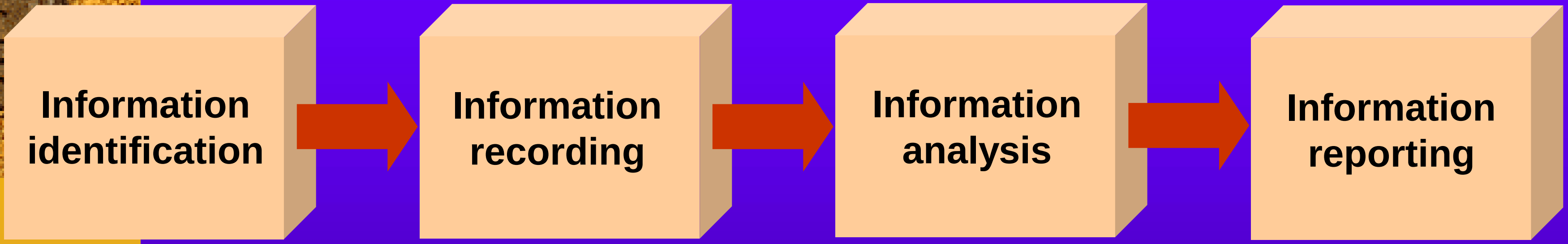
Accounting Concepts, Conventions & Principles

Accounting Information System



Information identification

Information recording

Information analysis

Information reporting

MEANINGS

1. Concepts
2. Conventions
3. Principles

CONCEPTS

1. Accrual Basis
2. Going Concern
3. Prudence (Conservatism)
4. Balance Sheet Equation (Equivalence)
5. Accounting Period

CONCEPTS…(2)

- (1) Accruals concept : revenue and expenses are taken account of when they occur and not when the cash is received or paid out;

CONCEPTS…(3)

- (2) Going concern : it is assumed that the business entity for which accounts are being prepared is solvent and viable , and will continue to be in business in the foreseeable future;
- (3) Prudence concept : revenue and profits are included in the balance sheet only when they are realized (or there is reasonable 'certainty ' of realizing them) but liabilities are included when there is a reasonable 'possibility' of incurring them. Also called conservation concept.

CONCEPTS… (4)

- (4) Accounting equation : total assets of an entity equal total liabilities plus owners' equity ;
- (5) Accounting period : financial records pertaining only to a specific period are to be considered in preparing accounts for that period

CONVENTIONS

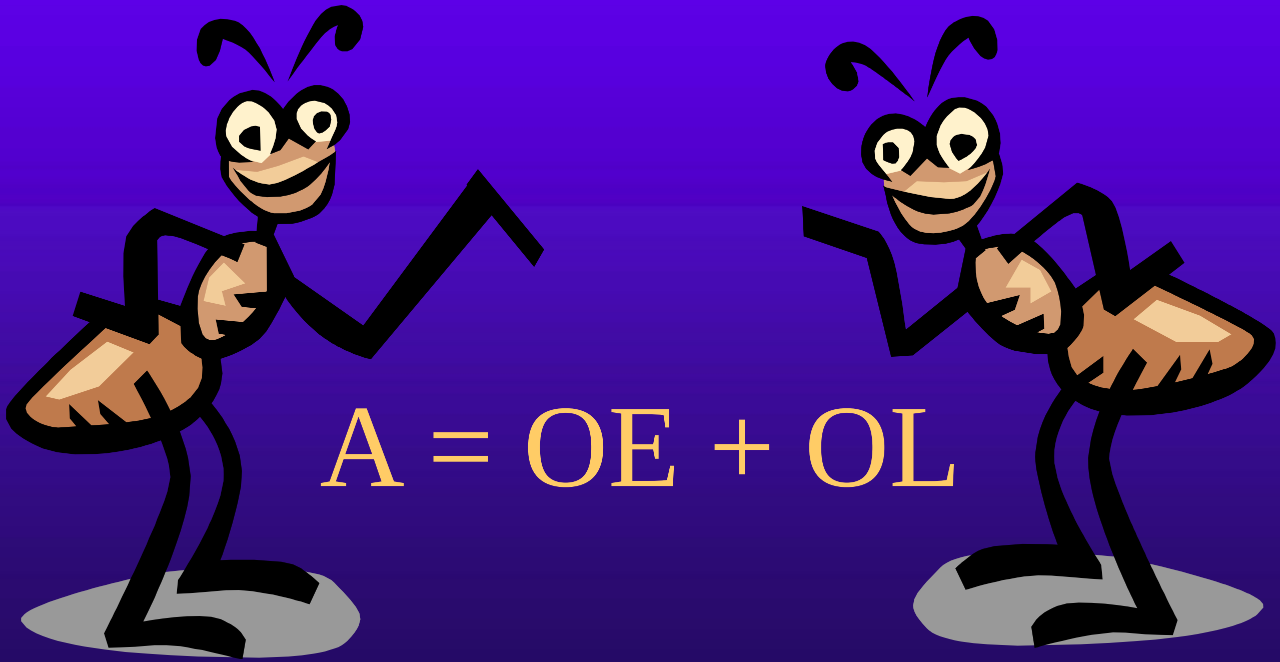
1. Historical Costs
2. Monetary measurement
3. Separate Entity
4. Realisation
5. Materiality

PRINCIPLES

1. Understandability
2. Relevance
3. Consistency
4. Comparability
5. Reliability
6. Objectivity

ACCOUNTING EQUIVALENCE

Assets = Owner’s Equity + Outside Liabilities



A = OE + OL

BALANCE SHEET

- BS is a ‘position’ statement.
- BS describes
  - the financial position of assets & liabilities
  - of the firm
  - as on a particular date

DEFINITION: BS

- Balance Sheet is defined as
  - a statement of the financial position
  - of an enterprise
  - as at a given date, which exhibits
  - assets, liabilities, capital, etc.

HORIZONTAL FORM OF BS

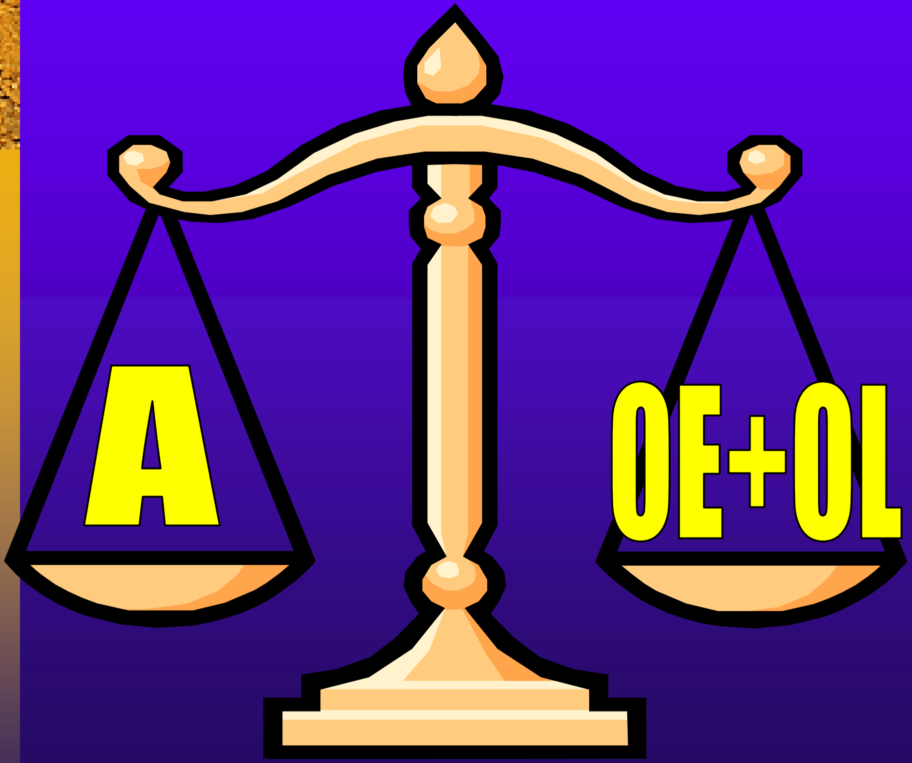
LIABILITIES	**Amount (£)**	**ASSETS**	**Amount (£)**
Capital	xx	Fixed Assets-Land, Bldg,	xx
Loan taken	xx	Current Assets	
Current Liabilities		•Cash / Bank B/s	xx
•Outstanding Expenses	xx	•Accounts Receivable (Debtors)	xx
•Bank Overdraft	xx	•Bills Receivable)	xx
•Accounts Payable (Creditors)	xx	•Inventories (Stock)	xx
	XYZ		XYZ

VERTICAL FORM OF BS

SOURCES OF FUNDS	Amount (£) py	Amount (£) cy
Share Capital	AA	XX
Reserves & Surplus	AA	
Secured Loans	AA	XX
Unsecured Loans	AA	XX
	ABC	XYZ
APPLICATION OF FUNDS	Amount (£) py	Amount (£) cy
Fixed Assets Gross Block - Depreciation	AA	XX
Investment	AA	XX
Current Assets – Current Liabilities	AA	XX
Loans & Advances	AA	XX
Miscellaneous Expenditure	AA	XX
	ABC	XYZ

A = OE + OL

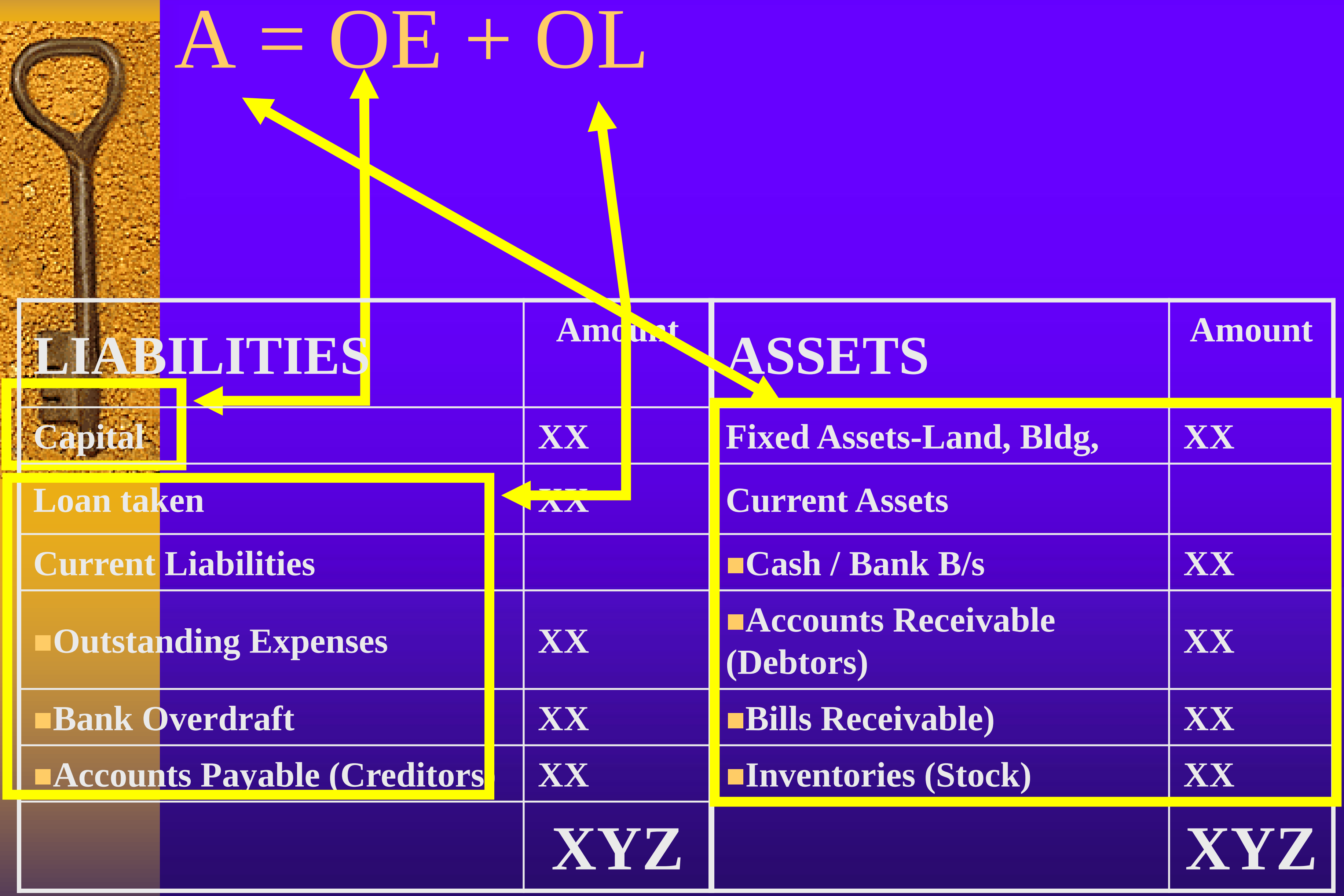
Assets are properties or economic resources owned by a business. They are expected to provide future benefits to the business.



Liabilities are obligations of the business. They are claims against the assets of the business.

Equity is the owner’s claim on the assets of the business. It is the residual interest in the assets after deducting liabilities.

A = OE + OL



LIABILITIES	Amount	ASSETS	Amount
Capital	XX	Fixed Assets-Land, Bldg,	XX
Loan taken	XX	Current Assets	
Current Liabilities		■Cash / Bank B/s	XX
■Outstanding Expenses	XX	■Accounts Receivable (Debtors)	XX
■Bank Overdraft	XX	■Bills Receivable)	XX
■Accounts Payable (Creditors	XX	■Inventories (Stock)	XX
	XYZ		XYZ

A = OE + OL

SOURCES OF FUNDS	Amount py	Amount cy
Share Capital	AA	XX
Reserves & Surplus	AA	
Secured Loans		XX
Unsecured Loans		XX
		XX
APPLICATION OF FUNDS	**Amount (£) py**	**Amount (£) cy**
Fixed Assets Gross Block - Depreciation		
Investment		
Current Assets – Current Liabilities		
Loans & Advances		
Miscellaneous Expenditure		

PROOF: A = OE + OL

Owners of Scox Company contributed £20,000 cash to start the business.

The accompanying accounts involved are:

(1) **Cash (asset)** ↑

(2) **Owner's Equity (equity)** ↑

Transaction Analysis

Owners of Scox Company contributed £20,000 cash to start the business.

		Assets		=	Liabilities		+	Owners' Equity
	Cash	Supplies	Equipment		Accounts Payable	Notes Payable		Owners' Capital
(1)	20000							20000
	20000	0	0		0	0		20000
		20000		=		20000		

Transaction Analysis

Purchased supplies paying £1,000 cash.

The accounts involved are:

(1) Cash (asset) ↓

(2) Supplies (asset) ↑

Transaction Analysis

Purchased supplies paying £1,000 cash.

		Assets		=	Liabilities		+	Owners' Equity
	Cash	Supplies	Equipment		Accounts Payable	Notes Payable		Owner's' Capital
(1)	20000							20000
(2)	-1000	1000						
	19000	1000	0		0	0		20000
		20000		=		20000		

Transaction Analysis

Purchased equipment for £15,000 cash.

The accounts involved are:

(1) Cash (asset) ↓

(2) Equipment (asset) ↑

Transaction Analysis

Purchased equipment for £15,000 cash.

	Assets			=	Liabilities		+	Owners' Equity
	Cash	Supplies	Equipment		Accounts Payable	Notes Payable		Owners' Capital
(1)	20000							20000
(2)	-1000	1000						
(3)	-15000		15000					
	4000	1000	15000		0	0		20000
		20000		=		20000		

Transaction Analysis

Purchased Supplies of £200 and Equipment of £1,000 on account.

The accounts involved are:

(1) Supplies (asset) ↑

(2) Equipment (asset) ↑

(3) Accounts Payable (liability) ↑

Transaction Analysis

Purchased Supplies of £200 and Equipment of £1,000 on account.

		Assets		=	Liabilities		+	Owners' Equity
	Cash	Supplies	Equipment		Accounts Payable	Notes Payable		Owners' Capital
(1)	20000							20000
(2)	-1000	1000						
(3)	-15000		15000					
(4)		200	1000		1200			
	4000	1200	16000		1200	0		20000
		21200		=		21200		

Transaction Analysis

The balances so far appear below. Note that the Balance Sheet Equation is still in balance.

		Assets		=	Liabilities		+	Owners' Equity
	Cash	Supplies	Equipment		Accounts Payable	Notes Payable		Owners' Capital
Bal.	4000	1200	16000		1200			20000
	4000	1200	16000		1200	0		20000
		21200		=		21200		

Now let's look at transactions involving revenues and expenses.

Transaction Analysis

Rendered consulting services receiving £3,000 cash.

The accounts involved are:

(1) Cash (asset) ↑

(2) Revenues (equity) ↑

Transaction Analysis

Rendered consulting services receiving £3,000 cash.

		Assets		=	Liabilities		+	Owner's Equity
	Cash	Supplies	Equipment		Accounts Payable	Notes Payable		Owner's Capital
Bal.	4000	1200	16000		1200			20000
(5)	3000							3000
	7000	1200	16000		1200	0		23000
		24200		=		24200		

Transaction Analysis

Paid salaries to employees, £800 cash.

The accounts involved are:

(1) Cash (asset) ↓

(2) Salaries expense (equity) ↓

Transaction Analysis

Paid salaries to employees, £800 cash.

	Assets			=	Liabilities		+	Owner's Equity
	Cash	Supplies	Equipment		Accounts Payable	Notes Payable		Owner's Capital
Bal.	4000	1200	16000		1200			20000
(5)	3000							3000
(6)	-800							-800
	6200	1200	16000		1200	0		22200
		23400		=		23400		

Transaction Analysis

Borrowed £4,000 from SBI

The accounts involved are:

(1) Cash (asset) ↑

(2) Notes payable (liability) ↑

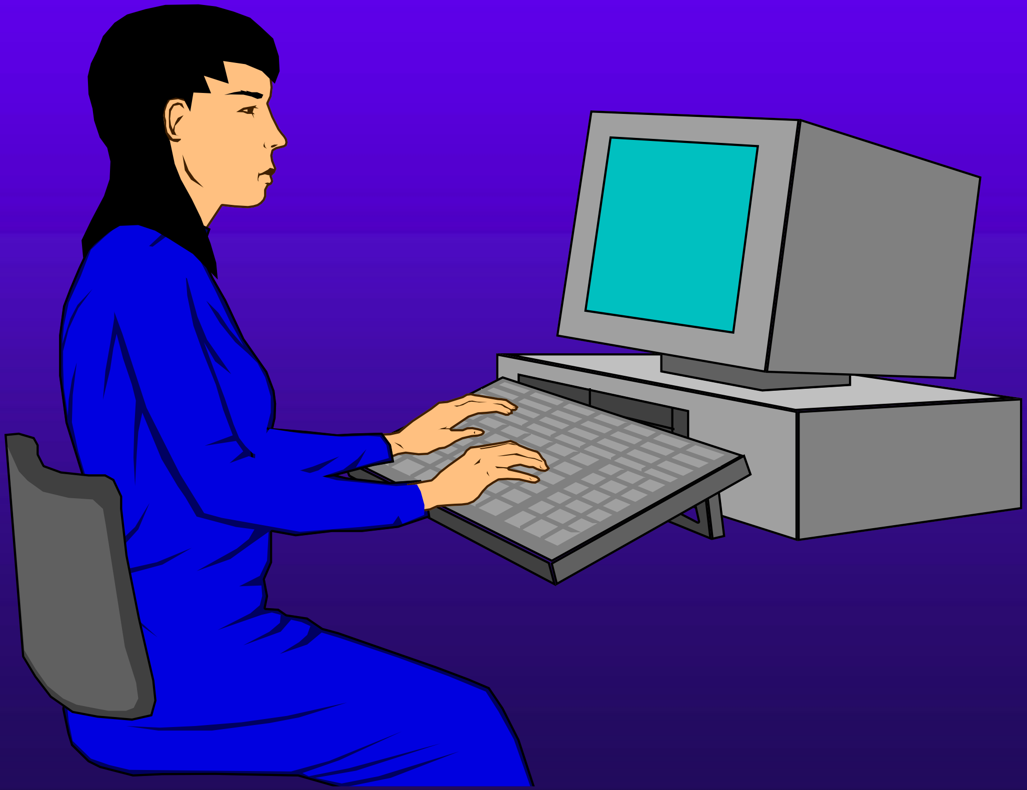
Transaction Analysis

Borrowed £4,000 from SBI

		Assets		=		Liabilities	+	Owner's Equity
	Cash	Supplies	Equipment		Accounts payable	Notes Payable		Owner's capital
Bal.	4000	1200	16000		1200			20000
(5)	3000							3000
(6)	-800							-800
(7)	4000					4000		
	10200	1200	16000		1200	4000		22200
		27400		=		27400		

Financial Statements

Prepare the Financial Statements reflecting the transactions we have recorded.



Income Statement

Scox Company
Income Statement
For Month Ended March 31, 2001

Revenues:	
Consulting revenue	3000
Expenses:	
Salaries expense	800
Net income	2200

The net income of £2,200 increases Scox's equity by £2,200.

Scox Company
Statement of Changes in Owners' Equity
For Month Ended March 31, 2001

Owners' equity, 1st April 2000	0
Plus: Investment by owners	20000
Net income	2200
Owners' equity, 31st March 200	22200

Balance Sheet

The balance sheet reflects Scox's financial position at March 31 2001

Scox Company
Statement of Changes in Owners' Equity
For Month Ended March 31, 2001

Owners' equity	0
Investment by owners	20000
Net income	2200
Owners' equity, March 31 2001	22200

Scox Company
Balance Sheet
March 31, 2001

Liabilities & Owners' Equity		Assets	
Accounts payable	1200	Cash	10200
Notes payable	4000	Supplies	1200
Total liabilities	5200	Equipment	16000
Owners' equity	22200		
Total liabilities and owners' equity	27400	Total assets	27400

DOUBLE ENTRY SYSTEM

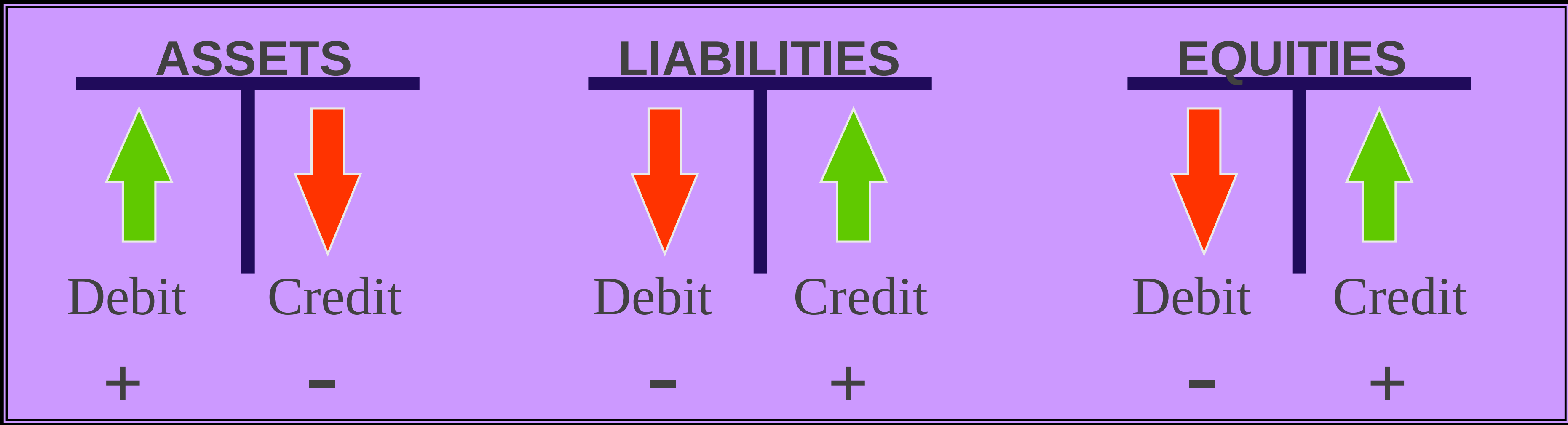
$$\underbrace{A}_{\text{Debit}} = \underbrace{OE + OL}_{\text{Credit}}$$

In the double-entry accounting system, every transaction is recorded by equal amounts of debits and credits.

ACCOUNTANT'S LIFE

A = OE + OL

ASSETS		LIABILITIES		EQUITIES	
Debit for Increase	Credit for Decrease	Debit for Decrease	Credit for Increase	Debit for Decrease	Credit for Increase

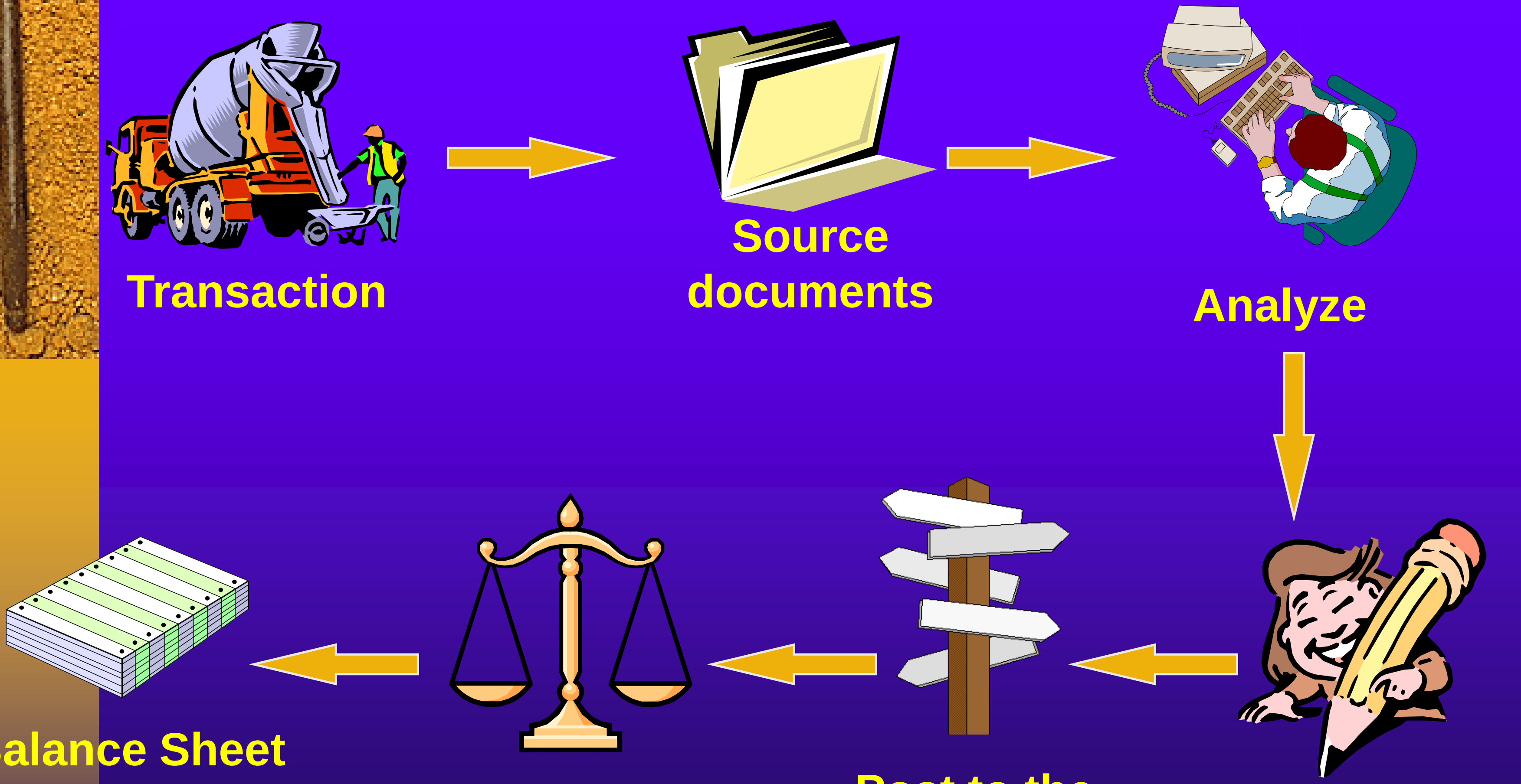


ASSETS		LIABILITIES		EQUITIES	
Debit	Credit	Debit	Credit	Debit	Credit
+	-	-	+	-	+

ACCOUNTING CYCLE

1. Business Transaction
2. Transaction is recorded in document (Voucher / Receipt)
3. Analyze the transaction – location ?
4. Journal Entry
5. Ledger Accounts (or ‘T’ account)
6. Trial Balance
7. Balance Sheet, P&L A/c, Cash Flow Statement

ACCOUNTANT’S ROUTINE



Transaction

Source documents

Analyze

Journal Entry

Post to the ledger

Prepare a trial balance

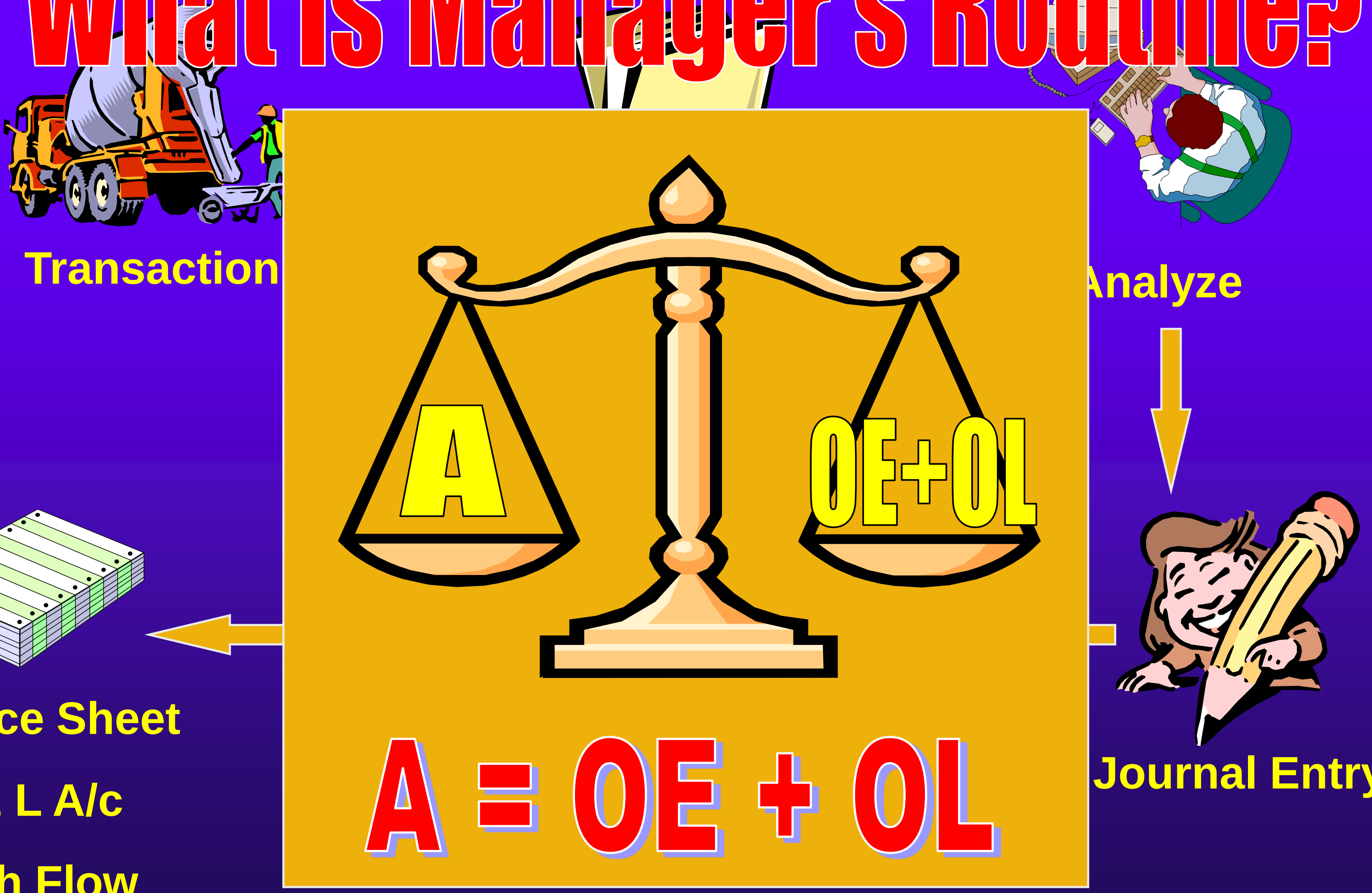
Balance Sheet

P & L A/c

Cash Flow

ACCOUNTANT’S ROUTINE

What is Manager's Routine?



Transaction

Analyze

Journal Entry

Balance Sheet

P & L A/c

Cash Flow

A = OE + OL

TRANSACTION-1

Chirag started business with cash £ 30,000.

The accounts involved are:

(1) Cash (asset) ↑

(2) Owner’s Equity (equity) ↑

	Assets			=	OE		+	OL
	Cash	Supplies	Equipment		Accounts Payable	Notes Payabl		Owners' Capital
(1)	30000							30000
	30000	0	0		0	0		30000
		30000		=		30000		

TRANSACTION-1

Chira usiness £

30,00

The ac are:

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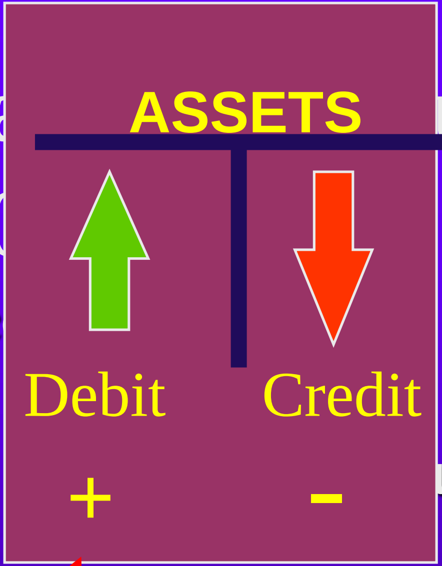

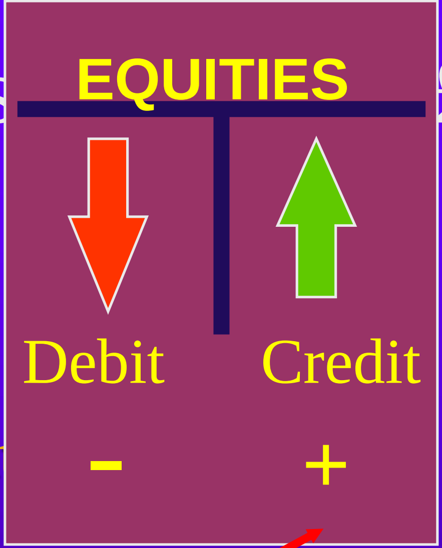

JOURNAL ENTRY **Page 1**

Date		Particulars	LF	Debit	Credit
2001					
Dec.	1	Cash		30,000	
		To Capital			30,000
		Investment by owner			

TRANSACTION-1 - LEDGER

JOURNAL ENTRY **Page 1**

Date		Particulars	LF	Debit	Credit
2001					
Dec.	**1**	**Cash**		**30,000**	
		To Capital			**30,000**
		Investment by owner			

Cash

(1)	30,000		

Capital

		(1)	30,000

Thank You

Now, was that debits to the left or credits to the left?
I sure wish I had paid more attention in class!