

## **Module 4 – Chapter 6- Accounting Principles**

Accounting principles are a set of rules and guidelines that are used to ensure consistency and accuracy in financial reporting. These principles provide the foundation for financial accounting and help investors and stakeholders understand the financial health of a company. This lesson will focus on three key accounting principles: revenue recognition, inventory valuation, and depreciation.

### **Revenue Recognition**

Revenue recognition is an accounting principle that outlines when and how revenue should be recorded. Under this principle, revenue should be recognized when it is earned and when it is realized or realizable. This means that revenue should only be recorded when the goods or services have been delivered or performed, and when the payment is either received or can be reasonably expected to be received.

For example, a company that sells products should only recognize revenue when the products are shipped or delivered to the customer, and when the payment is received or expected to be received in the near future. This principle helps to ensure that revenue is not overstated or understated, and that financial statements accurately reflect the company's performance.

## **Inventory Valuation**

Inventory valuation is an accounting principle that determines how the value of inventory is calculated and reported. This principle is important because it affects a company's profitability and financial position. There are several methods of inventory valuation, including First-In-First-Out (FIFO), Last-In-First-Out (LIFO), and Weighted Average Cost.

Under the FIFO method, the cost of the oldest inventory is recorded first, while under the LIFO method, the cost of the newest inventory is recorded first. The Weighted Average Cost method calculates the average cost of all inventory items. Each method has its advantages and disadvantages, and companies must choose the method that best fits their business model and financial reporting requirements.

## **Depreciation**

Depreciation is an accounting principle that allows companies to spread the cost of long-term assets over their useful life. This principle recognizes that assets such as machinery, buildings, and equipment lose value over time and should be reflected in the financial statements. Depreciation is typically calculated using one of several methods, including straight-line depreciation, declining balance depreciation, and units of production depreciation.

Straight-line depreciation evenly spreads the cost of an asset over its useful life, while declining balance depreciation allows for a larger deduction in the early years of an asset's life. Units of production depreciation is based on the amount of usage or output generated by the asset.

Understanding accounting principles such as revenue recognition, inventory valuation, and depreciation is essential for analyzing financial statements accurately. These principles provide a framework for financial reporting and help to ensure consistency and transparency in financial statements. Companies must adhere to these principles to maintain credibility with investors and stakeholders and provide a clear picture of their financial performance.

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