basic education

Department:
Basic Education
REPUBLIC OF SOUTH AFRICA

Accounting Principles and Concepts – Application: Grade 10 - 12

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Purpose of Study Guide

The purpose of this Guide is to assist teachers and learners to manage accounting principles. The principles are foundations of preparing and maintaining accounting records. The Guide provides learners with a foundation towards understanding the subject Accounting. In this Guide learners shall learn about various accounting principles, their meaning and significance.

This document is not intended to serve as a complete manual, but as a guide to assist teachers in coping with and managing the curriculum knowledge gap of learners. It will form part of many other strategies and resources that will help learners understand Accounting.

How to use this Guide

This Guide should be used as a **resource** for teachers and learners, and learners should continually be referred to the Guide for clarity-seeking issues when recording transactions. The Guide should be used in conjunction with other resources.

Introduction

In order to become effective in carrying out the accounting procedure, as well as in communicating the financial information of the business, there is a widely accepted set of rules, concepts and principles that governs the application of the accounting procedures, and it is referred to as the Generally Accepted Accounting Principles or GAAP.

In this guide, you will learn and familiarize yourself with the accounting principles and accounting concepts relevant in performing the accounting procedures. It is relevant to understand it because you need to abide by these concepts and principles every time you analyze record, summarize, report and interpret financial transactions of a business.

Application of principles and concepts

Principle / Concept	**The Business Entity Concept**
Explanation	The business entity concept provides that: ▪ The **accounting for a business or organization be kept separate from the personal affairs of its owner**, or from any other business or organization. This means that the owner of a business should not place any personal assets on the business balance sheet. ▪ The **balance sheet of the business must reflect the financial position of the business alone.** Also, when transactions of the business are recorded, any personal expenditures of the owner are charged to the owner and are not allowed to affect the operating results of the business.
Application	**Significance of the concept:** ▪ The profit of the business as only the business expenses and revenues are recorded and all the private and personal expenses are ignored. ▪ Restraints the business from recording of owner's private/personal transactions. ▪ Facilitates the recording and reporting of business transactions from the business point of view ▪ It is the very basis of accounting concepts, conventions and principles. ▪ Capital and Drawings accounts are kept to record amounts the owner gives to or takes from the business. **Example:** Suppose Ms Sally started business investing R100 000. She purchased goods for R40 000, Furniture for R20 000 and plant and machinery of R30 000. R10 000 remains in

	hand. 1. Everything that is bought and cash on hand are all the assets of the business and not of the owner. 2. According to the business entity concept R100 000 will be treated by business as capital i.e. a liability of business towards the owner of the business. 3. Now suppose, she takes away R5 000 cash or goods worth R5000 for his domestic purposes. This withdrawal of cash/goods by the owner from the business is his private expense and not an expense of the business. It is termed as Drawings. Thus, the business entity concept states that business and the owner are two separate/distinct persons. Accordingly, any expenses incurred by owner for himself or his family from business will be considered as expenses and it will be shown as drawings.

Principle / Concept	**The Going / Continuing Concern Concept**
Explanation	▪ This concept states that a business firm will continue to carry on its activities for an **indefinite period of time**, i.e. every business entity has continuity of life. Thus, it will not be dissolved in the near future. ▪ This is an important assumption of accounting, as it provides a **basis for showing the value of assets in the balance sheet.** ▪ In this basis, **assets are recorded based on their original cost and not on market value**. Assets are assumed to be used for an indefinite period of time and not intended to be sold immediately.
Application	**Significance of the concept:** ▪ This concept facilitates preparation of financial statements. ▪ On the basis of this concept, depreciation is charged on the fixed asset. ▪ The concept is of great help to the investors, because, it assures them that they will continue to get income on their investments. ▪ In the absence of this concept, the cost of a fixed asset will be treated as an expense in the year of its purchase. ▪ A business is judged for its capacity to earn profits in future. ▪ The going concern concept also implies that existing liabilities will be paid at maturity. ▪ There is no need to show assets at market value because these have been purchased for use in future and earn revenues and for sale purpose. ▪ If the business is not to continue then market value will have significance.

	Implication ▪ Assets are valued at historical cost less aggregate depreciation and **not** at disposable value since there is no intention to dispose of them. **Example 1:** A company purchases a plant and machinery of R100 000 and its life span is 10 years. Since business is to continue, **fixed assets will be shown at cost less depreciation basis**. **Example 2:** The motor vehicles sprayed with the company's colours and name printed on them would be valued at their cost. This would not be the case if the company were going out of business. In that case, the vehicles would be difficult to sell because the company's colours and name is on them. When a company is going out of business, the values of the assets usually suffer because they have to be **sold under unfavourable circumstances**. The values of such assets often cannot be determined until they are actually sold.

Principle / Concept	The Principle of Prudence / Conservatism
Explanation	▪ The principle of prudence provides that **accounting for a business should be fair and reasonable.** ▪ Accountants are required in their work to make evaluations and estimates, to **deliver opinions, and to select procedures.** ▪ They should do so in a way that **neither overstates nor understates the affairs of the business or the results of operation**, i.e. Profits should not be overstated and loss must not be understated.
Application	**Significance of the concept:** ▪ Accountants must use their judgment to record transactions that require estimation. ▪ The less optimistic estimate is chosen when two estimates are judged to be equally likely. ▪ It leads accountants to anticipate or disclose losses, but it does not allow a similar action for gains. ▪ Inventory of goods are valued at the lower of cost and net realisable value. ▪ Provisions for doubtful debts are made for potential loss in amount owed by credit

	customers. **Example 1: (Evidence to support the estimate)** Suppose a manufacturing company's Repair Department has documented a 3% return rate for product X during the past two years, but the company's Engineering Department insists this return rate is just a statistical anomaly and less than 1% of product X will require service during the coming year. Unless the Engineering Department provides compelling **evidence to support its estimate,** the company's accountant must follow the principle of conservatism and plan for a 3% return rate. Losses and costs—such as warranty repairs—are recorded when they are probable and reasonably estimated. **Gains are recorded when realized.** **Example 2: (Items that require estimation)** The **number of years that equipment will remain productive** and the portion of **accounts receivable that will never be paid** are examples of items that require estimation. **For example 3: (Disclosure of losses and not gains)** ***Potential* losses** from lawsuits **will be reported** on the financial statements or in the notes, but ***potential* gains will not be reported**. Also, an accountant may write **inventory *down* to an amount that is lower than the original cost**, but will not write **inventory *up* to an amount higher than the original cost**.

Principle / Concept	**The Objectivity Principle**
Explanation	▪ The objectivity principle states that accounting will be recorded on the basis of objective evidence, i.e. different people looking at the evidence will arrive at the same values for the transaction, and accounting entries will be based on fact and not on personal opinion or feelings. ▪ The **source document for a transaction** is almost always the best objective evidence available. The source document shows the amount agreed to by the buyer and the seller, who are usually independent and unrelated to each other.
Application	**Significance of the concept:** ▪ Recorded business transactions should have some form of impartial supporting evidence or documentation. ▪ It entails that bookkeeping and financial recording should be performed with

	independence, that's free of bias and prejudice. ▪ Documentation proves that the transaction did occur. **Example** ▪ The recognition of revenue should be based on verifiable evidence such as the delivery of goods or the issue of invoices **Transactions:** 1. Receive a **cheque** from C. Selborn for R1 000 as payment on the amount owing. 2. Issued **invoice No: 1564** for goods sold on credit to C. Selborn, R1 600. 3. C. Selborn returned merchandise for R200. Issued a **credit note 184**. 4. Sold goods on credit to C. Selborn for R2 100 and issue **invoice 1589**. 5. 10 July 2004: Received a **cheque** for R1 500 from C. Selborn as payment of his debt. Issued **receipt 601**. **Note:** The highlighted or bolded documents above serve as source documents or evidence that the transaction did occur.

Principle / Concept	**The Accounting / Time Period Concept**
Explanation	▪ The Accounting period concept provides that accounting take place **over specific time periods known as fiscal periods.** These fiscal periods are of equal length, and are used when measuring the financial progress of a business. o The accounting time period of one year in length is usually known as a **fiscal year.** o Periods of less than one year are called **interim periods.** ▪ All the transactions are recorded in the books of accounts on the assumption that profits on these transactions are to be ascertained for a specified period. ▪ Balance sheet and profit and loss account should be prepared at regular intervals. This is necessary for different purposes like, calculation of profit, ascertaining financial position, tax computation etc. ▪ Further, this concept assumes that, indefinite life of business is divided into parts. These parts are known as **Accounting Period**. It may be of one year, six months, three months, one month, etc. But usually one year is taken as one accounting period which may be a calendar year or a financial year.

	▪ All the transactions are recorded in the books of accounts for a specified period of time. Hence, goods purchased and sold during the period, rent, salaries etc. paid for the period are accounted for and against that period only.
Application	**Significance of the concept:** ▪ It helps in predicting the future prospects of the business. ▪ It helps in calculating tax on business income calculated for a particular time period. ▪ It also helps banks, financial institutions, creditors, etc to assess and analyse the performance of business for a particular period. ▪ It also helps the business firms to distribute their income at regular intervals as dividends. ▪ Accounts of the business are closed at a specific date every year and final accounts are prepared (profits/ losses calculated) **For example:** Year that begins from **1st of January and ends on 31st of December**, is known as **Calendar Year**. The management has decided on a twelve-month financial reporting period. They have just started on the 1st January so they will complete the twelve months reporting period by 31st December. The year that begins from **1st of April and ends on 31st of March** of the following year, is known as **financial year**.

Principle / Concept	**Accrual Concept**
Explanation	▪ The meaning of accrual is something that becomes due especially an amount of money that is yet to be paid or received at the end of the accounting period. It means that **revenues are recognised when they become receivable**. ▪ Though cash is received or not received and the **expenses are recognised when they become payable** though cash is paid or not paid. Both transactions will be recorded in the accounting period to which they relate. Therefore, the accrual concept makes a distinction between the accrual receipt of cash and the right to receive cash as regards revenue and actual payment of cash and obligation to pay cash as regards expenses. ▪ The accrual concept under accounting assumes that **revenue is realised at the time of sale of goods or services** irrespective of the fact when the cash is received.

	For example: A firm sells goods for R55 000 on 25th March 2005 and the payment is not received until 10th April 2005, the amount is due and payable to the firm on the date of sale i.e. 25th March 2005. It must be included in the revenue for the year ending 31st March 2005. Similarly, **expenses are recognised at the time services provided**, irrespective of the fact when actual payment for these services is made. **For example:** If the firm received goods costing R20 000 on 29th March 2005 but the payment is made on 2nd April 2005 the accrual concept requires that expenses must be recorded for the year ending 31st March 2005 although no payment has been made until 31st March 2005 though the service has been received and the person to whom the payment should have been made is shown as creditor. *In brief, accrual concept requires that* ***revenue is recognised when realised and expenses are recognised when they become due and payable*** *without regard to the time of cash receipt or cash payment.*
Application	**Significance of the concept:** ▪ It helps in knowing actual expenses and actual income during a particular time period. ▪ It helps in calculating the net profit of the business. ▪ Adjustment are made in accounts for accrued and prepaid items so that accounts reflect revenue earned (not amount received) and expenses incurred (not amount paid for). A company shows all the expenses related to its revenues of a specified period even if the expenses were not paid in that period. **Example** 1. Borrowed R60 000 on December 1, 2005 and make only payment for interest when the note is paid off on June 1, 2006. The total interest for the six months will be R6 000. On the December 2005 income statement the accountant reported Interest Expense of R1 000. 2. Received goods valued at R200 000 and billed the customers for all these goods but so far has only received suppliers invoices for R50 000. The balance of R150 000 is taken up into the books of account. 3. For the December year-end close, the utilities bills have not been received for the

	month of November & December. However, based on previous average month trends, take up R20 000 X 2 = R40 000 as utilities expenses as estimates for November & December.

Principle / Concept	**The Matching Principle**
Explanation	The matching principle is an extension of the revenue recognition convention. The matching principle states that each **expense item related to revenue earned** must be **recorded in the same accounting period** as the revenue it helped to earn. If this is not done, the financial statements will not measure the results of operations fairly. So once the revenue is realised, the next step is to allocate it to the relevant accounting period. This can be done with the help of accrual concept.
Application	**Significance of the concept:** ▪ It guides **how the expenses should be matched with revenue** for determining exact profit or loss for a particular period. ▪ It is very helpful for the investors/shareholders to know the exact amount of profit or loss of the business. **Let us study the following transactions of a business during the month of December, 2006:** i. Sale : cash R2 000 and credit R1 000 ii. Salaries Paid R350 iii. Commission Paid R150 iv. Interest Received R50 v. Rent received R140, out of which R40 received for the year 2007 vi. Carriage paid R20 vii. Postage R30 viii. Rent paid R200, out of which R50 belong to the year 2005 ix. Goods purchased in the year for cash R1 500 and on credit R500 x. Depreciation on machine R200 **Let us record the above transactions under the heading of Expenses and Revenue.**

	Expenses	Amount R	Revenue	Amount R
1	Salaries	350	1. Sales	
2	Commission	150	Cash 2000	
3	Carriage	20	Credit 1000	3000
4	Postage	30	2. Interest received	50
5	Rent paid 200 Less for 2005 (50)	150	3. Rent received 140 Less for 2007 (40)	100
6	Goods purchased Cash 1500 Credit 500	2000		
7	Depreciation on machine	200		
	Total	**2900**	**Total**	**3150**

- In the above example expenses have been matched with revenue i.e. (Revenue R3 150-Expenses R2 900). This comparison has **resulted in profit of R250**. If the revenue is more than the expenses, it is called profit.
- If the expenses are more than revenue it is called loss. This is what exactly has been done by applying the matching concept.
- Therefore, the matching concept implies that **all revenues earned during an accounting year**, whether received/not received during that year and **all cost incurred**, whether paid/not paid during the year should be taken into account while ascertaining profit or loss for that year.

Principle / Concept	**The Revenue / Realisation Concept**
Explanation	This concept states that **revenue** from any business transaction should be included in the accounting records only **when it is realised**, i.e. recording revenue when the bill for it is sent to the customer or if it is a cash transaction, the revenue is recorded when the sale is completed and the cash received. **In other words, it can be said that :** ▪ Revenue is said to have been realised when cash has been received or right to receive cash on the sale of goods or services or both has been created. ❖ Think of the building of a large project such as a dam. It takes a construction company a number of years to complete such a project. The company does not wait until the project is entirely completed before it sends its bill. Periodically, it bills for the amount of work completed and receives payments as the work progresses. **Revenue is taken into the accounts on this periodic basis.** It is

	important to take revenue into the accounts properly. If this is not done, the earnings statements of the company will be incorrect and the readers of the financial statement misinformed.
Application	**Significance of the concept:** ▪ It helps in making the accounting information more objective. ▪ It provides that the transactions should be recorded only when goods are delivered to the buyer. **Examples:** ▪ Mokoka Jeweller received an order to supply gold ornaments worth R500 000. They supplied ornaments worth R200 000 up to the year ending 31st December 2005 and rest of the ornaments were supplied in January 2006. ▪ Bonolo sold goods for R100 000 for cash in 2006 and the goods have been delivered during the same year. ▪ Akshika sold goods on credit for R50 000 during the year ending 31st December 2005. The goods have been delivered in 2005 but the payment was received in March 2006. **Now, let us analyse the above examples to ascertain the correct amount of revenue realised for the year ending 31st December 2005.** (i) The revenue for the year 2005 for Mokoka Jeweller is R200 000. Mere getting an order is not considered as revenue until the goods have been delivered. (ii) The revenue for Bonolo for year 2005 is R100 000 as the goods have been delivered in the year 2005. Cash has also been received in the same year. (iii) Akshika's revenue for the year 2005 is R50 000, because the goods have been delivered to the customer in the year 2005. Revenue became due in the year 2005 itself. **In the above examples, revenue is realised when the goods are delivered to the customers.** The concept of realisation states that revenue is realized at the time when goods or services are actually delivered. In short, the realisation occurs when the goods and services have been sold either for cash or on credit. It also refers to inflow of assets in the form of receivables.

Principle / Concept	The Cost (Historical Cost) Principle
Explanation	▪ Accounting cost concept states that all assets are recorded in the books of accounts at their purchase price, which includes cost of acquisition, transportation and installation and **not at its market price, i.e. original cost**. It means that fixed assets like building, plant and machinery, furniture, etc are recorded in the books of accounts at a price paid for them. ▪ This is the figure that appears on the source document for the transaction in almost all cases. The value recorded in the accounts for an asset is not changed until later if the market value of the asset changes. It would take an entirely new transaction based on new objective evidence to change the original value of an asset. ▪ There are times when the above type of objective evidence is not available. For example, a building could be received as a gift. In such a case, the transaction would be recorded at fair market value which must be determined by some independent means.
Application	**Significance of the concept:** ▪ This concept requires asset to be shown at the price it has been acquired, which can be verified from the supporting documents. ▪ It helps in calculating depreciation on fixed assets. ▪ The effect of cost concept is that if the business entity does not pay anything for an asset, this item will not be shown in the books of accounts. **Implication** Assets and expenses are recorded at the actual amount spent. Revenues are recorded at actual amount received/ receivable. Liabilities are recorded at actual amount borrowed, therefore, payable. **Example 1:** ▪ A machine was purchased by XYZ Limited for R500 000, for manufacturing shoes. An amount of R1 000 were spent on transporting the machine to the factory site. In addition, R2 000 were spent on its installation. The total amount at which the machine will be recorded in the books of accounts would be the sum of all these items i.e. R503 000. This cost is also known as historical cost. ▪ Suppose the market price of the same is now R90 000 it will not be shown at this value. Further, it may be clarified that cost means original or acquisition cost only for new assets and for the used ones, cost means original cost less depreciation. The cost concept is also known as historical cost concept. ▪ The effect of cost concept is that if the business entity does not pay anything for

	acquiring an asset this item would not appear in the books of accounts. Thus, goodwill appears in the accounts only if the entity has purchased this intangible asset for a price. **Examples 2:** ▪ Due to the high inflation rate, the replacement cost of the existing raw material has gone up by 30%. The company ignores this inflationary factor and records it at the value it has earlier bought. ▪ A company has bought this property for R1million in year 2003 but now the property has appreciated to R5 million. The company is recording the property at R1 million.

Principle / Concept	**The Consistency Principle**
Explanation	▪ The consistency principle requires accountants to apply the same methods and procedures from period to period, i.e. **the same accounting concepts are applied in the same way in each accounting period.** ▪ When they change a method from one period to another they must explain the change clearly on the financial statements. **Variations or changes in accounting policy and procedures must be justifiable.** The readers of financial statements have the right to assume that consistency has been applied if there is no statement to the contrary. ▪ Standards used to value inventory, depreciation assets, or accrued expenses must be consistent from on accounting period to the next. ▪ Similar items should receive similar accounting treatment.
Application	**Significance of the concept:** ▪ It prevents people from changing methods for the sole purpose of manipulating figures on the financial statements. ▪ It allows fair comparison of financial information between two accounting periods. ▪ The same depreciation method is applied for similar items in the same period and from one period to another. **Examples** ▪ If a company adopts straight line method and should not be changed to adopt reducing balance method in other period ▪ If a company adopts weight-average method as stock valuation and should not be changed to other method e.g. first-in-first-out method

Principle / Concept	**The Materiality Principle**
Explanation	▪ The materiality principle requires accountants to use generally accepted accounting principles except when to do so would be expensive or difficult, and where it makes no real difference if the rules are ignored. ▪ If a rule is temporarily ignored, the net income of the company must not be significantly affected, nor should the reader's ability to judge the financial statements be impaired. ▪ Immaterial amounts may be aggregated with the amounts of a similar nature or function and need not be presented separately ▪ Materiality depends on the size and nature of the item ▪ Any information, which is important to the reader, must be highlighted or reflected separately.
Application	**Significance of the concept:** ▪ It states that the requirements of any accounting principle may be ignored when there is no effect on the users of financial information. ▪ It indicates that there is no definitive measure of materiality but, the accountant's judgment on such matters must be sound. ▪ Several thousand rands may not be material to an entity such as General Motors, but that same figure is quite material to a small, family-owned business. ▪ Some items (stapler, paper clips etc) are not considered non-current assets though they may be used by the business for a long period of time. Rather, their costs are written off at one against profit in the period they are bought. **Example:** ▪ Small payments such as postage, stationery and cleaning expenses should not be disclosed separately. They should be grouped together as sundry expenses ▪ The cost of small-valued assets such as pencil sharpeners and paper clips should be written off to the profit and loss account as revenue expenditures, although they can last for more than one accounting period **Example** ➢ *A large company purchases a R150 chair and expenses it immediately instead of recording it as an asset and depreciating it over its useful life.* ➢ *The cost of a dust bin in an office is treated as an expense rather depreciating its cost over its useful life*

Principle / Concept	**Money Measurement Concept**
Explanation	This concept assumes that all business **transactions must be in terms of money** that is in the currency of a country. In our country such transactions are in terms of rands. Thus, as per the money measurement concept, transactions which can be expressed in terms of money are recorded in the books of accounts.
Application	**Significance of the concept:** The following points highlight the significance of money measurement concept : ▪ This concept guides accountants what to record and what not to record. ▪ It helps in recording business transactions uniformly. ▪ If all the business transactions are expressed in monetary terms, it will be easy to understand the accounts prepared by the business enterprise. ▪ It facilitates comparison of business performance of two different periods of the same firm or of the two different firms for the same period. ▪ Some strengths or benefits of the business may not be reflected in the books **For example:** ▪ Sale of goods worth R200 000, purchase of raw materials R100 000, Rent Paid R10 000 etc. **are expressed in terms of money, and so they are recorded in the books of accounts.** But the transactions which cannot be expressed in monetary terms are not recorded in the books of accounts. **For example:** ▪ Sincerity, loyalty, honesty of employees is not recorded in books of accounts because these cannot be measured in terms of money although they do affect the profits and losses of the business concern. Another aspect of this concept is that the records of the transactions are to be kept not in the physical units but in the monetary unit. **For example:** At the end of the year 2006, an organisation may have a factory on a piece of land measuring 10 acres, office building containing 50 rooms, 50 personal computers, 50 office chairs and tables, 100 kg of raw materials etc. These are expressed in different units. **But for accounting purposes they are to be recorded in money terms i.e. in rands.** In this case, the cost of factory land may be say R120 000, office building of

	R100 000, computers R10 000, office chairs and tables R20 000, raw material R30 000. Thus, the total assets of the organisation are valued at R280 000. Therefore, the **transactions which can be expressed in terms of money is recorded in the accounts books,** that too in terms of money and not in terms of the quantity.

Principle / Concept	**Dual (Double) Aspect Concept**
Explanation	Dual aspect is the foundation or basic principle of accounting. It provides the very basis of recording business transactions in the books of accounts. This concept assumes that every transaction has a dual effect, i.e. it affects two accounts in their respective opposite sides. Therefore, the transaction should be recorded at two places. It means, both the aspects of the transaction must be recorded in the books of accounts. For example: Goods purchased for cash has two aspects which are i. Giving of cash ii. Receiving of goods. These two aspects are to be recorded. **Thus, the duality concept is commonly expressed in terms of fundamental accounting equation :** **Assets = Liabilities + Capital** The above accounting equation states that the assets of a business are always equal to the claims of owner/owners and the outsiders. This claim is also termed as capital or owner's equity and that of outsiders, as liabilities or creditors' equity. The knowledge of dual aspect helps in identifying the two aspects of a transaction which helps in applying the rules of recording the transactions in books of accounts. The implication of dual aspect concept is that every transaction **has an equal impact on assets and liabilities** in such a way that total assets are always equal to total liabilities.
Application	**Significance of the concept:** ▪ This concept helps accountant in detecting error. ▪ It encourages the accountant to post each entry in opposite sides of two affected accounts. ▪ Transactions are recorded using the double entry system whereby each transaction has a debit entry and a corresponding credit entry. Let us analyse some more business transactions in terms of their dual aspect :

	1. Capital brought in by the owner of the business The two aspects in this transaction are : i. Receipt of cash ii. Increase in Capital (owners' equity) 2. Purchase of machinery by cheque The two aspects in the transaction are: i. Reduction in Bank Balance ii. Owning of Machinery 3. Goods sold for cash The two aspects are: i. Receipt of cash ii. Delivery of goods to the customer 4. Rent paid in cash to the landlord The two aspects are: i. Payment of cash ii. Rent (Expenses incurred). Once the two aspects of a transaction are known, it becomes easy to apply the rules of accounting and maintain the records in the books of accounts properly. The interpretation of the Dual aspect concept is that every transaction has an equal effect on assets and liabilities in such a way that total assets are always equal to total liabilities of the business.

Principle / Concept	**The Full Disclosure Principle**
Explanation	The full disclosure principle states that any and all information that affects the full understanding of a company's financial statements must be included with the financial statements. Some items may not affect the ledger accounts directly. These would be included in the form of accompanying notes. Examples of such items are: ▪ Outstanding lawsuits; ▪ Tax disputes; and ▪ Company takeovers.
Application	**Significance of the concept:** ▪ Financial statements should be prepared to reflect a true and fair view of the financial position and performance of the enterprise

	▪ All material and relevant information must be disclosed in the financial statements The financial statement of a firm must include all information necessary for the formation of valid decisions by the users. Requires the company's financial statements to have footnotes containing information that is important to users of the financial statements. **Example** In the Notes to the financial statements, Management disclosed that severe rains has destroyed one of their factories in Cleveland, hence stopping production and affecting the revenue of the company.

GAAP Relationship in Revenue and Expenses Recognition

The matching principle, accrual concept and revenue recognition principle are a culmination of accrual accounting. They all determine the **accounting period**, in which **revenues and expenses are recognized**.

Time Period Concept	Accrual Concept	Matching Principle	Realisation Concept
Time period means that all the transactions are recorded in the books of accounts for a **specified period of time**. Hence, goods purchased and sold during the period, rent, salaries etc. paid for the period are accounted for and against that period only**.** **Note:** Emphasis is on the **time period (accounting**	**Accrual concept** requires that **revenue is recognised when realised and expenses are recognised when they become due and payable** without regard to the time **of cash receipt or cash payment.** **Note:** Emphasis is on **accrued revenue and expenses** to be recognised and recorded in the **period it**	**The matching principle** basically states that **revenue and its related expenses** should be **matched in the same accounting period**. Under the matching principle, the invoice should be **accrued in the same accounting period as the revenue it was sourced from (the sale of that item).** **Note:**	**Revenue realization** is related in that **revenue** should be realized **when it is earned in the accounting period in which it is earned, and not when money is received.** If the revenue was not earned in the **same accounting period** that the cash was received, you will need to **accrue a liability** for unearned revenue, i.e. **accrue the unearned**

period).	**is earned**, regardless of the time the cash is received.	**Emphasis is on matching accrued revenues** against those **expenses incurred** to earn the revenues when **calculating profit.**	**revenue** since it was realized by you performing the service. **Note:** The revenue should be considered only when realised. Revenue is earned when goods are transferred. Revenue **deemed to have accrued when sales are made.**