I. INTRODUCTION:

In Chapter 2 ‘Conceptual Framework’ a reference has been made about the Generally Accepted Accounting Principles (GAAP). GAAP includes accounting principles, accounting standards, accounting guidelines issued by the controlling/statutory authorities, which are generally applied by a business firm to prepare and present their financial statements. It may be noted that accounting standards are largely meant for the companies and these are mandatorily applied by these entities. But for the sole proprietorship and partnership concerns it is not mandatory to comply with the requirements of accounting standards. But since a business firm has to transact with various groups of persons including financiers and statutory authorities, it is expected that it has complied with the minimum requirement under the ‘Generally Accepted Accounting Principles’. Present chapter is an effort to examine the application of these principles by the sample firms in recording and in preparing their financial statements.
It may be noted that in this study the researcher has used accounting principles without making any distinction among principle, concepts, assumptions, and conventions. These terms are used interchangeably in the study. This is because, insofar as recording of business transactions in the books of accounts and preparation of financial statements are concerned, the distinction among these terms bears no meaning.

Various accounting principles that are generally followed by the sample business enterprises under study are listed below.

1. Separate Business Entity or Accounting Entity,
2. Money Measurement /Cost Concepts,
3. Accounting Period Concept,
4. Accrual Assumption,
5. Going Concern Concept,
6. Dual Aspect Principle,
7. Consistency Concept,
8. Matching Concept,
9. Principle of Materiality and Principle of Full Disclosure,
10. Principle of Conservatism (Prudence),
11. The Revenue Recognition Principle,

A detail discussion on the application of the above accounting principles by the sample business enterprises under study is given below.
II. APPLICATION OF GAAP BY THE SAMPLE UNITS:

Application of the above accounting principles by the sample units is examined below.

1. **Separate Business Entity or Accounting Entity:**

Separate Entity or Business Entity assumption is also known as Accounting Entity concept. This is the first and one of the most important underlying assumptions of financial accounting which is applied by all business firms including sole proprietorship and partnership concerns. This concept implies that there is a distinction between the owner of the business firm and the business unit itself. If such distinction is not made it is not possible to measure the performance of the business unit. Profits earned or loss sustained cannot be ascertained. The firm acts under its own name in many occasions. This is why the name of the firm is prefixed by the term ‘M/S’, and not by Sri or Mr. For example, ‘M/S Green Tea Store’.

This concept also states that a business is a financial entity unto itself. This means that the business entity has its own financial status, and its position is distinct from the finances of its owners, employees and other stakeholders. Business entity assumption also implies that accounting information generated through business transactions is processed separately without mixing the information generated out of personal activities of its owners or financiers. Application of this concept facilitates good governance
so far as the operation and control of the firm is concerned. A businessman seldom considers private relations while dealing with the customers. From the field study it is found that only 4% percent of the sole proprietorship firms under study consider such private relationship in very special cases.

Following are some of the examples of application of business entity concept by Sole proprietorship and Partnership Business under study.

(a) Bank Accounts are maintained in the name of the firm by all the sample firms.

(b) Withdrawal of cash and goods by the proprietor/partners are recorded in the books and are treated as drawings by the owner of business firms.

(c) Fixed assets like furniture and fittings are recorded in the books of the business by all the firms. But it is found that land and buildings are in the name of owner and not shown in the books. But some business firms (only 17%) charge rent out of the income of the firm for the use of such assets.

(d) For tax purposes, a partnership firm is treated a legal entity

2. Money Measurement and Cost Concepts:

Accounting is defined as the systematic and comprehensive recording of financial transactions pertaining to a business. Thus money measurement concept is automatically applied by all types of business organisations while
recording transactions relating to the business operations. In other words, the unit of expression in accounting is monetary units. The sample firms under study are no exception.

All respondents follow cost concept while recording transactions in the books of accounts. All purchases are recorded at the value which is actually written in the invoice or challan. Sales are recorded at the net selling price which is net of any discount or rebate allowed. In other words all sales are recorded at the actual money value received or receivable. Like company accounts they do not consider the impact of inflation on accounts.

3. **Accounting Period Concept:**

Accounting period is the time span for the preparation of accounts. The basic objective of all business firms is to earn profit through legitimate operations. In order to facilitate the measurement of such profit and other performance indefinite time reference is not considered. Hence, a certain time period is considered for the preparation and finalization of accounts of every business organisation. Thus accounting period is a period for which a firm prepares its internal or external accounts.

A business firm may evaluate its performance every month and as such it may prepare profit and loss account on monthly basis. Another firm may like to prepare such statement after every six month. But all business
firms prepare the periodical accounts on annually and evaluate their performance accordingly.

Field study reveals that 10% of the sole proprietorship firms doing wholesalers business and 16% of the partnership firms prepare interim accounts for internal decision making purpose while all of the sample firms finalise their accounts annually. It is found that sample firms follow financial year, i.e., 1st April to 31st March, as the accounting year. When enquired on this, it is reported that they follow 1st April to 31st March as the accounting year since it is mandatory to follow by all the business entities as per various authorities. Some have cited that the State and Central Government follow the same period as financial year, so it is easier for them to prepare accounts accordingly. It is also reported that if accounts are prepared taking the financial year as accounting year, then accounts and financial statements are acceptable by all and more so the tax authorities do not enquire much. Thus it shows that this concept of accounting period is followed by all of the firms.

4. **Accrual Assumption:**

Accounts are kept either on the basis of cash or on the basis of accrual. Income tax laws allow both of these while Companies Act allows only accrual basis. As the sample business entities under study are outside
the purview of the Companies Act, so these sample firms are free to select any one of these two basis.

Field survey reveals that as a whole 95% of the sample firms follow accrual basis. All of the Partnership firms and 93% of the sole proprietorship firms apply accrual concept in recording business transactions and in preparing accounts. It is also found that all of the firms doing wholesale business and 89% of the retailers follow accrual basis.

It is also revealed that no firm is following a pure cash basis of accounting. The business firms under study sale goods on cash as well as on credit terms. These firms considers credit sale as income, and hence follow accrual system. But 11% of the retailers do not consider accrued interest as income while prepaid expenses as well as outstanding expenses are considered as expenses of the accounting year.

5. **Going Concern Concept:**

The going concern concept is the assumption considered in accounting which says that an entity will remain in business for the foreseeable future. In other words the entity will not be forced to stop its operations and to sale its assets in the near future. On this assumption transactions are recorded in the books of accounts, all accounts are prepared and reported accordingly.
The Ministry of Companies Affairs in its Indian Accounting Standard (Ind AS) 1 ‘Presentation of Financial Statements’ clearly mentions that when preparing financial statements, management shall make an assessment of an entity’s ability to continue as a going concern. An entity shall prepare financial statements on a going concern basis unless management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so. When management is aware, in making its assessment, of material uncertainties related to events or conditions that may cast significant doubt upon the entity’s ability to continue as a going concern, the entity shall disclose those uncertainties. When an entity does not prepare financial statements on a going concern basis, it shall disclose that fact, together with the basis on which it prepared the financial statements and the reason why the entity is not regarded as a going concern. (http://www.mca.gov.in/Ministry/pdf/IndAS1.pdf)

Therefore, it is imperative that all business entities irrespective of its organisational form or nature of business, which have no intention to liquidate its business, shall follow going concern concept of accounting. Hence, though it is not mandatory, sole proprietorship and partnership firms shall also follow this concept.

Present study covers sole proprietorship and partnership enterprises in Guwahati city. Field survey reveals that the sample firms do not own any land and building as a separate entity, but these are in the name of the
owners. So, there is no reporting of such assets in the name of the firm. Hence application of going concern does not take place in this case. But compliance with this concept has been found in case of their other fixed assets like furniture and equipments, and also in case of the firm as a entity. All the sample firms have applied this concept while reporting to the tax authorities and to the banks where there is bank loan. The firms prepare Profit and Loss Account and the Balance sheet as a going concern and submit the same to the appropriate authorities.

6. **Dual Aspect Principle:**

Dual aspect is the foundation or basic principle of accounting. It is also known as Duality Principle and popularly known as ‘Double Entry System”. It provides the very basis for recording business transactions into the book of accounts. This concept states that every transaction has a dual or two-fold effect and should therefore be recorded at two places. In other words, at least two accounts will be involved in recording a transaction in he books of account.

The sample firms are largely guided by the provisions of the Value Added Tax Act, 2003 of the Government of Assam. Section 55 (1) of the Act states that every registered dealer or every dealer liable to pay tax under this Act shall keep a true and up-to-date account of the value of goods purchased or manufactured and sold by him or goods held by him in stock,
in respect of each class of goods taxable at different rate of tax under this Act including input tax paid and output tax payable and, in addition to the books of account that a dealer maintains and keeps for the purpose referred to in this sub-section, he shall maintain and keep such registers and accounts in such form and in the manner as may be prescribed.

As compliance to the above requirement all the sample enterprises maintain their books of accounts properly. By and large proper accounts means accounts kept following Double Entry System of book keeping. Ledgers are maintained under this system and, thus, the Balance Sheet so prepared shows equation as, Capital + Liability = Asset and Trading and Profit and loss account shows Profit = Incomes – Expenses.

7. **Consistency Concept:**

The concept of consistency in accounting means that the accounting principles, methods, practices, and procedures adopted in accounting process shall be applied consistently. Frequent change in accounting methods is not desirable in accounting process since it reduces third party acceptability of financial statements.

In simple language matching concept means matching of expenses with the revenue while finalizing the accounts of a business firm for a particular period. Thus it is closely related to periodic concept. The primary objective of business is to earn profit in a legitimate way. Periodically,
generally on annual basis, profit is measured. In order to measure profit periodically costs, incurred to earn the revenue should be matched with that revenue. In other words the costs incurred are deducted from the revenue earned to get the profits.

Application of this principle is depends upon the application of principle of revenue recognition. During field survey it is found that all major costs are taken into account on the debit side of the Trading and Profit and loss Account. Thus these costs are matched with the sales revenue. But it is also found in some cases that some expenses which are incurred for the coming financial/accounting year are also recognized as expenses of current year and are matched with the income of this year. For example, prepaid rent, prepaid insurance, advance to the suppliers etc. Such anomalies are found in case where cash basis and accrual basis of accounting are followed simultaneously. There are 11% of the sole proprietorship retailers who adopt such a policy. This may be noted here that these retailers do not have proper accounting knowledge.

8. Principle of Materiality and Principle of Full Disclosure:

This is another accounting principle to be followed by business organisations. This principle states that all such information which has the chance of affecting the decisions of the users of financial information
including the owners is material and shall be incorporated in the accounting process properly.

Accounting Standard 1, states that financial statements should disclose all “material” items, i.e., the items, the knowledge of which might influence the decisions of the users of the financial statements. Thus materiality is an important guide for the accountants in deciding what should be disclosed in financial statements. It is essentially a matter of personal judgement and can be modified to the best interest of the business firm and the users of financial statements.

The term materiality refers to the relative importance of an item. What is material for one firm may be immaterial for another firm. Again, material in one context may be immaterial in another context. In deciding whether a piece of information is material or not requires considerable judgment. Information is material either due to the amount involved or due to the importance of the event.

During field survey it is found that most of the material events are recorded either through accounting process or in the form of statement. This concept is basically followed in three occasions – (i) to avail bank loan, (ii) to comply with the requirement of calculation of taxable income and tax liability and (iii) while reporting to the tax authorities. While seeking bank loans, the respondents have to submit financial statements duly certified by the practising chartered accountants. In these financial statements the
applicant has to disclose all material facts concerning their assets and liabilities. Such material facts to be disclosed include - any hypothecation of any assets to any financial institutions, loan taken for the business, private loans, quality and title deeds of assets etc. Though the financial statements, viz., Profit and loss Account and the Balance Sheet are certified by the practising chartered accountants as true and fair, the bank officials generally conduct physical verification of all material disclosures. Hence the respondents have to mandatorily disclose all the material facts.

9. **Principle of Conservatism (Prudence):**

The term conservatism implies that all probable or anticipated losses should be written off and no anticipated or unrealized gains should be considered. In other words, accountants should preferably report the highest values of liabilities and expenses, and the lowest values of assets and revenues. This principle is called modifying principle since it may not be applied in all cases. This principle should be applied carefully because it restricts the principle of objectivity and full disclosure.

It is revealed from the study that sample enterprises are very conservative in so far as anticipated expenses and incomes are concerned. All anticipated expenses are accounted and no such income is recognised. When enquired it is revealed that this done in order to show profit at a low level as far as possible to avoid tax. But so far as debtors are concerned it is
found that they do not provide any provision for doubtful debt. If any trade
debt is not recovered within a reasonable period of time then only it is
recorded as not recoverable and is treated as loss. Inventory and investment
are valued mostly at cost, which is generally lower than the market price.

10. **The Revenue Recognition Principle:**

Revenue is defined as the “gross inflow of cash, receivables, or other
consideration arising in the course of the ordinary activities of an enterprise
from the sale of goods, from the rendering of services, and from the use by
others of enterprise resources yielding interest, royalties, and dividends.
Revenue is measured by the charges made to customers or clients for goods
supplied and services rendered to them and by the charges and rewards
arising from the use of resources by them.” (Accounting Standard 9).

The revenue recognition principle helps in ascertaining the amount
and time of recognising the revenues from the ordinary business activities.
This principle is also known as Revenue Realisation Principle. In simple
words, revenue recognition principle tells us the procedure of determining
the income and expense to ascertain the amount of profit.

In revenue principle, there are certain stages. In the first step, the
revenue is to be recognised and it is done only when it is earned. Earning of
revenue constitutes the central operation of all business firms. Such central
operation include income earning activities like sale of products (goods and
services), merchandise or other assets acquired for re-sale, use of resources to earn interest, royalties, dividends and any form of income etc. While recognising a particular item as an income, care must be taken to see whether it can be recognised as revenue or not.

The next step in Revenue Recognition Principle is consideration of timing for recognition, that is, when to recognise the revenue. Revenue is recognised at the point of sale when title of the goods passes from the buyer to the seller, which is usually the date of delivery. In case of services, revenue is recognised when it is performed to the satisfaction of the customer and the later becomes liable to pay for this.

The study reveals the following facts in so far as recognition of income and expenses are concerned.

(i) 95% of the respondents do not recognise a transaction as sale even if cash is received in full before the goods are actually delivered. This means such firms recognise revenue when goods are actually delivered.

(ii) All credit sales are recognised as sale of the accounting period.

(iii) Any advance received for supply of goods is not recognised as sale.

(iv) Accrued incomes are not recognised as income.

(v) Rent payable is treated as expense of the corresponding month and year.
(vi) Purchase of a calculator for office use is accounted for as an asset by some of the retailers while some other treated it as an office expense. The first group of respondents reveal that the cost of calculator is around Rs. 2,000 and it is material to treat it as an asset. The second group of respondents’ view is that since it is a small equipment/machine, it may break down at any time, so it is treated as expense.

(vii) Any amount paid for publicity in the souvenir and magazines are treated as expenses as and when cash is paid without waiting for its actual publication.

(viii) Most of the sole proprietorship retailers (82%) treat the cost of the weighing equipments as business expense of the year in which it is purchased. But in case of wholesalers it is found that only 25% of them treat such cost as expense of the year concerned.

(ix) All electrical fittings are treated as expense of the year in which it is incurred by all respondents.

(x) Use or consumption of goods or cash withdrawal by the partners from the business firm is recorded at cost price and treated as payable by the partner.

(xi) It is reported by some sole proprietor retailers that if goods are taken by them for private/household use they do not record such withdrawal in the books of account.
11. **Principle of Timeliness:**

Accounting information to be useful must satisfy timeliness. Timeliness principle in accounting refers to the need for accounting information to be presented to the users in time to fulfil their decision making needs. Delay in providing information makes it irrelevant and will be less useful to the decision making needs of the users. The users of accounting information, in case of sole proprietorship and partnership enterprises, are the owners and partners who take decisions on various aspects of business. So they require accounts and financial statements on time. Apart from the owners, there are other users of accounting and other information relating to these business enterprises. They are – financial institutions, tax officials etc. Field survey reveals that all the sample business enterprises submit the tax returns within the time frame mentioned in the Assam VAT Act, 2003. These firms also abide by the formalities in furnishing necessary information to the financial institutions from where they seek financial assistance.

According to Section 29 of the Assam VAT Act, 2003 and rules framed under it, every registered dealer and every dealer liable to pay tax is required to furnish a correct and complete tax return in the prescribed form. The return must be submitted for such period and within such dates and to such authority, as may be prescribed. Hence legally also these firms are bound to follow the principle of timeliness.
Above discussion shows that ‘Generally Accepted Accounting Principles’ (GAAP) are the guide to the owner/owners or accountants of the sole proprietorship or partnership firm in the choice of accounting techniques for the purpose of recording, preparing and presenting the financial statements. All the sample sole proprietorship and partnership business maintain their accounts as required by customs and legal guidelines. Thus this may be construed that these business enterprises follow the GAAP in maintain accounts and in disseminating accounting information. Though it is not mandatory to apply the GAAP by the sample enterprises, they make an effort, knowingly or unknowingly, to apply accounting principles. This is because there are immense benefits arising out of the application of GAAP to these business enterprises. These benefits are briefly discussed below.

III. BENEFITS FROM GAAP TO THE SOLE PROPRIETORS AND PARTNERSHIP BUSINESS ENTERPRISES:

The following benefits may accrue to the business enterprises including Sole proprietorship and Partnership enterprises from compliance with the GAAP.

(1) Guidelines to owners or Accountants in preparing and presenting financial statements: Accounting principles provides guidelines to the accountants in preparing and
presenting financial statements in different situations. Thus the scope of personal influence is reduced to the minimum.

(2) **Reliability of Accounting Information**: Financial statements show operational results and financial position of a business. As application of GAAP in accounting makes the financial statements more reliable and non-biased, it becomes reliable to the various financing institutions and taxing authorities in force for their decision making purposes. Reliable accounting information also facilitates better control over management function.

(3) **Neutrality in Accounts**: Accounting principles help to maintain neutrality in presenting the financial information and leave little scope for statements becoming biased to a particular class of users. Financial information is required by different classes of users having conflicting interests.

(4) **Uniformity of Accounting**: Accounting principles bring the uniformity in accounting practices. Accounting is considered as the language of business. Accounting as a language, to be understandable to all, must follow certain principles uniformly all over the world.

(5) **Consistency and Comparability of accounting information**: As accounting principles are consistently followed over a
number of periods, the accounting information are comparable for those periods and comparison may be made with other firms of similar line. Such comparison reveals the strength and weaknesses of the business entity. Thus, accounting information is comparable and it becomes useful for making intra firm comparison and inter-firm comparison.

(6) **Prompt and Timely decision:** When timeliness principle of GAAP is applied, there is automatic flow of accounting information on time. This helps the users in taking decisions on time.

(7) **Verifiability of the accounting information:** GAAP mandates that accounting information should be subject to verifiability. Accounting information is said to have verifiability if such information can be verified from source documents i.e. the documents on the basis of which recording has been made. For example, cash memos, purchase invoices, sales invoices, etc. Verifiability ensures the truthfulness of the recorded transactions which can be independently checked by any person to ascertain the true position.

Accounting provides useful information about the activities of an entity to the users for their use in making informed judgments and decisions. In order to make the accounting information more meaningful, uniform and
understandable, the accounting practices adopted by the sole proprietor and partnership firm followed certain principles and these forms of business enjoy some specific benefits which are elaborated below.

(1) Credit allowed by the supplier of goods and assets: On the basis of the financial statement prepared by these business entities, creditors and suppliers of materials use accounting information to ascertain the short term liquidity, long term liquidity or solvency position, the ability of the entity to repay the amount in scheduled time and the earning capacity.

(2) Providing funds by the Bankers and lenders: On the basis of the financial statement prepared by these business entities, bankers and lenders advance money to a business entity. They are interested in financial statements to ascertain short term and long term debt repaying and debt servicing capacity of the business entity. Short term lenders are interested in liquidity position and long term lenders are interested in solvency position of the borrowing entity.

(3) Reliable to the Government and regulatory agency: Government and other regulatory authorities assess, levy and collect vat or sales tax, excise duty, custom duty, income tax, wealth tax etc. on the basis of the financial statements prepared by these business entities. Information conveyed by financial statements are useful to government in formulating industrial policy also.
(4) **Social responsibilities and helpful to the Researchers:** Research scholars make use of financial statements for making analysis and interpretation of data to derive new findings. Besides, economic newspapers and financial journals also conduct analysis over the financial statements to report the operational result of the business entities. Financial data are also used for creating information database about industry performance.

(5) **Trade association and chambers of commerce:** Trade association and chambers of commerce make use of financial statements to frame various types of demands to be placed before the concerned authority and also to formulate business policy, trade pattern, strategy of the enterprise etc.

In case of sole proprietorship and partnership form of business, the parties interested in financial statements are the proprietor, tax authorities, workers, researchers, bankers and regulatory authorities.

(6) **Evidence in Legal Matter:** In case of disputes, the properly maintained accounts are accepted as a piece of evidence even by the court of law. Supported by authenticated documents are accepted by the courts as a legal evidence.