

Cambridge IGCSE · Accounting 0452 · Notes

Accounting principles

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Read first: [The accounting equation](#), [The double entry system of book-keeping](#)

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What you need to know

By the end of this topic you should be able to explain each of these ten accounting principles, and recognise when a business has applied it (or failed to):

1. **Business entity:** the business is separate from its owner.
2. **Consistency:** once a method is chosen, keep using it from year to year.
3. **Duality:** every transaction has two sides, a debit and a credit.
4. **Going concern:** assume the business will carry on for the foreseeable future.
5. **Historic cost:** record assets and expenses at what they actually cost.
6. **Materiality:** don't spend time recording small items in detail.
7. **Matching:** set the costs of a period against the revenue of the same period.
8. **Money measurement:** record only what can be measured in money.
9. **Prudence:** don't overstate profits or assets, and don't understate losses or liabilities.
10. **Realisation:** revenue is earned when the legal title to the goods passes to the buyer.

You will meet these principles again in other topics (depreciation, accruals and prepayments, doubtful debts, inventory). This topic is about naming them, explaining them and spotting them in use.

Understand it

Why accounts need rules

Two traders with the same year could report very different profits if each chose their own way of recording things. Accounting principles are the shared rules that make financial statements **reliable** and **comparable**: an owner, a bank or a buyer can trust what the figures mean. Each principle answers one question an accountant faces.

Whose transaction is it? Business entity

The business is treated as **separate from its owner**, and every transaction is recorded **from the business's point of view**. That is why the money an owner puts in is the business's **capital** (a debt the business owes the owner), and why money or goods the owner takes out are **drawings**, not business expenses.

If the owner pays a private bill from the business bank account and it is recorded as a business expense, profit is **understated**. The fix is to transfer the amount to drawings.

How many entries? Duality

Every transaction has **two aspects**: something is received and something is given. So every transaction is recorded twice, once as a debit and once as a credit, for the same amount. Duality is the basis of **double entry** and of the **accounting equation** (assets = capital + liabilities): each transaction changes two items so the equation still balances.

Most real transactions show two principles at once. When an owner pays \$5 000 of her own money into the business bank account:

- **business entity**: the business records it as capital it owes her, not as income;
- **duality**: debit bank 5000, *credit capital* 5 000.

Can it be measured in money? Money measurement

Only things that can be given a **money value** go into the books. Skilled and loyal staff, the owner's selling skills, good staff morale, a good location, a new competitor opening nearby or a rival's cheaper machine all matter to the business, but none can be measured reliably in money, so none is recorded. Putting a value on the skill of employees would break this principle.

At what value? Historic cost

Assets and expenses are recorded at their **actual cost**: the price the business paid. A machine bought for 12 000 *stays in the books at* 12 000 (less depreciation), even if a new one would now cost \$15 000. Cost is a fact backed by an invoice; a current value is only an opinion.

Will the business carry on? Going concern

Accounts assume the business will **continue trading for the foreseeable future**. That is why non-current assets are shown at **cost less depreciation** (book value), spreading their cost over the years they will be used, rather than at what they would fetch if sold tomorrow.

If the business is known to be **closing** soon, the assumption no longer holds. The assets are then valued at what they are **expected to sell for**.

Which year does it belong to? Matching

To find the true profit of a year, the revenue of that year is set against the **costs of the same year**, whether or not the money has been paid or received (this is also called the **accruals** principle). That is why:

- expenses **owing** at the year end are added to the expense (accruals), and expenses **paid in advance** are taken off (prepayments);
- income received in advance is taken off that year's income;
- non-current assets are **depreciated**: their cost is spread over the years that benefit from them.

For example, a year ends on 31 December and a trader pays

1200 on 1 October for a year's insurance. Only 3 months belong to this year, so the expense is $1\,200 \times \frac{3}{12} = 300$ and the other 900 is prepaid (an asset). Charging the whole \$1 200 this year would break the matching principle.

Is it worth the effort? Materiality

Recording and depreciating a \$12 stapler that lasts five years would cost more time than the information is worth. So items of **small value** are simply treated as an **expense** when bought, even if they last several years, and small left-over supplies (stationery, price labels, cleaning materials) are not counted and valued as inventory at the year end. Charging cheap items such as batteries or light bulbs straight to general expenses applies materiality.

What is "small" depends on the **size of the business**: \$300 could be material to a market stall but trivial to a large company. The reason behind the principle is that the **cost of recording** the item would **outweigh the benefit** of the information.

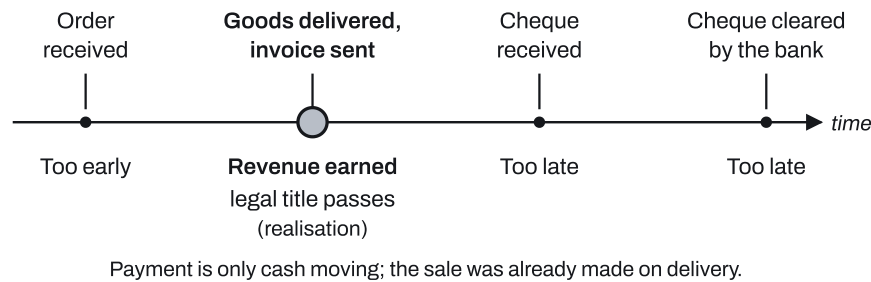
Be careful, not hopeful: Prudence

When there is doubt, accounts should **not overstate profits or assets**, and **not understate losses or liabilities**. Expected losses are allowed for as soon as they are foreseen; expected gains are not counted until they are earned. Prudence is behind:

- **writing off** irrecoverable debts, so trade receivables and profit are not overstated;
- keeping a **provision for doubtful debts**: increasing it reduces profit and the net trade receivables; reducing it increases them;
- valuing **inventory at the lower of cost and net realisable value**.

When is a sale made? Realisation

Revenue (and so the profit on a sale) is treated as **earned when the legal title to the goods passes to the buyer**. For normal trading that is when the goods are **delivered** (or supplied) and the invoice is sent. It is **not** when the order is placed, and **not** when the customer pays, whether by cash or by a cheque that clears later.



The same timing matters for a credit sale: it is recorded as revenue (debit the customer, credit sales) on delivery, even though the money arrives weeks later.

Consistency

Once a business chooses a method, such as straight-line depreciation or a way of valuing inventory, it must keep using it **from one year to the next** (not just throughout one year), and change only for a good reason. Otherwise the profit of a year could be distorted just by switching methods, and this year's statements could not be **compared** fairly with last year's. Consistency means the same **method**, not the same amount: straight-line depreciation gives the same charge each year, but reducing-balance depreciation used consistently gives a smaller charge each year, and both apply consistency.

Consistency only helps a business compare itself with its own past years. It does not make its figures comparable with a different business, which may use different methods.

One action, several principles

Exam questions often ask which **pair** or **group** of principles an action applies. Ask each principle's question in turn:

Action	Principles
Owner pays in capital: debit bank, credit capital	Business entity, duality
Writing off a customer's debt: debit irrecoverable debts, credit the customer	Duality, prudence
Depreciating by the same method and rate every year	Consistency, matching, prudence
A prepayment taken off an expense	Matching
Goods taken by the owner recorded as drawings	Business entity
Low-value item charged as an expense	Materiality

Key facts and formulas

There is no formula list in the IGCSE Accounting exam: learn every definition.

Formula	Status
Business entity: the business is separate from its owner; record from the business's point of view	Learn it
Consistency: use the same methods from one year to the next, so years can be compared	Learn it
Duality: every transaction has two aspects, a debit and a credit of the same amount	Learn it
Going concern: the business will continue for the foreseeable future, so assets are at book value	Learn it
Historic cost: assets and expenses are recorded at their actual cost	Learn it
Materiality: low-value items are treated as expenses; the cost of recording would outweigh the benefit	Learn it
Matching (accruals): costs are set against the revenue of the same period	Learn it
Money measurement: only items with a money value are recorded	Learn it
Prudence: profits and assets are not overstated; losses and liabilities are not understated	Learn it
Realisation: revenue is earned when legal title passes to the buyer	Learn it
Expense for the year = amount paid + amount owing at the end – amount prepaid at the end (with no opening balances)	Learn it
Inventory is valued at the lower of cost and net realisable value	Learn it

How to do it

We have 42 tagged questions for this topic from 2021 to 2025 (32 different, as some appear on more than one paper variant): 36 one-mark multiple-choice questions from Paper 1, and 6 twenty-mark Paper 2 questions where one or two parts are about principles. The same Paper 2 question, 0452/22/M/J/21 Q2 and 0452/23/M/J/21 Q2, has a part of both written types, so the counts add up to 44.

Question type	Questions
Which principle is being applied? (multiple choice)	16
What a principle means or requires (multiple choice)	11
Realisation: when is revenue earned? (multiple choice)	9
Explain a principle and how it is applied (written)	5
Name the principle (written)	3

1. Which principle is being applied? (multiple choice) (16 questions)

A short situation, then four principles (or four pairs or groups of them) to choose from.

1. **Find the key fact** in the situation: what was recorded, what was left out, or at what value.
2. **Match it to the principle's question:**
 - something real left out because it has **no money value** (skills, morale, competition): money measurement;
 - recorded at **what was paid**: historic cost;
 - a **cheap item** treated as an expense, or small supplies not valued: materiality;
 - the **same method** every year: consistency;
 - **owner** versus **business**: business entity;
 - **two entries**, or the accounting equation: duality;
 - costs set against the **same period's** revenue, or a prepayment not carried to the next year: matching;
 - a loss allowed for, or a value kept **low** when in doubt: prudence.
3. **Test each option.** Wrong options are real principles that don't fit this fact; historic cost is a common trap for items left out of the books.

Variations you will meet:

- **A pair or group of principles** (for example "business entity and duality"): check that **every** principle in the option applies. Capital paid in is business entity and duality; writing off a debt is duality and prudence; depreciating the same way every year is consistency, matching and prudence.
- **"Which principle has not been applied?"**: find what went wrong. A whole insurance payment charged to one year when half is for next year breaks **matching**.
- **"Which principle makes it easier to compare statements year on year?"**: consistency.
- **"Which principle is the accounting equation based on?"**: duality.

2. What a principle means or requires (multiple choice) (11 questions)

The question names a principle and asks what it means, what it requires, what it ensures, or which action applies it; or it describes a decision and asks for the reason.

1. **Say the definition to yourself** from the table above.

2. Pick the option that follows from it, and watch for options that are nearly right:

- prudence ensures profits are **not overstated** (and assets not overstated); it does **not** say losses are not anticipated: losses **are** allowed for;
- consistency requires the same **method** each year, not the same amount of depreciation, the same repairs or the same activity;
- business entity means recording from the **business's** point of view, not ignoring goods the owner takes (those are recorded as drawings).

3. Reverse questions ("which action applies materiality?", "what had she done to break money measurement?"): look for the option that shows the principle in action, such as charging cheap items to expenses, or putting a value on staff skills (which breaks money measurement).

Variations you will meet:

- **"Why is a small stock of stationery not valued?"**: because it is of **very low value** (materiality), not because it is not for resale or will be used soon.
- **"Why match costs with revenue?"**: to show the **correct profit** for the period.
- **A business closing soon**: going concern no longer applies, so its assets are valued at their **expected sale value**, not book value, cost or replacement cost.

3. Realisation: when is revenue earned? (multiple choice) (9 questions)

1. **List the events in order**: order, delivery (with the invoice), payment, cheque clearing.
2. **Pick the moment the legal title passes**: when the goods are **delivered** or supplied to the customer.
3. Reject the order (too early) and every payment step (too late), including a first instalment or a cheque paid into the bank.

Variations you will meet:

- **A story over several days** (test drive, order, delivery with invoice, cheque cleared): the sale counts on the day the customer **takes the goods and the invoice**.
- **"Which principle states that profit is recognised when title passes?"**: realisation (not prudence or matching).
- **"Which statement describes realisation?"**: the one saying profit is earned when goods are supplied and ownership passes.

4. Explain a principle and how it is applied (written) (5 questions)

Usually 2 marks: one for what the principle says, one for how it applies to the item in the question.

1. **State the principle** in one precise sentence, using the key words: "profits and assets are not overstated", "the business is separate from the owner", "the same method from one year to the next", "when legal title passes".
2. **Apply it to this item** and say its **effect on the figures**, for example: "Writing off the debt ensures that trade receivables and profit are not overstated."

3. For "explain the meaning **and importance**", give the importance too: consistency means profit is not distorted and years can be compared accurately.

Variations you will meet:

- **Prudence and a provision for doubtful debts:** not overstating profit and trade receivables; increasing the provision reduces profit and assets.
- **Business entity and drawings recorded as wages:** the owner's items are kept separate; otherwise profit is understated (or capital overstated).
- **Realisation and credit sales:** revenue is earned when title passes, not when payment is received.

5. Name the principle (written) (3 questions)

One mark each: "State the accounting principle applied when ...".

1. Decide which principle's question the situation answers, as in type 1.
2. **Write its exact name:** "money measurement", not "money"; "matching" (or "accruals"), not "prudence", for prepayments.
3. Where two principles fit, either earns the mark: a small inventory of price labels not valued is materiality (prudence was also accepted).

Worked examples

Example 1

Leila's shop bought a delivery van for \$18 000 two years ago. A similar new van now costs \$21 000, but the van is still recorded in her books at \$18 000 less depreciation.

Which accounting principle is Leila applying? **[1]**

A going concern B historic cost C materiality D prudence

The van is kept at the price actually paid, not at today's price. **B (1)**

(Going concern explains why she uses cost less depreciation rather than a selling price, but the fact the question points to is the **\$18 000 paid.**)

Example 2

A furniture maker receives an order for a table on 3 May. The customer pays a deposit on 10 May. The table is delivered with an invoice on 24 May, and the customer pays the balance on 15 June.

On which date should the sale be recorded as revenue? **[1]**

A 3 May B 10 May C 24 May D 15 June

Legal title passes when the table is delivered with the invoice. The order is too early; the deposit and the final payment are just cash. **C (1)**

Example 3

Which of the following apply the prudence principle?

1 creating a provision for doubtful debts 2 valuing inventory at net realisable value when this is lower than cost
3 increasing the value of premises in the books because local property prices have risen

A 1 and 2 only B 1 and 3 only C 2 and 3 only D 1, 2 and 3 **[1]**

1 and 2 both avoid overstating assets and profit. 3 counts a gain before it is earned (and breaks historic cost).
A (1)

Example 4

Kofi is a sole trader. His financial year ended on 31 December 2025. His draft profit for the year was \$14 600.

(a) On 1 October 2025 Kofi paid \$1 800 for a year's insurance, and the whole amount was charged in the income statement for 2025. Name the accounting principle that has not been applied, and calculate the correct insurance expense for 2025. **[2]**

(b) Kofi paid his home electricity bill of \$180 from the business bank account and recorded it as a business expense. Explain how the business entity principle applies to this payment. **[2]**

(c) Kofi's provision for doubtful debts is to be increased from 2% to 5% of his trade receivables of \$8 000. Explain how this applies the prudence principle. **[2]**

(d) Calculate Kofi's corrected profit. **[1]**

(a) Matching (or accruals) (1). Only October to December belong to 2025: $1\,800 \times \frac{3}{12} = 450$. The insurance expense is \$450, and \$1 350 is prepaid **(1)**.

(b) The business is treated as separate from its owner, so only the business's own transactions are recorded as its expenses (1). Kofi's home electricity is a personal cost, so the \$180 should be recorded as drawings; charging it as an expense understates the profit by \$180 **(1)**.

(c) Prudence means profits and assets must not be overstated (1). The provision rises from $2\% \times 8\,000 = 160$ to $5\% \times 8\,000 = 400$; the increase of \$240 is charged against profit, so trade receivables are shown at a realistic \$7 600 and profit is not overstated **(1)**.

(d) $14\,600 + 1\,350 + 180 - 240 = 15\,890$. Corrected profit \$15 890 (1).

Common mistakes

- **Answering "historic cost" for something left out.** When items such as a salesman's skill or a small stock of labels are left out of the statement of financial position, the principle is money measurement or materiality. Examiners reported historic cost as a common wrong answer to both parts of one such question.
- **Thinking revenue is earned when the money arrives.** Under realisation the sale counts when legal title passes, usually on delivery. A cheque received, or cleared, is too late; an order is too early.
- **Half-defining prudence.** "Being careful" earns nothing. Say that profits and assets are not overstated (or losses and liabilities not understated), then link it to the item: writing off the debt or raising the provision keeps profit and trade receivables from being overstated.
- **Leaving the period out of matching.** Costs are matched with the revenue **of the same accounting period**. Examiners found most answers missed that last part.
- **Confusing consistency with continuity.** Consistency is using the same method **from one year to the next**, so years can be compared; it is not about the business continuing (that is going concern), and not about being consistent within one year. It also doesn't make comparisons with other businesses accurate.
- **Giving prudence for materiality.** Writing a cheap item off at once is materiality: the cost of recording it would outweigh the benefit. Examiners did not accept prudence as the reason for not depreciating low-value items.
- **Stopping at "it is an expense" in an "explain" question.** Say what the principle is **and** what it does to the figures (profit understated, assets not overstated).
- **Choosing a pair where only one principle fits.** In "which principles" questions, every principle in the option must apply.

How to get the marks

- **"State" or "name" the principle:** its exact name, one mark. Matching or accruals are both accepted.
- **"Explain" a principle:** 2 marks usually means the definition (1) and its application or effect on profit or assets for this item (1). Use the item and the business's name from the question.
- **"Explain the meaning and importance":** the meaning (1) and why it matters (1): for consistency, the profit of a year is not distorted and accurate comparisons can be made with earlier years.
- **Use the key phrases:** "separate from the owner", "from the point of view of the business", "not overstated", "same accounting period", "legal title passes", "from one year to the next", "cost of recording outweighs the benefit".
- **Multiple choice:** find the one fact the question hinges on (left out, valued at cost, same method, delivered) before reading the options, then check that every principle named in the option applies.

Quick check

1. A business does not record the value of the loyal customers it has built up over ten years. Which principle is being applied?
2. A large trader buys a stapler for \$15. It will last five years. How should it be recorded, and which principle allows this?
3. Pearl's business will close next month. Its machinery cost \$20 000 and has \$12 000 of depreciation to date; it is expected to sell for \$5 000. At what value should the machinery be shown, and why?
4. A trader changes his depreciation method from straight-line to reducing balance and back again every other year. Which principle is he breaking, and why does it matter?
5. A trader rents out part of her shop for \$300 a month. In the year to 31 March 2026 she received \$4 200, which included the rent for April and May 2026. What rent income should her income statement show, and which principle does this apply?

Answers

1. Money measurement: the customers' loyalty cannot be measured reliably in money.
2. As an expense in the income statement for the year, not as a non-current asset. Materiality: its value is too small for recording and depreciating it to be worth the effort.
3. At \$5 000, its expected sale value. Going concern no longer applies because the business is closing, so book value ($20\,000 - 12\,000 = 8\,000$) would overstate the asset.
4. Consistency. Switching methods changes the depreciation charge, so each year's profit is distorted and the years can't be compared fairly.
5. $4\,200 - 2 \times 300 = 3\,600$, which is 12×300 : a full year's rent. The \$600 received in advance belongs to next year. Matching.

Past questions to try

- 0452/12/O/N/22 Q34: what the business entity principle means.
- 0452/11/M/J/21 Q33: valuing assets when a business is about to close.
- 0452/12/O/N/21 Q34: the day a car dealer can count the profit on a sale.
- 0452/21/M/J/22 Q4: part (c), the meaning and importance of consistency.