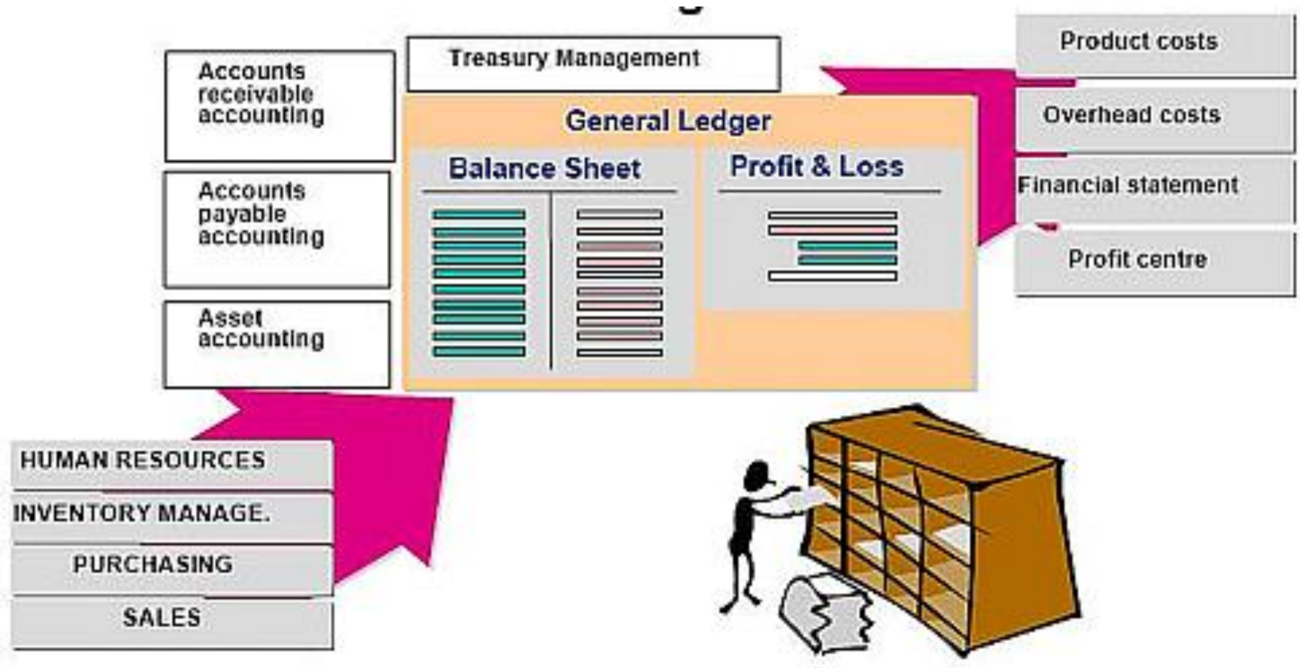
Introduction to Accounting
Chapter 1 – Basic concepts

A. Decision-making by Accounting

- **Accounting** -systematic recording & reporting of financial transactions of a business.

1. Planning: setting goals & method to attain them (e.g. debt position: raise fund)
2. Evaluating: by results of plans (e.g. sales figures: sales target/level)
3. Controlling: monitoring plans & taking corrective actions (if not achieved)



B. Types

Types	Financial	Management
Definition	Recording & summarizing business trans-actions & reporting externally	Preparing, analyzing & interpreting internally
Purpose	External	Internal
Users	People who have interest	Managers
Format	Standardized	Various (by needs)
Regulations	? Standards	? Standards
Period	Fixed time internal (e.g.1 years)	Not fixed
Contents	Past	Past/Future

C. Functions

1. **Recording**: daily transactions in different journals
2. **Classifying**: grouping data in different ledgers by nature
3. **Summarizing**: presenting classified data in understandable & useful way (reports)
4. **Communicating**: provide users with financial statements and explain key result, sending data to interested parties format

D. Process

- **Booking-keeping** -system of recording business transactions in a set of accounting records.

1.**Identifying**
2.**functions 1-3**: by trade documents (provides evidence to support business transactions)
3.**functions 4**: by financial statements(show entity's performance.

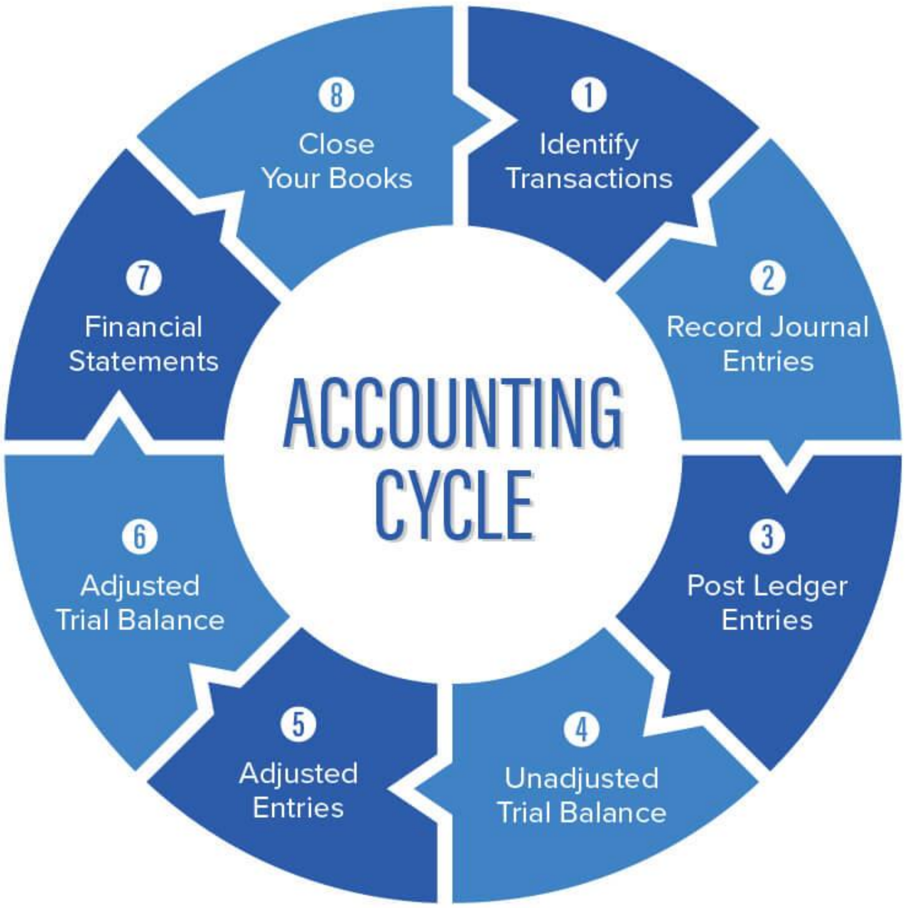
Importance of accounting

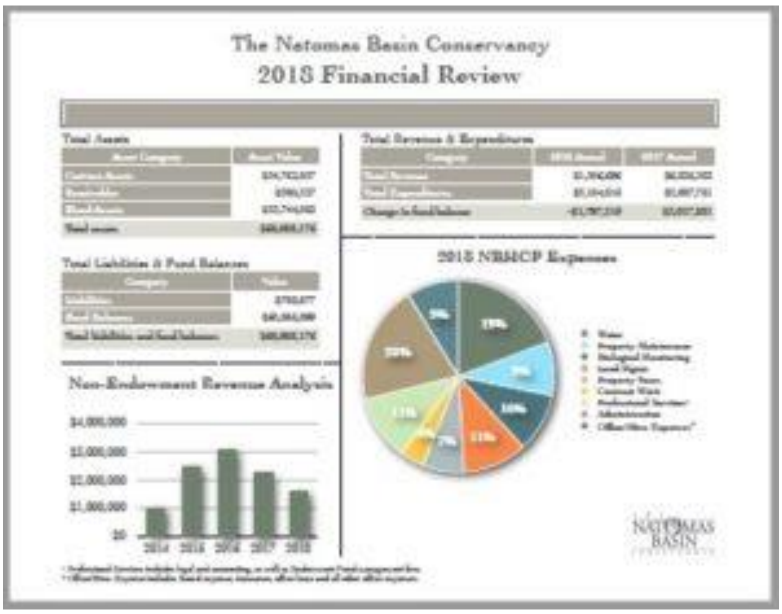
- provides financial information → useful for **decision-making**.

E. Cycle

- **Accounting cycle** -collective process of recording business transactions & preparing financial statement.

1. Analysing: business transactions
2. Recording: in books of entry (primary accounting books) (original entry)
3. Posting: to ledgers (accounting books for keeping accounts) (double entry)
4. Trial balance
5. Period-end adjustments
6. Financial statement





F. Financial statements

Income statement

- reports revenues & expenses & result in net profit or
- during a period of time (R-E)

Statement of financial position

- reports assets, liabilities & owner's capital
- at a specific date
- Statement of changes in equity
- Statement of cash flows
- Notes to the financial statement

ENGLAND TOURS COMPANY Income Statement For the Year Ending December 31, 20X3		
Revenues		
Tour services		$32,800
Expenses		
Salaries	$17,000	
Advertising	5,000	
Fuel	2,000	
Depreciation	5,000	
Interest	1,200	30,200
Net income		$ 2,600

ENGLAND TOURS COMPANY Statement of Retained Earnings For the Year Ending December 31, 20X3	
Beginning retained earnings	$ -
Plus: Net income	2,600
	$2,600
Less: Dividends	1,000
Ending retained earnings	$1,600

ENGLAND TOURS COMPANY Balance Sheet December 31, 20X3		
Assets		
Cash		$15,500
Accounts receivable		4,500
Equipment	$45,000	
Less: Accum. depreciation	(5,000)	40,000
Total assets		$60,000
Liabilities		
Accounts payable	$ 4,000	
Salaries payable	2,000	
Interest payable	1,200	
Notes payable	20,000	
Unearned revenue	1,200	
Total liabilities		$28,400
Stockholders' equity		
Capital stock	$30,000	
Retained earnings	1,600	
Total stockholders' equity		31,600
Total liabilities and equity		$60,000

#Users

- **Internal**

a. **Managers:** responsible for operation & monitoring
b. **Owners**: may not participate in operations → understand how much
c. **Employees**: job security & promotion & payment prospects

- **External**

a. **Investors**: prospects → hold/buy/sell shares
b. **Lenders**:access repayment ability
c. **Customers** : expect stable supply
d. **Suppliers**: access repayment ability of debts
e. **Government bodies** : tax assessment/investigation of business crimes

#Limitations

a. **No standard accounting methods & policies**: hinders compensation (different values)
b. **Provision of historical information**: past transactions→ outdated →may not happen again
c. **Involvement of judgement & estimation**: may be biased/subjective →misleading
d. **Lack of non-financial information**: only quantitative information ($) →exclude other activities (e.g. expertise, experience, quality, morale, customer loyalty)
e. **Ignoring time value of money**: different values in different period →not adjusted
f. **Too general purpose**: not detailed enough to satisfy specific needs of specific users

Accounting Equation

$$\boxed{\text{Assets} = \text{Capital} + \text{Liabilities}}$$

Assets: resources owned by a business.
Capital: resources supplied to business by the owner(s).
Liabilities: resources supplied to a business by people other than the owner(s).

Expanded accounting Equation

$$\boxed{\text{Assets} = [\text{Capital} + (\text{Revenues} – \text{Expenses}) - \text{Drawings}] + \text{Liabilities}}$$

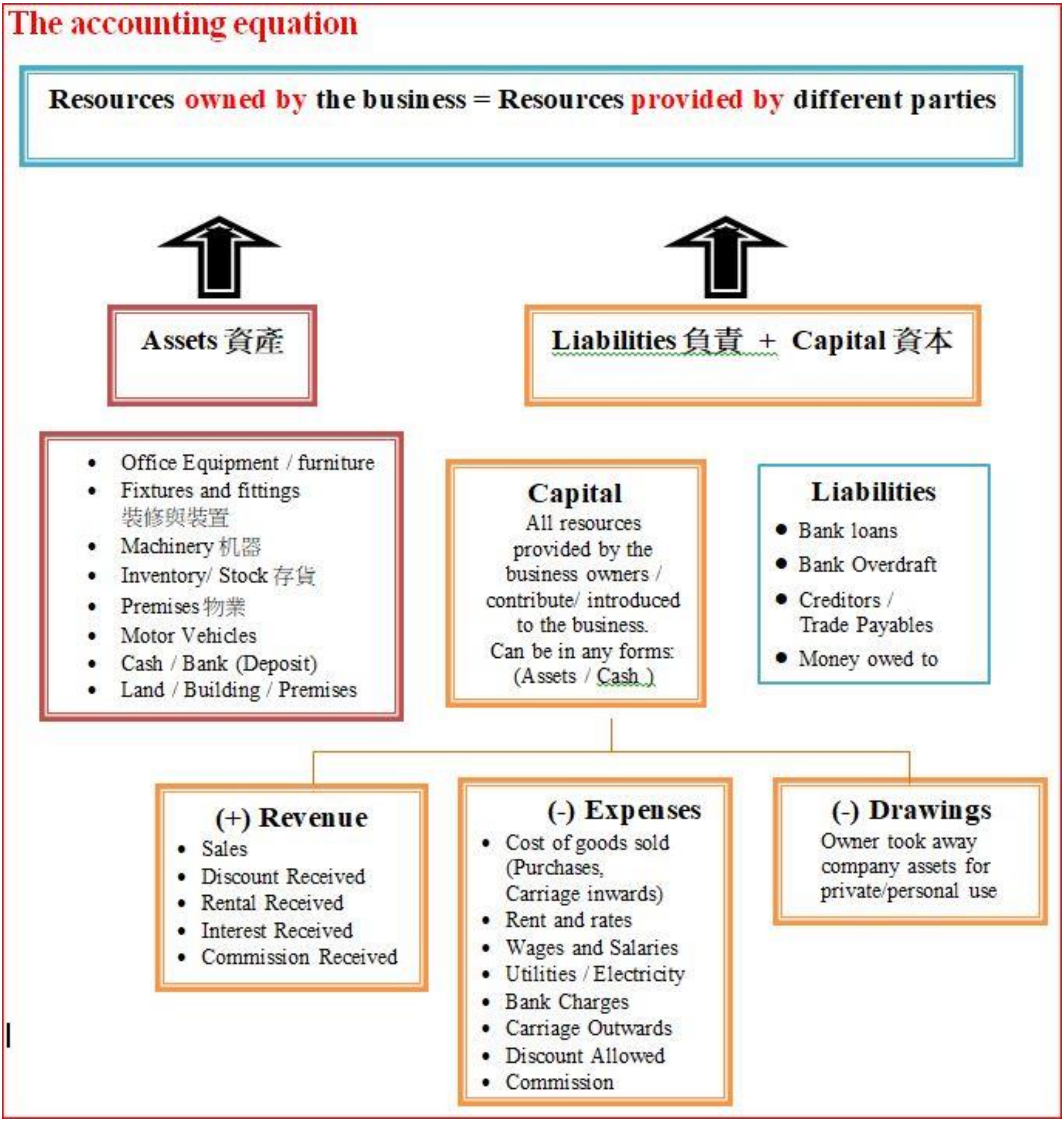
Revenues: income earned from the sale of goods or provision of services to customers +the income earned from other sources→ increase capital
Expenses: costs incurred to generate revenue → reduce capital
Drawings: resources of a business taken by its owner(s) for personal use → reduce capital

Chapter 2 – Double entry system

Business entity concept - a business is an entity separated from its owners and other entities.
→ ∴personal transactions: excluded from accounting records

A. Accounting equation

- **Resources owned by business(A) = resources provided by owners & other external partners(L+C)**
- **Every transaction**: affects≥2 items in equation (2 sides equal after recording)
- **Assets(A)**: general incomes (e.g. fixture & fittings, equipment, furniture, premises)
- **Liabilities(L)**: debts & obligations (future payments →otherwise: liquidation)



B. Creditor & Debtor (company name if given)

- **Credit period** –duration for buyers to delay payments
- **Account receivable(A/R=A)** - amount owed by customers to a business (selling on credit)
- →debtor: person/ organisation
- **Account payable(A/P=L)** - amount owed to supplier by a business (buying on credit)
- →creditor: person/ organisation

(c)**Extended equation**: Assets(A) = Liabilities(L) + (Capital(C) + Revenues (R) **-** Expenses(E) **-** Drawing(D))

- **Revenues(R=C)** -gross income earned from business operation (e.g. sales, interest income)
- **Expenses (E=-C)** -costs and consumption incurred when generating revenues (e.g. wages)
- **Drawings (D=-C)** -withdraw of assets for personal use

Assets =	Liabilities +	[Capital +	(Revenues -	Expenses)]	- Drawings
Cash/Bank ↑ │ **Trade debtors** **Trade Receivable** ↑ │ D.A, R.I **Credit Sales (Customers)	**Bank loans** │ ↑ **Trade-creditor** **Trade Payable** R.O, D.R │ ↑	**Capital** │ ↑ ** Owner's investment e.g Cash, or all kinds of assets brought into the business.	**Interests Received** │ ↑ **Commission Rec'd** │ ↑ ** Other revenue earned in addition to Sales.	**Expenses** ↑ │ ** Operating Expenses** e.g. Electricity /Water bills, Rent, Insurance, *Discount Allowed* salary, Carriage Outwards, *(Transportation cost for customer)* **Cost of Goods Sold**	**Drawings** ↑ │ **Withdrawal of cash or other assets by the owner from the business for his personal use.
Assets ↑ │ ** Equipment, Furniture, Fixtures, Motor Van, Computer, stationery *(not for re-sales)*	**Credit Purchase (Supplier) Purchase goods from Pet Store for re-sales **non-Trade-creditor **Accounts Payable** │ ↑ **Buy assets from Pet City *(NOT for re-sales)*		**Sales** │ ↑ ** Goods sold to Customers **Returns Inwards** ↑ │ **Customers return goods **Discounts Allowed** ↑ │ **Discounts allowed to Customers for early payments (**Expenses**)	**Purchases** ↑ │ **Goods purchased for re-sales **Returns Outwards** │ ↑ ** Goods Returned to suppliers **Discounts Rec'd** │ ↑ **Discounts received from Suppliers for early payments **Carriage Inwards** ↑ │	e.g. Cash, Bank, Purchase, assets **Transportation costs

Assets = Liabilities + Capital [+ Revenue – Expenses] - Drawings

Principles of double entry:

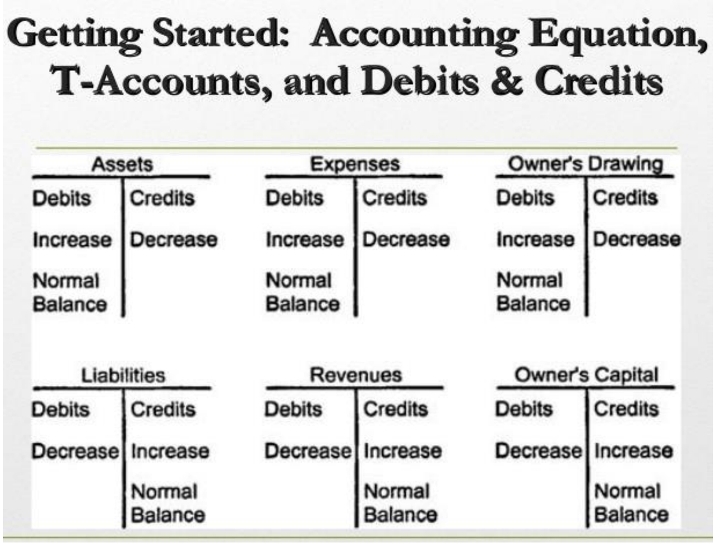
Assets = [Capital + (Revenues – Expenses)] - Drawings + Liabilities

Assets + Expenses + Drawings = Capital + Revenues + Liabilities

C. Double entry system

Tool to record business transactions in an account

- Dual effects: debt side (Dr) & credit side (Cr)
- Amount: A(Dr) = L(Cr) + C(Cr) + R(Cr) - E(Dr) - D(Dr)



(I) Steps for recording

1. Analyse transaction
2. Determine affected accounts
 & their nature
3. Determine⇧ /⇩ in amounts
4. Translate⇧ /⇩ into (Dr)/(Cr)
5. Record in accounts

Debit (Dr.) **Credit (Cr.)**

A = **C + L**

Expenses - +

Drawings Revenues

	Assets	Expenses	Drawings	Capital	Revenues	Liabilities
To record ↑	Debit (Dr)	Debit (Dr)	Debit (Dr)	Credit (Cr)	Credit (Cr)	Credit (Cr)
To record ↓	Credit (Cr)	Credit (Cr)	Credit (Cr)	Debit (Dr)	Debit (Dr)	Debit (Dr)

(II) Items in extension (cash/cheque/credit)

Sales(R) - occur when selling goods to customers → trade discount allowed (E): (-C)

⍰ record →directly record new account

Purchase(E) -occur when buying goods from suppliers → trade discount received (R): (+C)

⍰ record →directly record new amount

Return inwards - goods returned by customers
Return outwards - goods returned to suppliers

Carriage inwards (E): Costs of goods sold
transporting cost of collecting goods from suppliers

Carriage outwards(E)
transporting cost of delivering goods to customers

(III) Cash discounts

Discount allowed(E) (-C)
supplier allows its customers to pay earlier for smaller amount

Discount received (R) (+C)
customer settles to its supplier earlier for smaller amount

The four steps for recording transactions in double-entry accounts are:

Step 1	Determine the accounts (at least two) that are affected by the transactions.
Step 2	Classify the accounts as assets, capital, liabilities, revenues, expenses or drawings.
Step 3	Determine whether to debit or credit the accounts involved.
Step 4	Enter the date, details and the amount of the transaction in each of the accounts.

Balancing off accounts

- process of calculating the **outstanding** balance in each account at the end of a period.
- This helps firms monitor the status of each account more closely

Debit Balance (b/d)	Total od Dr. > Total of Cr.	Asset
Credit Balance (b/d)	Total od Dr. < Total of Cr.	Capital, Liabilities
Zero Balance (X c/d)	Total od Dr. = Total of Cr.	

Chapter 3 – Trial Balance

Balance off Accounts– computing balance in each account at end of period

Types of balances

(a) Debit Balance: total on Dr. > total on Cr. [accounts :(A), (E), (D)]

(b) Credit Balance: total on Dr.< total on Cr. [accounts :(L), (C),(R)]

(c) Zero Balance: total on Dr. = total on Cr. [no bal c/d & bal b/d]

Trial Balance as at 31 December 20X1

		Dr $	Cr $
Cash		✓	
Bank		✓	
Assets		✓	
Inventory (Opening)		✓	
Account Receivable:		✓	
Debtors (AA+CC)			
Account Payable:			✓
Creditors (DD+FF)			
Purchase		✓	
Sales			✓
Expense		✓	
Revenue			✓
(Interest/commission/rent received)			
Returns Outwards			✓
Returns Inwards		✓	
Carriage Inwards		✓	
Carriage Outwards		✓	
Drawings		✓	
Capital			✓
Non-trade Debtor		✓	
Non-trade Creditor			✓
		TT	TT

Trial Balance: list of all balances from accounts in ledgers at certain date

- Dr. Balances=Cr. Balances (if double entry principle applied correctly) [trial balances agrees]
- Format
- Group all [A/R] &[A/P] into single balance respectively
- Show zero balances
- Inventory: opening (closing :stated under trial balance)

Functions

a. To identify errors in ledgers : Dr.= Cr. ?
b. To form basis for preparing financial statement[full accounts]
c. For auditing purpose: – save time of following all ledger account
   – check for posting errors
   – check for illogical/irregular items

Limitations (errors may still exist even Dr.= Cr.)

a. Transaction omitted : no entry on any side of an account
b. Transaction entered to wrong account [still with correct amount on same side]

Steps for preparing a trial balance

Step 1 Extract the **closing** balances of ledger accounts
Step 2 List the debit/credit balances in the debit/credit column with their account titles shown in the first/second column.
Step 3 **Add up** the debit balances and the credit balances separately.

Trial Balance as at 30 April 2007

	Dr $	Cr $
Capital		90,000
Cash	2,200	
Bank	58,900	
Equipment	25,500	
Purchases	13,400	
Sales		12,000
Returns inwards	1,500	
Returns outwards		1,200
Accounts payable: G Yeung		1,900
Accounts receivable: T Mok	1,500	
C Ho	2,100	
	105,100	105,100

Step 2

Remarks:

1. No Closing Inventory (if income statement had not been done and posted to trial balance)
2. If there is missing figure, assume Dr = Cr , then find the unknown
3. Dr: Assets, Expenses, Drawings
   Cr: Capital, Liabilities, Revenues

Returns Inwards	Dr	Returns Outwards	Cr
Carriage Inwards	Dr	Carriage Outwards	Dr
Bank	Dr	Bank Overdraft	Cr

Chapter 4 – Income Statement (Sole proprietorship)

A. Period-end Closing-closing off accounts at end of accounting year by preparing closing entry

I. Types of Ledger Accounts

(a) Personal Accounts (A/P, A/R): close off> → transferred to next → statement of Financial Position

Account Receivable (Sales) Ledger

Debtor A

Date	Details	$	Date	Details	$
	Sales	S1		R.I.	RI1
	↑			Bal c/d	AA
	Bal b/d	AA			

Debtor B

Date	Details	$	Date	Details	$
	Sales	S2		Cash	

Debtor C

Date	Details	$	Date	Details	$
	Sales	S3		Cash	28
		30		R.I.	RI3
				Dis A	2
				Bal c/d	CC
	Bal b/d	CC			

Account Payable (Purchases) Ledger

Creditor D

Date	Details	$	Date	Details	$
	R.O.	RO		Purchases	P1
	Bal c/d	1		↑	
		DD			
				Bal b/d	DD

Creditor E

Date	Details	$	Date	Details	$
	Bank			Purchases	P2

Creditor F

Date	Details	$	Date	Details	$
	Cash			Purchases	P3
	R.O.	RO3			
	Dis R				
	Bal c/d	FF			
				Bal b/d	FF

Sales

Date	Details	$	Date	Details	$
	Transfer to Income Statement			Total Cash Sales	
				Total Credit Sales	AR
				↑	

Purchases

Date	Details	$	Date	Details	$
	Total Cash purchases			Transfer to Income Statement	
	Total Credit purchases	AP			
	↑				

Returns Inwards

Date	Details	$	Date	Details	$
	Total Returns Inwards	RI		Transfer to Income Statement	
	↑				

Returns Outwards

Date	Details	$	Date	Details	$
	Transfer to Income Statement			Total Returns Outwards	RO
				↑	

Discount Allowed

Date	Details	$	Date	Details	$
	Total DA	DA		Transfer to Income Statement	
	↑				

Discount Received

Date	Details	$	Date	Details	$
	Transfer to Income Statement			Total DR	DR
				↑	

(b) Impersonal Accounts

1. **Real [/Permanent]** (Assets, Liabilities): close off → transferred to next → statement of position

Assets					
Date	Details	$	Date	Details	$
	Total XX			Bal c/d	
	↑				

Liability					
Date	Details	$	Date	Details	$
	Bal c/d			Total XX	
				↑	

2.**Nominal [Temporary]** (R, E ,D) close off> → no balance brought forward → Income statement

- At the end of an accounting period, **financial statements** are prepared to **report** the financial performance (Income Statement) and financial position (Balance Sheet) of a business.

<u>Period-end entries</u>

Closing entries

- double entries required to close off certain accounts at the end of an accounting period.
- **'nominal accounts' (expenses and revenues)** will close off (transfer to **Profit and Loss** account)
- **Entries for inventory**
- It has to be physically counted (stock-taking), valued at cost
- To record closing inventory :*(Dr) Inventory account; (Cr) Profit & loss account*

<u>Income statement</u>

Purpose: Report the performance (profit or loss made) of a firm

<u>Statement of financial position (Balance sheet)</u>

Purpose: Report the financial position of a business as at a particular date

Differences between the income statement & the statement of financial position

1. the statement of financial position measures the wealth, while the income statement measures the periodic income and expenses
2. The income statement reports the flows of revenues and expenses over a period of time. This is called the flow concept.
   The statement of financial position reports the balances of assets, liabilities and capital as at a particular date. This is called the stock concept.

Capital					
Date	Details	$	Date	Details	$
	Bal c/d			Total XX	
				↑	

Revenue					
Date	Details	$	Date	Details	$
	Transfer to Income Statement			Total XX	
				↑	

Expenses					
Date	Details	$	Date	Transfer to Income Statement	$
	Total XX				
	↑				

Drawings					
Date	Details	$	Date	Details	$
	Total XX			Bal c/d	
	↑				

II. **Closing Entries (Replace[bal c/d] with[profit and loss])in Nominal Accounts –transferring close balances of closed nominal to profit and loss account at end of accounting**

B.2 parts in Income Statement

I. **Trading Account: calculate gross profit/loss from goods trading**

- **Costs of Good Sold - costs of obtaining goods that are sold to customers**
  Purchased =sold ▯ unsold = inventory/stock

  COGS=Opening Inventory+ Purchases-Closing Inventory

- **Inventory[A]-goods held by business for resale**

(a) **opening:** held at beginning of accounting year (from previous: ready for sale)
(b) **closing:** held at end of accounting year (deducted →get actual units of goods)

Physically counted in warehouse: inventory taking

Inventory

2018		$	2018		$
Jan 1	Bal b/f	X	Jan 1	Profit and loss	X
Dec 31	Profit and loss	X	Dec 31	Bal c/f	X
		X			X

Profit and loss

2018		$	2018		$
Jan 1	Opening inventory	X	Dec 31	Closing inventory	X

- **Other items related to gross profit**

(a) **Return Inwards** [E]: actual sales ⇩→ Net sales = Sales – RI ∴gross profit ⇩
(b) **Return Outwards**[R]: actual purchases ⇩→ Net Purchases= Purchases-RD
COGS ⇩ ∴ Goss profit ⇧

(c)Carriage Inwards[E]: purchase cost ⇧ → COGS ⇧ ∴gross profit ⇩

- **Gross profit** = [Sales-Return Inwards]
  - [Opening Inventory+ (Purchases-Return Outwards+ Carriage Inwards)
  - Closing Inventory]

II. Profit & Loss Account: calculate net profit/ loss [overall profit made]

- Other Revenues: revenues other than sales revenues (e.g. discounts received, commission)
- Expenses:

-(a) administrative (e.g. rent &wages, wages & salaries, water & electricity, insurance)
-(b) selling & distribution (e.g. sales commission, carriage outwards)
-(c) financing (e.g. loan interest, bank overdraft interest)

Income Statement for the year ended 31 December 20X1

	$	$	$
Sales			
<Less> Returns Inwards			( )
<Less> Cost of goods sold			
Opening Inventory		OI	
Add Purchases	P		
Carriage Inwards			
<Less> Returns Outwards	( )		
<Less> Closing Inventory		( )	( )
Gross Profit			
Add *Other revenues:*			
Discount/interest received			
Rent/bonus received			
<Less> Expenses			
Carriage Outwards			
Rent and rates			
Salaries			
Discounts allowed			
Sundry expenses			( )
Net Profit / Loss			

C. Post-closing Trial Balance
[after personal and real accounts carried to next accounting period]

Inventory: closing
Capital: net profit added & drawings deducted

Classification of assets & liabilities

Assets **Total Assets = Current Assets + Non-current Assets**

- ***Current assets***: likely to be converted into cash/ sold/ consumed within 1 year
  Examples: inventory; trade receivables; deposit; bank balances; cash
- ***Non-current assets:*** are assets other than current assets; durable; not for reselling
  Examples: land & buildings; fixtures & fittings; furniture; machinery; equipment; motor vehicles

Liabilities **Total liabilities = Non-current liabilities + Current liabilities**

- ***Non-current liabilities***: refer to liabilities that do not have to be repaid within one year
  Examples: long-term loans, mortgages
- ***Current liabilities***: refer to liabilities that have to be repaid within one year
  Examples: trade payables, bank overdraft, loan (repayable within 1 year)

Closing entries

1. To transfer the balance of the profit and loss account

Profit for the year	***Loss for the year***
Dr Profit & loss account *Cr Capital account*	*Dr Capital account* *Cr Profit & loss account*

2. To transfer the balance of the drawings account
   Dr Capital account; Cr Drawings account

Classification of ledger accounts

Personal accounts	***Impersonal accounts***
Accounts of individuals or entities having transactions with the firm, such as: Debtors' accounts, Creditors' accounts	Accounts other than personal accounts, such as: cash account, office equipment account

Nominal accounts	***Real accounts***
Accounts that will be closed off at the end of an accounting cycle and whose balances will be shown in the income statement.	Accounts whose balances will be carried forward to the next accounting cycle and will appear in the statement of financial position.

Chapter 5 – Statement of Financial Position (Sole Proprietorship)

A.3 Parts in Statement of Financial Position

Statement of Financial Position as at 31 December 20X1		
	$	$
Non-Current assets		
Shop premises		
Fixtures and fittings		
Motor Vehicles		
Current assets		
Inventory (Closing)		
Account Receivable		
Trade Receivables		
Bank		
Cash		
Total Assets		
Capital		
Balance as at 1 January 20X1		
Add Net Profit for the year		
<Less> Net Loss for the year		
<Less> Drawings		( )
Non-current Liabilities		
Loan from XX		
Current Liabilities		
Account payable		
Non-trade Creditor		
Total Capital and Liabilities		

(I) **Assets [A] (Net Assets = Total Assets – Total Liabilities + Closing Inventory)**

(a)Non-current [Fixed/Long-term](e.g. premises, machinery, fixture & fittings, motor, equipment)

- generate future benefits for > 1 year [durable]
  - ⍰ intended for resale : ⍰ operation

(b) Current [Liquid/Short-term] (e.g. inventory, A/R, bank, cash)

ˈgenerate future benefits for ≦ 1 year [shorter useful life]

- for resale
- □converted into cash within short time

(II) **Liabilities [L]**

(a) <u>Non-current-debts and obligations that has to be repaid after a year</u>

e.g. long-term bank loans, mortgage loans

(b) <u>Current-debts and obligations that has to be repaid within a year</u>

e.g. short-term bank loans, bank overdraft, A/P

(III) **Capital**

- **closing balance**

(a)Net Profit/Loss (P&L [Dr] + Capital [Cr])

(b)Capital Introduce

(c)Drawings

Capital

20XX		$	20XX		$
Dec31	Drawings	X	Jan1	Bal b/f	X
Dec31	Bal c/f	X	Dec31	P&L	X
		XX			XX

B.Differences between Income Statement & Statement of Financial Position

- Income Statement : [R]& [E]

flow concept (reporting item over period of time) → ⍰ bal c/f

- Statement of Financial Position : [A],[L]&[C]

stock concept (reporting item at particular point in time) → ⍰ bal c/f

Users of financial statements

Internal users	External users
Business owners: • need to know their businesses financial performance & position • useful when deciding whether their businesses should continue to operate or whether they need to put more money into their businesses • ***Management(responsible for the operations):*** • Summarising the operational results of a business, so to formulate and implement plans, evaluating operational performance • need to know which business lines are making or losing money, and then decides how resources should be reallocated to better use • find out whether cash flows are sufficient to finance daily operations and repay debts	***Lenders:*** • need to know whether a firm will be able to pay interest and repay debts. • needs to monitor the firm's financial performance by requiring it to provide regular financial statements. ***Potential investors*** • needs to know the prospects before deciding whether to invest in it ***Suppliers & customers*** • understand more about the financial performance and debt position of their trading partners. • ***Suppliers*** know whether the firm will be able to pay on time • ***Customers*** know whether their suppliers are financially healthy and will be able to keep on supplying goods ***Government bodies*** • The Inland Revenue Department needs to study financial statements to assess profits tax payable

Limitations of financial statements

1. **Reporting past results**
   - Information may not be relevant to current or future decision-making. Therefore, decision-makers should not rely too heavily on past financial information when making long-term decisions.

2. **Assets valued at historical cost**
   - Information provided by financial statements about assets is not based on current market value and may not reflect their true worth.

3. **Alternative accounting policies and methods can be used**
   - When treating same type of transactions or items, companies are allowed to choose among alternative accounting policies and methods. Therefore, it could be very misleading to compare the financial results of firms without understanding the accounting policies and methods used by these firms.

   |

4. **Involvement of personal judgments**
   - Financial statements involve estimates and personal judgments made by accountants and management. These judgements may lead to errors, manipulation or even fraud.

5. **Lack of qualitative information**
   - Financial statements only provide quantitative information which is expressed in monetary terms. Qualitative information is not provided. For example, you cannot know the morale of staff from the financial statements. However, these qualitative factors may have a great impact on decision-making.

6. **Providing a summary without details**
   - Financial statements only provide a summary of the financial results of a business. Users of financial statements may not be aware of the hidden issues or problems behind the reported figures.

Chapter 6 -Detailed concepts

A. Accounting concept –basic assumptions, nations or principles related to financial report

→ = conventions: widely accepted way of thinking & behaving

- **Importance**

(a)**Accountants:** objectivity & uniformity of financial statements⇧
(b)**Users of financial statements**: misunderstanding & inappropriate decision

B. Fundamental concepts(5)

(I) **Business entity concept –business objective separated & distract from activities of owners and all other business entities**

- Scope & boundary of accounting record
- Transactions affecting business: record in accounting books
- Business itself: owns assets & be liable of debts
- Personal activities recorded: only capital & drawings

(II) **Historical cost concept –assets recorded at original cost of acquisition**

- Any Δ market value afterwards: irrelevant

? **Verifiable & reliable**: trade documents (e.g. purchase contract/invoice)
? Manipulation⇩: estimated current value→ biased/overstated→ affect decisions

? Outdated information: irrelevant to current decisions –making

(III) **Going concern concept –assumes that business will continue operation in foreseeable future**

- No intention/need to liquidate/reduce scale
- Consistent with historical cost concept
- If going to close: assets reported in expected resale value→ disclose reasons & effects

(IV) **Consistency concept –accounting policies and methods, once adopted should be applied from one accounting period to the next one**

- Similar items: similar treatment/classification (same firm only)
- Changes: only for more appropriate presentation→ disclose reasons & effects

? Manipulation⇩
? Comparability⇧ : different periods→ trends & performance→ less misleading

(V) **Accrual concept –transactions recorded in accounting period that the events happen, no matter cash received or paid or not**

- Delayed payment: Irrelevant