

Bookkeeping

Principles and assumptions



Economic entity assumption

The business is a separate entity, so the activities of a business must be kept separate from any other financial activities of the business owners.

Example: Business and personal expenses need to be separate.

The reliability assumption

It is mandatory for companies to record only accounting transactions that can be verified through invoices, billing statements, receipts and bank statements.

Example: If you don't have a receipt and paid in a non-trackable way (cash), then you cannot record the item in a financial document.

Full disclosure principle

All information that is relative to the business and is important to a lender or investor has to be disclosed in financial statements or in the notes of the statements.

Example: If a worker files worker's comp, then this needs to be included in the notes of financial statements.

Conservatism assumption

When bookkeepers or accountants are uncertain and need to determine how to report an item, conservatism guides them to choose the option that show less income or asset benefit. Potential losses can be recorded, while potential gains cannot.

Example: A potential lawsuit should be considered a loss and noted, however a possible new gain from increased traffic due to a new business opening nearby could not be counted as potential gain.

Materiality principle

An accounting standard can be ignored if the impact has such a small effect on financial statements that it would not be misleading. This is very subjective and bookkeepers should ask for advice from colleagues or an accountant when needed.

Example: When recording documentation, round to the nearest whole dollar, not cents.

Consistency principle

When a business adopts a specific accounting method, it will enter all similar items in the exact same way in the future. This principle applies to line items on all financial statements and reports. Only change an accounting principle or method if the new version improves reporting.

Example: If you hire a new bookkeeper who handles depreciation calculations differently, your expenses may look different from previous statements, without an actual change in finances.

Monetary unit assumption

One currency is used throughout all accounting activities. In the US, the US dollar is currency used in accounting. Inflation is not a consideration in recording finances.

Example: Land prices have increased, but no additional information other than price paid at the time of purchase should be made.

Going concern assumption

A business is stable enough to operate and meet obligations for the foreseeable future. The business acts and makes decisions based on the objective of continuing to run the business, rather than liquidating the business. If a business is no longer a going concern it should report the issues it's having including ongoing losses, credit denial, and lawsuits.

Example: When a business is assumed to be in danger of failing in the next year due to unpaid debts and is denied a loan to repay the debt, it is no longer a going concern.