Riargo

ACCOUNTING FOR MANAGERS

SUBJECT CODE: MS5A-511

UNIT –I Introduction to Accounting

FOR: MBA EXAMINATION

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UNIT –I Introduction to Accounting

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1.1. Accounting Evolution, Significance,

What is accounting?

Accounting is like keeping track of a business's money. It helps businesses know how much they've earned, spent, and saved. Think of it as a diary for a business's finances.

History of Accounting

- **Ancient Times:** Even in ancient India, people like Chanakya wrote about managing money and keeping records.
- **Middle Ages:** A man named Luca Pacioli invented a way to keep track of money called double-entry bookkeeping. This is still used today.
- **Modern Times:** Big companies use computers to do accounting. They have special software to help them keep track of their money.

Father of Accountancy

- Lucas Pacioli
- Mathematician
- In Italy 1494 AD

Objectives of Accounting/ Significance of Accounting/Needs/ Importance

- Replacing memory
- Maintaining proper record of business
- Assessing the performance of business
- Assistance to Management
- Facilitates settlement of tax liabilities
- Progress of business
- Determination of employee Increment & bonus

1.2. Accounting Principles, Concepts &Conventions GAAP

GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

GAAP is a set of rules, conventions, standards, and procedures used by companies to report financial information. It's a combination of official standards set by policy boards and commonly accepted practices.

Key points of GAAP:

- **Consistency:** Ensures investors can compare financial statements of different companies.
- **Relevance:** Covers important aspects like revenue recognition, balance sheet classification, and share measurements.
- **Purpose:** Helps investors analyze companies for investment decisions.

Accounting Principles

Accounting principles are fundamental guidelines that provide a framework for consistent and reliable financial reporting. They ensure uniformity and understandability of financial information.

Basic Accounting Principles

- **Realization Concept:** Records transactions only when realized (cash received or ownership transferred).
- **Matching Concept:** Matches expenses with related revenues in the same period.
- **Full Disclosure Concept:** Discloses all significant information in financial statements.
- **Duality Concept:** Every transaction has two aspects: giving and receiving.
- **Verifiable Objective Evidence Concept:** Accounting data must be verifiable through evidence.
- **Historical Cost Concept:** Records transactions at their original cost.

- **Balance Sheet Equation Concept:** Assets = Liabilities + Equity.

Key points of accounting principles:

- **Standards for accounting practices:** Provide a set of rules for recording and reporting transactions.
- **Guidance for transaction recording:** Offer guidance on how to properly record business activities.
- **Uniformity and understandability:** Ensure that financial statements are comparable and easy to understand.
- **Foundation for accounting concepts:** Serve as the basis for various accounting concepts.

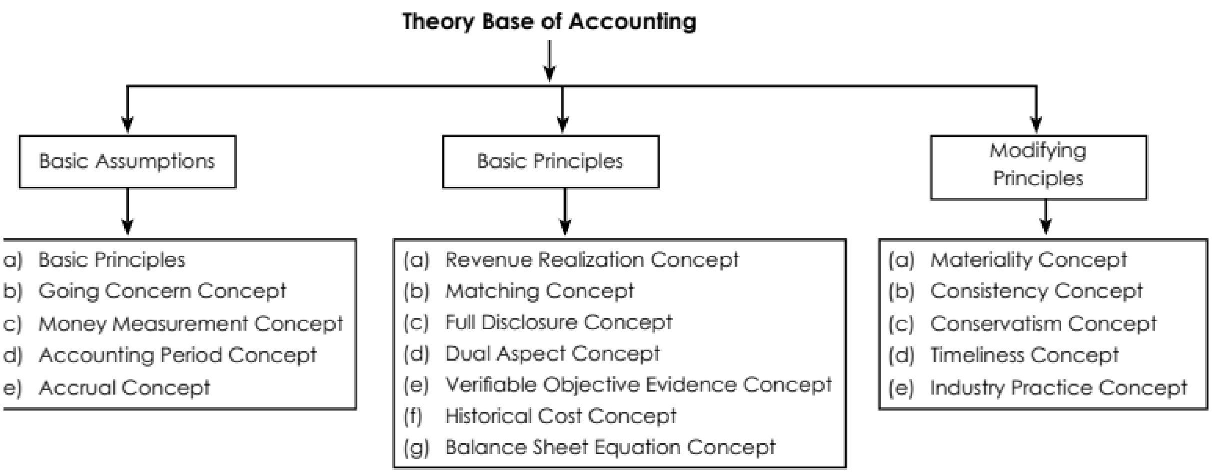
Overview of International Accounting Standards (IAS)

IAS are a set of globally accepted accounting standards developed by the International Accounting Standards Board (IASB). They provide a common language for financial reporting, making it easier to compare financial statements of companies from different countries.

Key points of IAS:

- **Global acceptance:** Adopted by many countries around the world.
- **Common language:** Provides a consistent framework for financial reporting.
- **Improved comparability:** Makes it easier to compare financial statements of companies from different jurisdictions.
- **Convergence with US GAAP:** The IASB is working to converge its standards with US Generally Accepted Accounting Principles (GAAP).

Theory Base of Accounting



Basic Assumptions in Accounting

Accounting is based on several fundamental assumptions that guide the recording and reporting of financial information. These assumptions help ensure consistency and relevance in accounting practices.

Key Assumptions:

1. **Business Entity Concept:**
   - A business is a separate entity from its owners.
   - Transactions are recorded solely from the business's perspective.
2. **Going Concern Concept:**
   - A business is assumed to continue operating indefinitely.
   - Financial statements are prepared based on this assumption.
3. **Money Measurement Concept:**
   - Only transactions that can be measured in monetary terms are recorded.
   - Non-monetary items (e.g., employee morale) are not included in financial statements.
4. **Accounting Period Concept:**
   - Business activities are divided into specific time periods (e.g., monthly, quarterly, annually).

- Financial statements are prepared for each period to assess performance and financial position.

5. **Accrual Concept:**
    - Revenues and expenses are recognized when they are earned or incurred, regardless of when cash is received or paid.
    - This differs from the cash basis of accounting, which only records transactions when cash changes hands.

Modifying Principles

Materiality:

- Considers the significance of information, amount, procedure, and nature.
- Immaterial items may be treated differently to save time and effort.

Consistency:

- Requires consistent accounting practices over time.
- Changes in accounting policies should be disclosed.

Conservatism:

- Prioritizes caution and prudence in accounting.
- Recognizes expenses and losses sooner than revenues and gains.
- Avoids overstating assets and net income.

Timeliness:

- Ensures timely recording of transactions.
- Delays can lead to errors and manipulation.
- Particularly important for cash balance verification.

Industry Practice:

- Accounts for industry-specific characteristics and practices.
- May involve modifications to general accounting principles.
- Examples include insurance companies and non-trading organizations.

1.3 Accounting Equation

The accounting equation is a core principle in accounting that states:

Assets = Liabilities + Equity

This means that a company's resources (assets) must always equal its debts (liabilities) plus the owners' stake (equity).

Key components:

- **Assets:** Resources owned by the company (e.g., cash, property, equipment).
- **Liabilities:** Debts owed to others (e.g., loans, accounts payable).
- **Equity:** Owners' stake in the company (e.g., common stock, retained earnings).

  Importance:
- **Balance sheet:** Ensures the balance sheet remains balanced.
- **Double-entry accounting:** Forms the basis of double-entry accounting.
- **Financial analysis:** Used to assess a company's financial health, solvency, and profitability.

1.4. Concept of Capital and Revenue,

Importance: Identifying these transactions is crucial for:

- Calculating accurate accounting profit
- Recognizing business assets

Capital Transactions:

- Long-term effects (lasting more than one accounting period) on the business.
- Examples:
- Purchase of fixed assets (land, buildings, machinery)
- Improvement of existing fixed assets
- Preliminary expenses (legal fees, registration)

Revenue Transactions:

- Short-term effects (within one accounting period) on the business.
- Examples:
- Day-to-day operating expenses (wages, rent, supplies)
- Cost of goods sold

Capital Expenditure:

- Expenditure related to acquiring or improving fixed assets.
- Added to the cost of the asset on the balance sheet.

Revenue Expenditure:

- Daily operating expenses.
- Charged as an expense on the income statement for the current period.

Distinguishing Features:

- **Useful life:** Capital expenditure has a longer useful life than revenue expenditure.
- **Impact on profit:** Capital expenditure affects profit over multiple periods, while revenue expenditure affects the current period's profit.

Additional Notes:

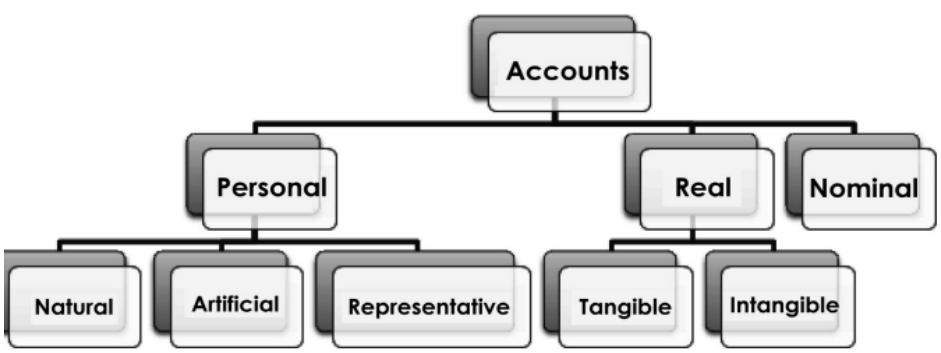
- **Treatment:**
  - Capital expenditure: Recorded as an asset on the balance sheet.
  - Revenue expenditure: Charged as an expense on the income statement.
- **Examples:**
  - **Capital:** Purchase of land, building renovations, legal fees for company formation
  - **Revenue:** Wages, rent, supplies, cost of goods sold

1.5. Types of Accounts,

Definition: An account is a summarized record of transactions related to a person, thing, or entity.

Types of Accounts:

- **Personal:** Related to individuals or entities (e.g., customers, suppliers, employees).
- **Real:** Related to assets (tangible or intangible).



- **Nominal:** Related to expenses, losses, incomes, or gains.

1.6. Rules of Debit and Credit

A. American approach

For Assets	Increase in Assets Decrease in Assets	Dr. Cr.
For Liabilities	Decrease in Liabilities Increase in Liabilities	Dr. Cr.
For Capital	Decrease in Capital Increase in Capital	Dr. Cr.
For Incomes	Decrease in Income Increase in Income	Dr. Cr.
For Expense	Increase in Expense Decrease in Expense	Dr. Cr.
For Stock	Increase in Stock Decrease in Stock	Dr. Cr.

B. British Approach of Double Entry System:

Personal Account → Debit the receiver or who owes to business Credit the giver or to whom business owes

Real Account → Debit what comes into business
Credit what goes out of business

Nominal Account → Debit all expenses or losses
Credit all income or gains