Assignment

Financial Accounting

Program

MBA (Non Business)

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Q2:The following are some of the accounting concepts that are quite popular in accounting:

1. Money Measurement Concept:

Only those transactions, which can be expressed in monetary terms, are recorded in accounting though their quantitative records may also be kept. All business transactions should be expressed only in money. Thus transactions, which cannot be expressed in money, will not be recorded in accounting books.

Thus, labour-management relations, sales policy, labour unrest, effectiveness of competition etc., which are of vital importance to business concern, do not find place in accounting. Another limitation of this concept makes the assumption that the money value is constant. It is contrary to fact as there are fluctuations in the money value. For instance, a land, purchased for Rs 10,000 in 1980, may cost four or five times in 2004. This is because of fall in money value.

2. Business Entity Concept:

Business is treated as separate from the proprietor. This concept is important and implies that a business is separate and distinct from the persons who supplied capital to the firm. All transactions of the business are recorded in the books of the firm. If business affairs and private affairs are mixed, the true picture of the business will not be available.

The proprietor is treated as a creditor to the extent of his capital. Capital is thus a liability to the firm and the proprietor is the creditor of the business. The proprietors—sole trader, partners of a partnership firm etc. may draw amount out of the business and this reduces the liability of the firm.

Because of this concept, financial position of the business can be easily found out and earning capacity of the firm can be easily ascertained. It is important to note that transactions of the business affairs and private affairs are separated for recording only and in law; no such distinction is recognized except for an incorporated company.

3. Going Concern Concept:

This concept relates with the long life of the business. A business is intended to continue for an indefinitely long period. For all practical purposes, a business firm comes under going concern concept, when there is no evidence to the contrary. All firms that continue to operate on a profitable footing are treated as going concerns.

Accordingly, continuity of activity is assumed, thus accounting reports are fashioned as a going concern, just as against liquidation. The current disposal value is irrelevant for a continuing business. Thus under this assumption fixed assets are recorded at original cost and are depreciated in a proper manner.

In Balance Sheet market price of fixed assets are not considered. While preparing final accounts, record is made for outstanding expenses and pre-paid expenses with the assumption that the business will continue.

4. Cost Concept:

Under this concept fixed assets are recorded in the account books at the price at which they are acquired. The price paid to acquire the assets is termed as cost and this cost is the basis for all the subsequent accounting for the asset.

When an asset is acquired for Rs 5,000, it is recorded in the account books at Rs 5,000 even though the market value may be different. But the asset is shown in balance sheet year after year, at cost price minus depreciation.

This value is called book value. If the business pays nothing for an item it acquired, then this will not appear in the accounting records as an asset. Thus, all such events are ignored which affect the business but have no cost, for example, a favourable location, a good reputation with its customers, market standing etc.

5. Dual Aspect Concept (Accounting Equation Concept):

This concept signifies that every business transaction involves a two-fold aspect:

(a) The yielding of benefit and

(b) The giving of the benefit.

For an exchange of value, two parties are required a giver and a receiver. Thus, a firm sells goods worth Rs100; the two simultaneous implications on the seller are:

(1) Forgoing goods worth Rs 100 and

(2) Receipt of cash Rs 100.

And those on the purchaser would be (1) receipt of goods for Rs 100 and (2) forgoing cash Rs 100. Every transaction affects two accounts and entails two-fold simultaneous effect on each party. Thus a giver necessarily implies a receiver and receiver necessarily implies a giver and each transaction affects receiving account and giving account equally.

Technically speaking, "for every debit, there is a credit". Therefore, we can say that every debit must have a corresponding credit and vice versa. This is the only system of modern account keeping.

The underlying principle of Double Entry is very simple but wonderfully effective. "Double Entry book-keeping is a system of accounting by which receiving and giving aspects of each transaction are recorded at a time." As such transaction affects giving account and receiving account equally, the assets of a business entity will always be equal to its equities, i.e.,

Total Assets = Total Liabilities

Total Assets = Capital + Outsiders' liabilities

Capital = Total Assets – Outsiders' liabilities.

6. Accounting Period Concept:

Accounting is a continuous process in any business undertaking. Every businessman wants to know the result of his investment and efforts at frequent intervals. Accountants choose some shorter period to measure the result.

Therefore, one year has been, generally, accepted as the accounting period. It may be 3 months, 6 months or 2 years also.

This period is called accounting period. Financial period chosen, in this regard, should be neither too long nor too short. Closing day of the accounting period is known as accounting date. At this date, accountant prepares income and position statements, shows the business operations, brings the changes of positions since the construction of last statements.

The financial reports prepared facilitate to make good decision, corrective measures, expansion etc. On the basis of income and position statement, financial position and earning capacity of one year can be compared with another.

Their comparison helps the business for expansion and the outsiders to draw various conclusions. One year accounting period is recognized by law and the taxation is assessed annually. Reports to the outsiders are provided on this accounting period.

7. Matching Concept:

According to this concept, it is necessary to match the expenses incurred during the accounting period with the revenues recognized during the same period. Since profit is an excess of revenue over expenses, it becomes necessary to bring together all revenues and expenses pertaining to a particular period.

In other words, expenses incurred in an accounting year should be matched with the revenues recognized in that year. Again, only such expenses as incurred in generating revenues during the period should be deducted from those revenues for deriving the amount of income or profit during the period.

The object of accounting is that accounting record be made in such a manner that cost may be compared with revenue. If the accounting method does not facilitate the comparison, then accounting method is considered unsatisfactory. Neither receipt of cash for revenue nor payment of cash for expenses is necessary.

What is necessary is this that they must accrue in the current year so that the incurred expenses are matched against the realized revenue. American Institute of Certified Public Accountants' Committee on Accounting Procedure states that "it is plainly desirable to provide, by charging in the current income statement, properly classified, for all foreseeable costs and losses applicable against current revenues, to the extent that they can be measured and allocated to fiscal periods with reasonable approximation."

All costs incurred during the period are taken. Similarly, expenses paid in advance are excluded from the total costs incurred to arrive at the expired costs. By application of this concept, proprietor can easily know about the profit/loss and he can make effort to increase earning capacity.

8. Realisation Concept:

This concept revolves around the determination of the point of time when revenues are earned. A business firm invests money to purchase or manufacture goods for sale. To earn profit, sales have to be made. There can be no profit without realisation of sale proceeds.

According to realisation concept, which is also known as the "revenue recognition concept", revenue is considered as being earned on the date on which it is realized, i.e., the date on which goods and services are transferred to customers either for cash or for credit. "Credit transactions create debtors and the promise of debtors to make payment is sufficient for the purpose of realising revenue.

The realisation concept is important in ascertaining the exact profit earned during a period in a business concern. This concept is very important as it prevents firms from inflating their profits by recording sales and incomes that are likely to accrue.

9. Objectivity Concept:

This concept implies that all accounting transactions should be evidenced and supported by business documents, i.e., invoices, vouchers etc.

The evidence substantiating the business transactions should be objective, i.e., free from the bias of the accountant or others. These supporting documents form the basis for record of entries and of audit. Accounting record based on documentary evidence is readily and objectively verifiable and therefore universally acceptable.

10. Accrual Concept:

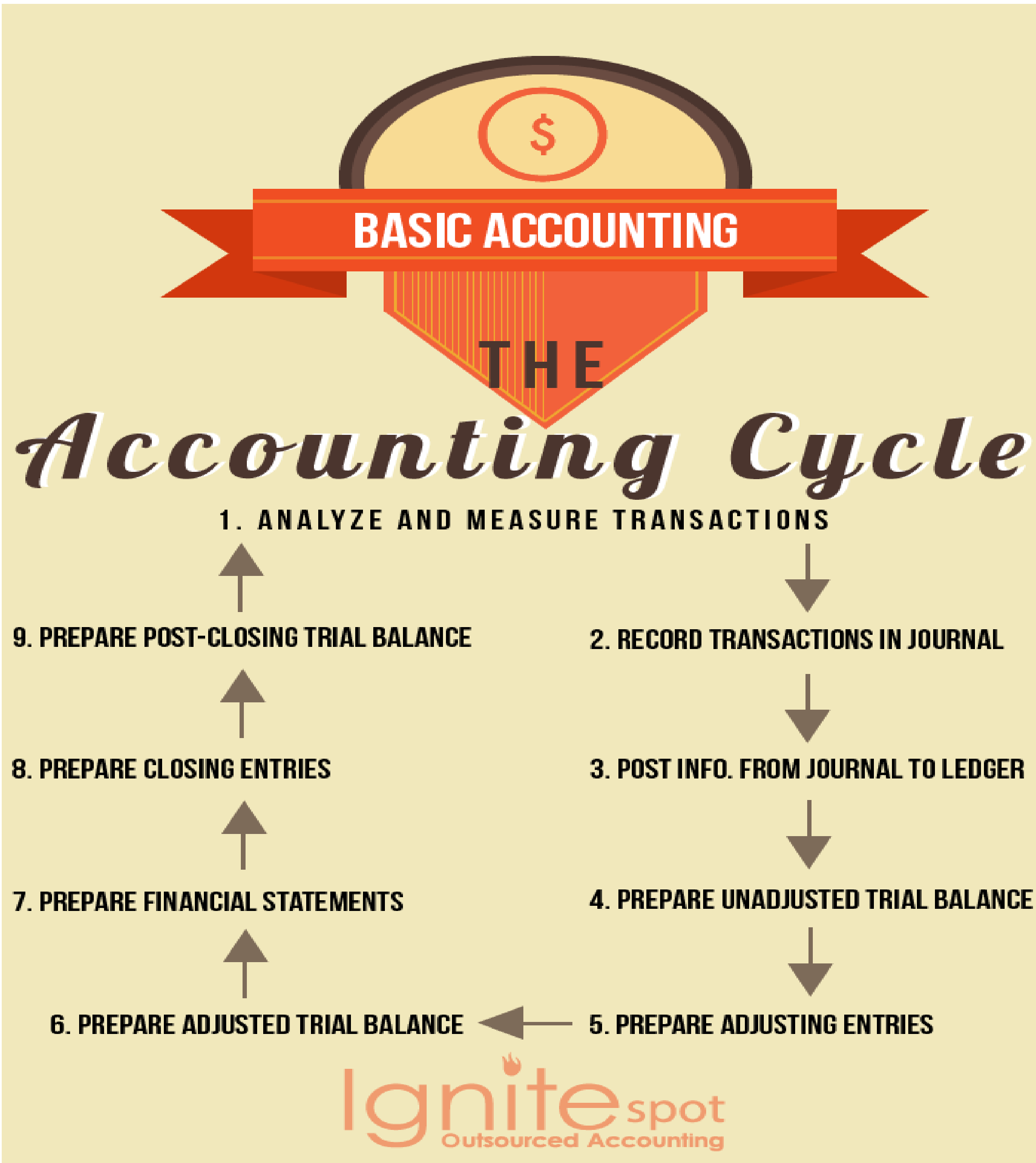
Accrual concept is the most fundamental principle of accounting which requires recording revenues when they are earned and not when they are received in cash, and recording expenses when they are incurred and not when they are paid.

GAAP allows preparation of financial statements on accrual basis only (and not on cash basis). This is because under accrual concept revenues and expenses are recorded in the period to which they relate and not when they are received or paid. Application of accrual concept results in accurate reporting of net income, assets, liabilities and retained earnings which improves analysis of the company’s financial performance and financial position over different periods.

At the end of each reporting period, companies pass adjusting journal entries to record any accruals, for example accrual of utilities expense, interest expense, accrual of wages and salaries, adjustment of prepayments, etc.

Q1: ACCOUNTING CYCLE

As previously stated, the accounting cycle is a series of activities that compiles an organization's transactions at the end of a reporting period in order to prepare important financial statements Since there are quite a few steps involved in the accounting cycle, feel free to print off the following graphic for your future needs.



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1. Analyze and measure transactions.

Obviously in this phase, your business collects their transactions for analysis, measurement, and recording. But here's the first hang-up: what do you have to record?

As a general rule of thumb, a business should minimally record:

1. All cash sales.
2. All purchases (no matter how small).
3. Anything that's measurable, relevant, or reliable.
4. All events:
    - **External transactions**: are between the entity and its environment, such as exchanges with another company or a change in the cost of goods your business purchases.
    - **Internal transactions**: are exchanges that occur within the organization.

In short, a company records as many transactions as possible that affect its financial position.

2. Record transactions in the journal.

This is also known as journalizing. A journal chronologically lists transactions and other events in terms of debits and credits to accounts. Each journal entry consists of four parts:

1. The accounts and amounts to be debited.
2. The accounts and amounts to be credited.
3. The date of transaction.
4. A transaction explanation.

3. Post information from the journal to the ledger.

This is the act of transferring information from the journal to the ledger. Posting is needed in order to have a complete record of all accounting transactions in the general ledger, which is used to create a company's financial statements.

4. Prepare an unadjusted trial balance.

The unadjusted trial balance is a list of the accounts and their balances at a given time, before any adjusting entries are made to create financial statements. The accounts are listed in the order which they appear in the ledger, with debit balances listed in the left column and credit balances in the right column. The totals of these two columns must match.

5. Preparing adjusting entries.

Adjusting entries are journal entries recorded at the end of an accounting period that alter the final balances of various general ledger accounts. These adjustments are made in order to more closely align the reported results and the actual financial position of a business. Adjusting entries follow the principles of revenue recognition and matching.

6. Prepare an adjusted trial balance.

After journalizing and posting all adjusting entries, many businesses prepare another trial balance from their ledger and accounts. This is called the adjusted trial balance. It shows the balance of all accounts, including those adjusted, at the end of the accounting period. Therefore, the end result of this adjusted trial balance demonstrates the effects of all financial events that occurred during that particular reporting period.

7. Prepare financial statements.

Financial statements can be prepared directly from the adjusted trial balance. A financial statement is an organization's financial results, condition, and cash flow.

8. Prepare closing entries.

In the closing phase, temporary balances are reduced to zero in order to prepare the accounts for the next period's transactions. This process empties the entity's temporary accounts and deposits anything remaining into a permanent account.

9. Prepare a post-closing trial balance.

The post-closing balance consists only of assets, liabilities, and owners' equity, also known as real or permanent accounts. This balance provides evidence that the company has properly journalized and accurately posted the closing entries.

Now that your company has performed a complete accounting cycle, it's ready for the next reporting period.

Q3: Balance sheet:

A balance sheet is a financial statement that communicates the so-called "book value" of an organization, as calculated by subtracting all of the company's liabilities and shareholder equity from its total assets.

A balance sheet offers internal and external analysts a snapshot of how a company is currently performing, how it performed in the past, and how it expects to perform in the immediate future. This makes balance sheets an essential tool for individual and institutional investors, as well as key stakeholders within an organization and any outside regulators.

Most balance sheets are arranged according to this equation:

Assets = Liabilities + Shareholders' Equity

Why it is necessary to be prepared.

The balance sheet is prepared in order to report an organization's financial position at the end of an accounting period, such as midnight on December 31.

A corporation's balance sheet reports its:

Assets (resources that were acquired in past transactions)

Liabilities (obligations and customer deposits)

Stockholders' equity (the difference between the amount of assets and liabilities)

You can view the balance sheet as reporting the assets and the claims against those assets (liabilities and stockholders' equity). You can also view the balance sheet as reporting a corporation's assets and the amounts that were provided by creditors (the liabilities) and the amounts provided by the owners (the stockholders' equity).

A classified balance sheet reports the current assets in a section that is separate from the long-term assets. Similarly, current liabilities are reported in a section that is separate from long-term liabilities. This allows bankers, owners, and others to easily compute the amount of an organization's working capital and current ratio.

The balance sheet has some limitations. For example, the property, plant and equipment are reported at cost minus the accumulated depreciation (except land). If these assets have increased in value, the fair value is not reported because of the cost principle. Also, brand names and trademarks may have significant value, but cannot be reported on the balance sheet unless they were acquired in a business transaction. The balance sheet should be read with the other financial statements (income statement, statement of comprehensive income, statement of cash flows, and the statement of changes in stockholders' equity) including the notes to the financial statements.