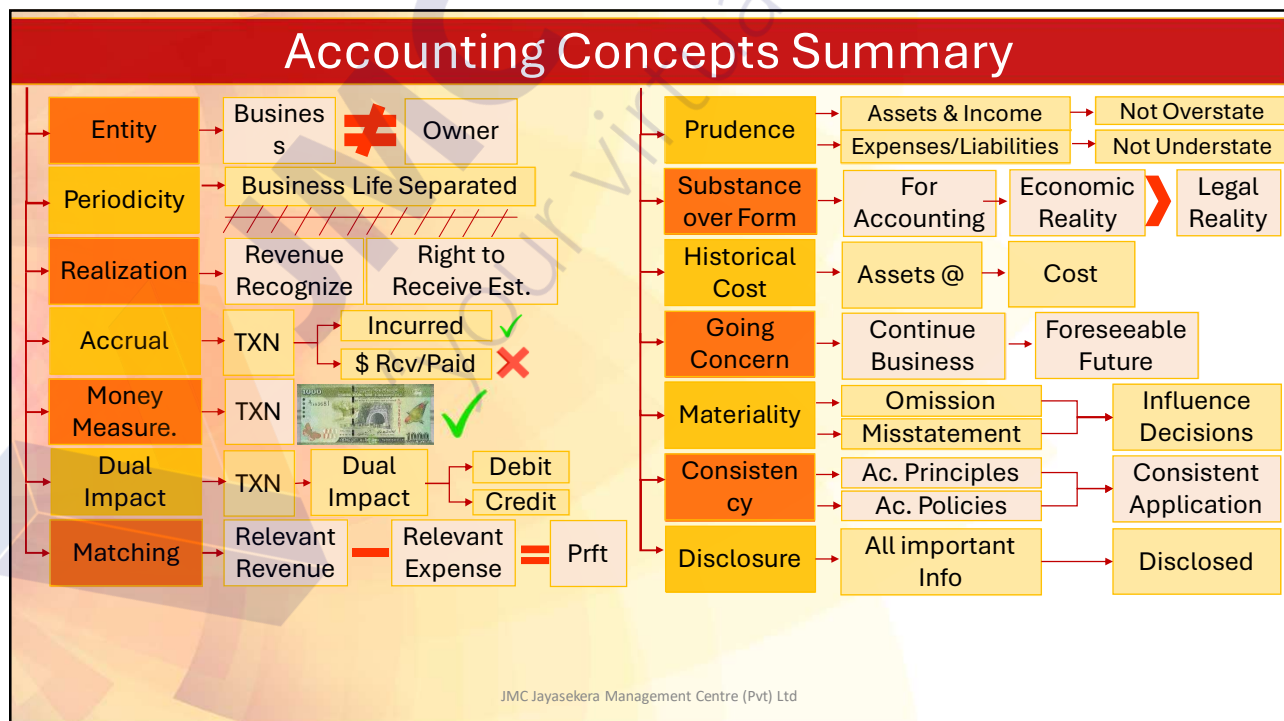
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Accounting Concepts

Concept	Description	Examples	
Business Entity	Business is a separate independent entity from the owners.	<ul style="list-style-type: none"> Equity is an internal obligation. Drawings is a reduction of equity and not an expense. Owner's personal transactions are not recorded in financials. Financials named under the name of business. Statement of changes in equity to show txns with owners. 	
Going Concern	Business will continue its operations for a foreseeable future without liquidation	<ul style="list-style-type: none"> Assets and liabilities classified as current and non-current. Liabilities shown at cost and not in net realizable value Depreciation of Property, plant and equipment. 	
Periodic	Business life is divided into periods to ascertain the business performance, financial position and cash flows	<ul style="list-style-type: none"> Stating the financial year in statement of profit or loss. Stating the reporting date on statement of financial position. Considering income and expense for that particular year in statement of profit or loss. 	
Accrual	Transactions shall be recognized as and when it has been incurred and not at the point of cash receipt or the payment.	<ul style="list-style-type: none"> Recognizing Accrued liabilities Prepaid expenses Debtors 	<ul style="list-style-type: none"> Creditors Income receivables Income received in advance

Concept	Description	Examples	
Dual impact	Every transaction or event has a dual impact that will be recorded as debit and a credit. It helps to have the mathematical accuracy.	Transactions recorded as debit and credit	Owner invested money Cash Dr. Capital Cr.
Matching	All the expenses incurred to generate the income shall be compared in arriving at the profit.	<ul style="list-style-type: none"> Recognizing closing inventory Depreciation of property, plant and equipment. Writing off bad debts and doubtful debt provision. Damaged inventory loss Cost of sales compared with sales income. 	
Prudence	Financial statements shall not be manipulated. Assets and income shall not be overstated. Expenses and liabilities shall not be understated.	<ul style="list-style-type: none"> Provision for doubtful debts Impairment provisions Gratuity provisions Inventory measured at lower of cost or net realizable value Depreciation of assets. 	
Realization	Income shall be recognized as and when the legal right to receive is established. Legal right to receive is established when seller has delivered the performance obligations	<ul style="list-style-type: none"> Sale of a good is recognized when goods are being accepted by the buyer. Service income are recognized over the service period. 	

Concept	Description	Examples
Historical cost	Assets & Liabilities recorded at the cost of acquisition.	<ul style="list-style-type: none"> Property, plant and equipment initially measured at cost.
Consistency	Accounting principles, methods and bases used in preparing and presenting financials shall not be changed regularly.	<ul style="list-style-type: none"> Use of same accounting principles without a change. Changes to accounting principles will made only if standard requires it or if more reliable and relevant information can be provided with change
Money measurement	Transactions and events that can be measured in monetary terms can only be accounted.	<ul style="list-style-type: none"> The currency is mentioned in all financial statements. Things that cannot be measured in monetary terms are not accounted. Customer loyalty, Employee loyalty & talents
Substance over form	In accounting, the economic reality is more important than the legal reality.	<ul style="list-style-type: none"> Leased out assets are recognized in financial position Unsold inventory send on sale or return recognized as inv. Debtors factored with recourse are considered as debtors
Materiality	Information is material if it influence the decisions of the stakeholders. it depends on both size & nature.	<ul style="list-style-type: none"> Immaterial tools and equipment purchased are charged to profit or loss (Staplers, punchers) Loans given to directors are disclosed, even immaterial
Disclosure	All material information shall be disclosed without omitting.	<ul style="list-style-type: none"> Property, plant and equipment note. Disclosing events after reporting period. Disclosing any important info not available in other FS.





Q1

Expenditure incurred in a particular accounting period should be taken into account during that particular accounting period irrespective of the actual payment. The accounting concept relating to this treatment is:

- (1) Accrual Concept.
- (2) Consistency Concept.
- (3) Entity Concept.
- (4) Historical Cost Concept.

Q2

Briefly explain, the “Concept of Going Concern” .

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Q3

Perera, a sole proprietor has taken Rs.5,000/- in cash from his business for his private expenses and it was considered as drawings of the business. The accounting concept relating to this treatment is:

- (1) Entity concept.
- (2) Accrual concept.
- (3) Realization concept.
- (4) Consistency concept.

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Q4

State the Accounting Concept applicable for each of the following circumstances:

- (a) It is assumed that the entity will continue for a long time, unless and until it has entered into a state of liquidation. _____
- (b) Revenue is recognized in the particular accounting period irrespective of receipt of cash or not. _____
- (c) The accounting policies followed by an entity should be consistently applied over the years. _____

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Q5

The accounting policy on the depreciation method followed by the entity should not be changed over the years. The accounting concept relating to this treatment is:

- (1) Going Concern concept.
- (2) Entity concept.
- (3) Consistency concept.
- (4) Realization concept.

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Q6

Identify the accounting concept applicable for each of the following transactions:

- (a) Assets with insignificant amounts are expensed. _____
- (b) A land of the business is shown in the statement of financial position at the purchase price. _____
- (c) A provision should be made for doubtful debts from its debtors.

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Q7

“It is assumed that the entity will continue for a long time unless and until it has entered into a state of liquidation.”

The accounting concept relating to the above statement is:

- (1) Historical cost concept.
- (2) Going concern concept.
- (3) Realization concept.
- (4) Entity concept.

02 Marks

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Q8

Identify the relevant accounting concept applicable for each of the following statements.

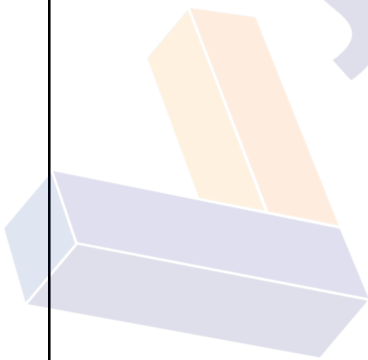
- (a) A company should follow consistently the method adopted for valuation of inventory. _____
- (b) Every transaction is recorded in terms of money. _____
- (c) Goods withdrawn by the owner for his personal use are considered as drawings. _____

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Q9

Briefly explain the “Accounting Periodic Concept”.



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Q10

Recognizing transactions considering business and owner as two separate independent entities.”

Which one of the following accounting concept explains the above statement?

- (1) Entity concept. (2) Going Concern concept.
(3) Consistency concept. (4) Prudence concept.

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Q11

State whether each of the following statements is/are true or false

1. As per materiality concept, inventories are recorded at the lower of cost or net realizable value. _____
2. As per the accrual concept, revenue is recognized in the particular accounting period, irrespective of receipt of cash or not. _____
3. As per materiality concept, items which are material should be separately disclosed in the financial statements. _____
4. As per the entity concept, the business and managers are considered as two separate independent entities. _____

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Q12

Briefly explain the “Consistency Concept”.

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Q13

“Inventories are valued at lower of Cost or Net Realizable Value (NRV)”.
The accounting concept relating to the above statement is:

- (1) Prudence Concept.
- (2) Going Concern Concept.
- (3) Entity Concept.
- (4) Accrual Concept.

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Q14

“The indefinite life of a business is separated to periods to assess the financial performance.” The most appropriate accounting concept that explains the above statement is:

- (1) Periodic Concept.
- (2) Going Concern Concept.
- (3) Accrual Concept.
- (4) Entity Concept.

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Q15

As at 31st March 2021, Samanala Traders recorded Rs.25,000/- as the electricity expense for the month of March 2021, but the payment was made in the month of April 2021. The accounting concept relating to the above statement is:

- (1) Entity Concept.
- (2) Accrual Concept.
- (3) Going Concern Concept.
- (4) Prudence Concept.

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Q16

Rama Traders has a land in Kandy and it is shown in the Statement of Financial Position of Rama Traders as at 31st March 2021 at purchase price of Rs.5,000,000/-. However, the market value of this land as at 31st March 2021 was Rs.6,000,000/-. The accounting concept relating to this is:

- | | |
|------------------------------|----------------------------|
| (1) Consistency Concept. | (2) Matching Concept. |
| (3) Historical Cost Concept. | (4) Going Concern Concept. |

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Q17

"A telephone bill of the owner of the business was paid by the business and it was considered as a business expense." The accounting concept violated in the above treatment is:

- | | |
|-----------------------|----------------------------|
| (1) Accrual concept. | (2) Going concern concept. |
| (3) Matching concept. | (4) Entity concept. |

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Q18

Of the following, select the incorrect statement:

- (1) Materiality is considered based on size only.
- (2) As per prudence concept, inventories are valued at the lower of cost or net realizable value.
- (3) As per realization concept the income can be recognized when the legal right to receive money is established.
- (4) The accrual concept states that income or expense can be recognized as an when it's incurred.

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Q19

“Information that are important for decision makers shall be included in the financial statements.”

The accounting concept relating to the above statement is:

- (1) Going Concern concept.
- (2) Disclosure concept.
- (3) Entity concept.
- (4) Periodic concept.

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Q20

State whether each of the following statements is/are true or false

1. It is required to record all the transactions and events of a business whether it can be measured in money or not. _____
2. Valuing inventory at higher of cost or Net Realizable Value (NRV) is an example of prudence accounting concept. _____
3. As per the Going Concern Concept, financial statements are prepared on the assumption that an entity will continue in operation for an unforeseeable future period _____

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Q21

The accounting policy on the stock valuation method followed by the entity should not be changed over the periods. The accounting concept relating to this treatment is:

- | | |
|------------------------------|----------------------------|
| (1) Accrual Concept. | (2) Going Concern Concept. |
| (3) Historical Cost Concept. | (4) Consistency Concept. |

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Q22

Virath has stated “As at 31st March 2022” in the header of his Statement of Financial Position, when he prepared the financial statements for his business. The most relevant accounting concept which he has followed is:

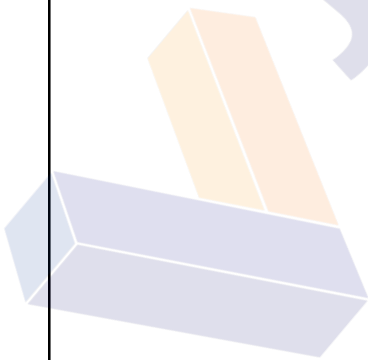
- (1) Periodic concept.
- (2) Materiality concept.
- (3) Matching concept.
- (4) Accrual concept.

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Q23

Briefly explain the concept, “Substance Over Form”.



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Q23

A part of the building of **ABC Ltd.** has been given out on rent at Rs.10,000/- per month. During the year ended 31st March 2023, an amount of Rs.110,000/- was received and balance Rs.10,000/- was received during the next financial year. **Vishnu**, Assistant Accountant of the company has recognized only Rs.110,000/- as rent income for the year ended 31st March 2023. Which one of the following accounting concept has been violated by **Vishnu**?

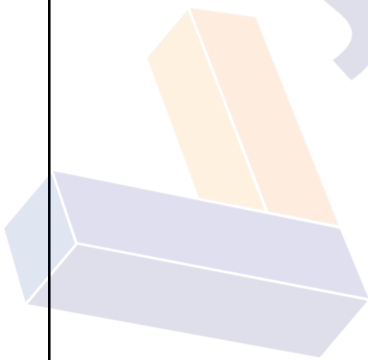
- (1) Matching Concept.
- (2) Entity Concept.
- (3) Accrual Concept.
- (4) Materiality Concept

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Q24

Briefly explain the “Matching Concept”.



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Q25

Which of the following accounting concepts provides the basis for non-recognition of employee competencies in the financial statements of a business?

- 1) Materiality
- 2) Money Measurement
- 3) Prudence
- 4) Matching

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Q26

Which of the following accounting concept provides the basis for the recognition of debtors and creditors in the financial statements of a business?

- 1) Going Concern
- 2) Matching
- 3) Prudence
- 4) Accrual

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Q27

State the accounting concepts applicable for the scenarios given below.

A. Indication of the reporting period of the financial statements

B. Deduction of distributions made to owners from the retained earnings _____

C. Measurement of property, plant and equipment at acquisition cost

D. Measurement of inventory at the lower of cost or net realizable value

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Q28

State whether following statement/s is are True or False.

A - Entity name is separately shown in financial statements inline with the entity concept _____

B - Going concern concept provides the basis for classification of assets and liabilities as current and non-current in the financial statements

C - Recognition of depreciation for each period in the income statement is inline with the matching concept _____

D - Drawings is deducted from the income in accordance with matching concept _____

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Q29

The following transactions took place in Isuru's catering business.

15/1/20X8 - Accepted an order to supply food and received a cash advance of Rs.100,000

28/1/20X8 - Supplied the food for the above order and received Rs.200,000 in cash

05/2/20X8 - Received the balance amount of Rs.50,000 for this order

In relation to recognition of revenue of the above order

A - What is the date to recognize the revenue? _____

B - How much is the value of revenue to be recognized on this date?

C - What is the applicable accounting concept? _____

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Q30

State whether following statements are True or False.

- 1) The basis to show the dividends paid to ordinary shareholders as a deduction from the retained earnings is provided by the entity concept _____
- 2) The basis to classify income receivable as a current asset in the statement of financial position is provided by the materiality concept _____
- 3) The basis to recognize discounts received from creditor as an income is provided by the matching concept _____
- 4) The basis to recognize discounts allowed to debtors as an expense is provided by the realization concept _____

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Q31

State the most appropriate accounting concept for the following accounting treatment.

A - Making a provision for warranties provided on goods sold _____

B - Recording a building obtained on lease as an asset in the lessee's books _____

C - Recognizing depreciation as an expense in the profit or loss account _____

D - Presenting assets as current and non-current in the statement of financial position _____

E – Financial statements prepared for a financial year _____

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Q32

State whether following statements are True or False.

A - The basis for recognition of debtors and creditors is provided by the accrual concept _____

B - The basis for measuring inventories at lower of cost or net realizable value is provided by the matching concept _____

C - The basis for classification of assets and liabilities as current and non-current in the statement of financial position is provided by the going concern concept _____

D – The loan given by directors are disclosed irrespective of the value due to materiality concept _____

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Q33

Which statement below reflect the application of substance over form concept? Put Yes or No.

A - Recognition of income tax payable by an entity as a liability _____

B - Recognition of asset obtained through lease arrangement in the statement of financial position _____

C - Recognition of bonus payable of an entity as a liability _____

D – Recognizing inventory sent on sale or return as an inventory until inventory being sold to final customer _____

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Q34

Select the situations which the historical cost concept is NOT practiced when preparing the financial statements.

A - Property, plant and equipment are revalued (Brought to market value) as per the revaluation model _____

B - Inventory measured at cost or net realizable value which ever is lower _____

C - Financial assets and liabilities measured at fair value _____

D – Machinery purchased measured at the purchase cost. _____

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Q35

The liabilities to be settled within 12 months from the reporting date is recognized as current liabilities. What is the underline accounting concept?

- 1) Prudence
- 2) Classification
- 3) Consistency
- 4) Going Concern

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Q36

The useful life of a machine estimated at 10 years was revised to 8 years. Accordingly, the depreciation was calculated and charged to profit or loss.

What is the underline accounting concept for the above adjustment?

- 1) Consistency
- 2) Materiality
- 3) Matching
- 4) Prudence

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Q37

A company purchased goods costing Rs. 850,000/- and sold part of those during the year. The cost of the goods sold was Rs. 600,000/-. The said Rs. 600,000/- has been considered as cost of sales while the balance of Rs. 250,000/- was included in the closing stocks. The accounting concept relevant to the above treatment is:

- 1) Consistency
- 2) Materiality
- 3) Matching
- 4) Prudence

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Q38

John Keels (Pvt) Ltd (A)
Statement of Profit or Loss and Other Comprehensive Income for the
year ending 31 March 20X9 (B)
Rs.000' (C)
Revenue XXX (D)
Cost of Sales XXX (D)

Recognize the relevant accounting concepts indicated in

- A - _____
B - _____
C - _____
D - _____

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Q39

State the accounting concepts for following situations of a company.

- A. Reporting a land at its acquisition price though the fair value of the land is greater _____
- B. Recognizing depreciation of machinery over the period they are intended to use _____
- C. Recognizing all assets with a purchase price less than Rs.5,000 as an expense _____
- D. Using first in first out method to value the inventory _____

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Q40

A firm is unable to continue its operations for the foreseeable future. Which of the following accounting concepts are **not relevant** in the preparation of financial statements of this firm?

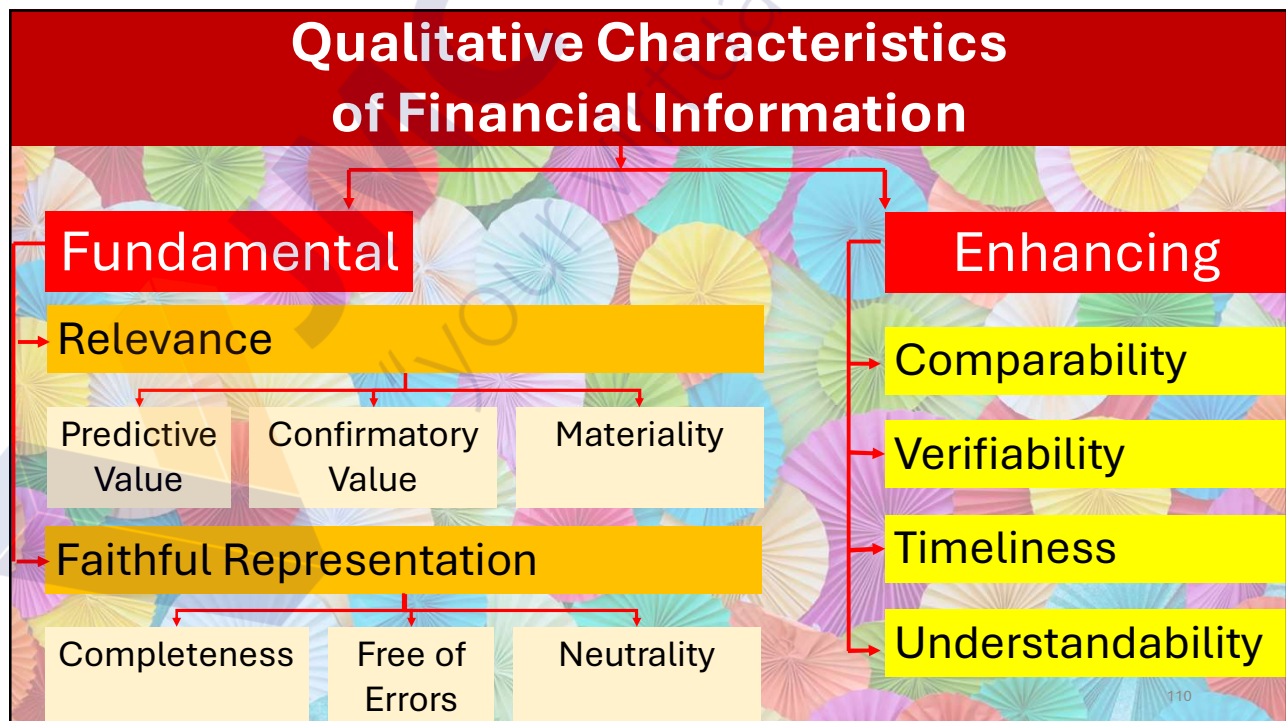
- (1) Business Entity and Accruals
- (2) Business Entity and Money Measurement
- (3) Going Concern and Historical Cost
- (4) Substance over form and Realisation
- (5) Prudence and Realisation

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3.2 Qualitative Characteristics of Useful Financial Information

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Fundamental Qualitative Characteristics of Financial Information	
QC	Description
Relevance	<p>Information is relevant, if it can make a difference in user's decisions. Sub qualities of relevance include predictive value, confirmatory value and materiality.</p> <ul style="list-style-type: none"> • Predictive value is ability to predict the future. • Confirmatory value means ability confirm the previous predictions. • Materiality means the ability of an information to influence the decisions. Materiality depends on both size and nature.
Faithful Representation	<p>Faithful representation means that the financial reports shall present the economic phenomena in numbers and words. Sub qualities of faithful representation include completeness, neutrality and free of errors.</p> <ul style="list-style-type: none"> • Completeness means all necessary information shall be included. • Free of errors means financial statements shall maintain the accuracy. • Neutrality means financial information shall not be biased.

Enhancing Qualitative Characteristics of Financial Information	
QC	Description
Comparability	Users must be able to compare financial statements with previous year, competitors and industry averages.
Verifiability	Different knowledgeable observers shall be able to reach the consensus of an information.
Timeliness	Information shall be available on time.
Understandability	Information shall be presented in a clear and concise manner, where the users can understand.

Q1

Of the following, select the correct statement:

- (1) Relevance is a fundamental qualitative characteristic of financial information.
- (2) Transactions are considered as the accounting output.
- (3) The main objective of accounting is to protect employees of the organization.
- (4) There are no limitations of financial information.

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Q2

Which one of the following is a qualitative characteristic of financial information?

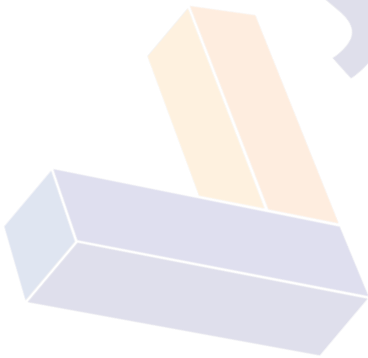
- (1) Going Concern.
- (2) Relevance.
- (3) Accrual Basis.
- (4) Historical Cost.

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Thank You



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