UNIT 10: FINANCIAL ACCOUNTING

LO2: PREPARE FINAL ACCOUNTS FOR SOLE TRADERS,PARTNERSHIPS AND LIMITED COMPANIES IN ACCORDANCE WITH APPROPRIATE PRINCIPLES,CONVENTIONS AND STANDARDS

UNIT 10: FINANCIAL ACCOUNTING

M2: ANALYSE PROFIT AND LOSS ACCOUNTS,BALANCE SHEET AND CASHFLOW STATEMNST APPROPRIATE FOR THE GIVEN EXAMPLES

OVERVIEW

- **Accounting Principles** are those rules of conduct or procedure which are adopted by the accountants universally, while recording the accounting transactions.
- **Accounting Convention** implies that those customs, methods and practices to be followed as a guideline for preparation of accounting statements.

UNDERSTANDING ACCOUNTING RULES AND PRINCIPLES

- Accounting rules are statements that establishes guidance on how to record transactions. As per accounting rules all the accounting transactions should be recorded in the books of entity using double entry accounting method.

UNDERSTANDING ACCOUNTING RULES AND PRINCIPLES

- Double entry accounting method means for each transaction two (or more) accounts are involved, one account shall be debited and the other account shall be credited with the same amount.

UNDERSTANDING ACCOUNTING RULES AND PRINCIPLES

- Golden Rules of Accounting (Traditional Approach):
- Golden rules of accounting are the basic accounting rules on the basis of which accounting entries are recorded.

UNDERSTANDING ACCOUNTING RULES AND PRINCIPLES

- Personal Account:
- The rule related to Personal account states debit the receiver and credit the giver. In other words, if a person receives something, receiver's account shall be debited and if a person gives something, giver's account shall be credited.

UNDERSTANDING ACCOUNTING RULES AND PRINCIPLES

- Real Account:
- The rule related to real account states debit what comes in, credit what goes out. In other words, if something comes into business, it shall be debited and if something goes out of business, it shall be credited.

UNDERSTANDING ACCOUNTING RULES AND PRINCIPLES

- Nominal Account:
- The rule related to nominal account states that debit all expenses and losses, credit all incomes and gains.

UNDERSTANDING ACCOUNTING RULES AND PRINCIPLES

- In other words, if any expense or loss is incurred for the business, expense or loss account shall be debited and if any income or gain is earned in business, income account or gain/profit account shall be credited.

UNDERSTANDING ACCOUNTING RULES AND PRINCIPLES

- Modern Rules of accounting (Classification of Accounts):
- As per modern rules of accounting, transaction will be categorised into 6 heads or accounts and any increase or decrease in such account will either be debited or credited in the manner shown in the table given below:

Types of Account	***Account to be debited***	***Account to be credited***
Assets account	Increase	Decrease
Liabilities account	Decrease	Increase
Capital account	Decrease	Increase
Revenue account	Decrease	Increase
Expenditure account	Increase	Decrease
Withdrawal account	Increase	Decrease

UNDERSTANDING ACCOUNTING RULES AND PRINCIPLES

› The following table summarizes classifications of Accounting Principles:

Accounting Principles

Accounting Concept	*Accounting Conventions*
(1) Entity Concept	(1) Convention of Disclosure
(2) Dual Aspect Concept	(2) Convention of Conservatism
(3) Accounting Period Concept	(3) Convention of Consistency
(4) Going Concern Concept	(4) Convention of Materiality
(5) Cost Concept	
(6) Money Measurement Concept	
(7) Matching Concept	
(8) Realization Concept	
(9) Accrual Concept	
(10) Rupee Value Concept	

UNDERSTANDING ACCOUNTING CONCEPTS

- There are a number of conceptual issues that one must understand in order to develop a firm foundation of how accounting works. These basic accounting concepts are as follows:
- **Accruals concept.** Revenue is recognized when earned, and expenses are recognized when assets are consumed.

UNDERSTANDING ACCOUNTING CONCEPTS

- This concept means that a business may recognize revenue, profits and losses in amounts that vary from what would be recognized based on the cash received from customers or when cash is paid to suppliers and employees.

UNDERSTANDING ACCOUNTING CONCEPTS

- Auditors will only certify the financial statements of a business that have been prepared under the accruals concept.

UNDERSTANDING ACCOUNTING CONCEPTS

- **Conservatism concept.** Revenue is only recognized when there is a reasonable certainty that it will be realized, whereas expenses are recognized sooner, when there is a reasonable possibility that they will be incurred. This concept tends to result in more conservative financial statements.

UNDERSTANDING ACCOUNTING CONCEPTS

- **Economic entity concept.** The transactions of a business are to be kept separate from those of its owners. By doing so, there is no intermingling of personal and business transactions in a company's financial statements.

UNDERSTANDING ACCOUNTING CONCEPTS

- **Going concern concept**. Financial statements are prepared on the assumption that the business will remain in operation in future periods. Under this assumption, revenue and expense recognition may be deferred to a future period, when the company is still operating. Otherwise, all expense recognition in particular would be accelerated into the current period.

UNDERSTANDING ACCOUNTING CONCEPTS

- **Matching concept.** The expenses related to revenue should be recognized in the same period in which the revenue was recognized. By doing this, there is no deferral of expense recognition into later reporting periods, so that someone viewing a company's financial statements can be assured that all aspects of a transaction have been recorded at the same time.

ACCOUNTING CONVENTIONS: CONSISTENCY

- The use of the same methods for the same items, either from period to period within a reporting entity or in a single period across entities.’
- In essence, consistency is a straightforward principle. It is intended to enhance financial reporting by making it easier for users to make comparisons. In that sense it contributes to the achievement of comparability.

ACCOUNTING CONVENTIONS: CONSISTENCY

- By requiring similar items to be treated in the same way (‘the use of the same method’ as stated in the Framework), it is fairly obvious that this contributes to making comparisons more meaningful.
- The two key points to note is that consistency should be applied in two ways:
- ‘from period to period’ – ie by a single entity, and
- ‘across entities’ – ie across entities (in the same period).

ACCOUNTING CONVENTIONS: MATERIALITY

- Information is material if omitting it or misstating it could influence decisions that users make on the basis of financial information about a specific reporting entity.
- The first is that materiality is different to accuracy. This leads to the second issue – materiality is related to the fact that the purpose of financial statements is to provide information so that it can be used to make decisions about whether to undertake transactions with a particular business.

ACCOUNTING CONVENTIONS: MATERIALITY

- The final issue is that materiality is affected both by:
- (i) whether information is included or omitted from financial statements
- and
- (ii) whether it is sufficiently informative.

ACCOUNTING CONVENTIONS: FULL DISCLOSURES

- The full disclosure principle requires a company to provide the necessary information so that people who are accustomed to reading financial information are able to make informed decisions regarding the company.
- Examples of Full Disclosure Principle:-
- The disclosures required under this principle can be found in a number of places, such as:
- The company's financial statements including the notes to the financial statements and supplementary schedules.

ACCOUNTING CONVENTIONS: FULL DISCLOSURES

- Quarterly earnings reports, press releases and other communications.
- The notes to a company's financial statements will likely begin with a description of the company's significant accounting policies such as how and when revenues are recognized, how property is depreciated, how inventory and income taxes are accounted for, and more.

ACCOUNTING CONVENTIONS: FULL DISCLOSURES

- Other disclosures in the notes to the financial statements include the effects of new accounting pronouncements, details regarding earnings per share, receivables, advertising, leases, related-party transactions, income taxes, stock options, contingent liabilities, and much more.

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