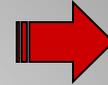


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# Introducing ... Accounting

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# Accounting



## Financial Accounting

## Accounting Analysis

Generating Financial information

Using the Financial information

Recording, Classifying & Summarising

Analyze, Interpret & Communicate

Used for Reporting

Provides Information for Planning & Control

**Audience:** Internal (Managers, Employees & Owners) and External (Investors, Government Bodies, Society, Customers, etc)

# Accountant as a Historian

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- Accountant can be perceived as a historian – who keeps records
- As historian the accountant has the duty to:
  - Respect the facts
  - To see the facts are accurate
  - Bring into focus, all known and knowable relevant facts
  - Finally, provide an interpretation of the history proposed

# Financial Accounting – Evolution

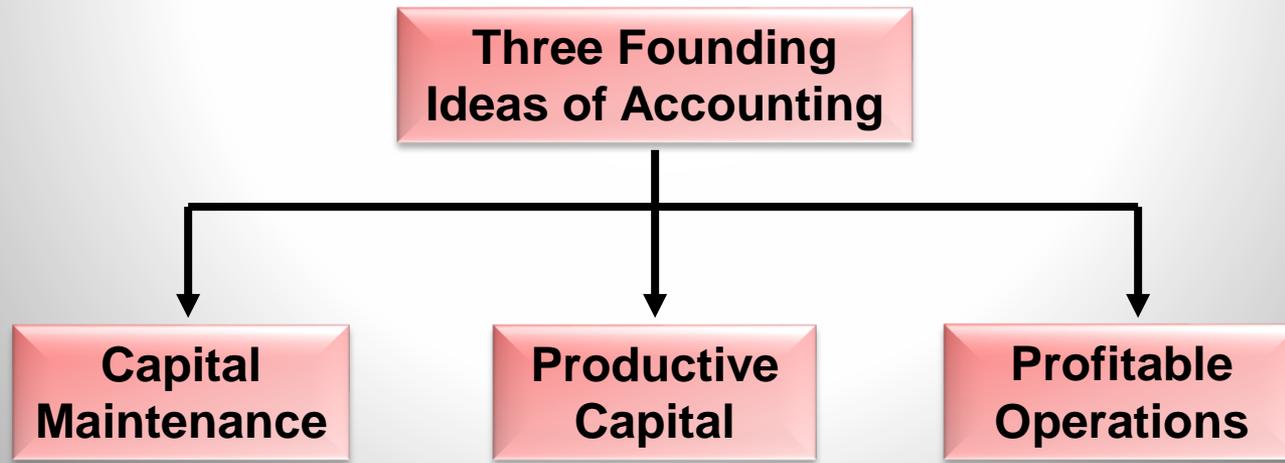
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- ❑ Product of economic environment
- ❑ Gradually evolved as a profession with the development of economic activity
- ❑ especially ... Industrial Revolution
- ❑ Scope and nature of accounting is closely associated with the gradual changes in the field of organization and management of organizations
- ❑ In the modern IT era, accounting is getting integrated into software packages and constantly adapting itself (say, Navision, SAP)
- ❑ Latest in India: Companies Act 2013 & Ind AS (Example: FT and MCX; Consolidated Financial Statements)

# Foundations of Accounting

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- Three basic ideas, which gained currency along with the growth in the economic activity, can be considered as the foundation of accounting system



# Capital Maintenance

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- The idea is to preserve and maintain resources used for generating wealth
  - Implies the generation of wealth while keeping intact the resource used for such generation
  
- $\text{Income (during the year)} = \text{Capital at the end of the year} - \text{Capital at the beginning}$
  
- If the above figure is negative, there is 'capital erosion'
  
- Continuous capital erosion threatens business survival

# Productive Capital

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- ❑ Productive organization of modern industrial society is founded on the use of capital
- ❑ 'Wealth' is used for generation of further wealth
- ❑ Accumulation and deployment of large-scale productive capital involves the problem of maintenance and preservation of such resources
- ❑ Consider the Oil Wells owned by the Oil Companies – *Would that be productive capital if it does not result in any revenue during a particular period?*
- ❑ Throws up the important information function of the valuation of such resources.

# Profitable Operations

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- When productive capital is to be used on a large scale for economic activities, the idea of profit becomes the motive force
- This induces one to go in for future consumption in preference to present consumption
- Resources can be deployed for large number of alternative uses. There is an important criterion for making decisions in the exercise of choice
- This coupled with the idea of maintenance of capital makes the problem of measurement of profit crucial to accounting.

# Development of Accounting

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- Early medieval commerce was agency book-keeping for a specified venture
  
- Development of Joint Stock Companies
  - Operating individuals were not the owners
  
- Investment Banking – keeping records for inspection
  
- Large scale manufacturing and service organizations
  - creation of artificial juridical entities based on common stock of capital collected from large number of investors

# ... Development of Accounting

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- Recording and summarizing of business related events and transactions for the purpose of financial reporting
  
- Two basic principles
  - Form of the 'account' – the basic information formats
  - Equilibrium of the complete set of accounts forms the foundation of the accounting system

# Accounting as a Measurement & Valuation System

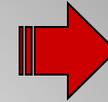
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- Basic orientation of financial accounting is income determination
- Oriented towards an entity- a business unit
- Tries to prescribe a series of concepts, standards, postulates and principles
- Accounting theory as a doctrine is explanatory in nature and the underlying reasoning and justifications are related to practice

# Match the following

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- Income should be properly "matched" with the expenses
- Guideline for financial accounting
- Entity will continue as a going concern.
- Companies are required to use the accrual basis of accounting
- Concepts
- Standards
- Postulates
- Principles



# Definition of accounting

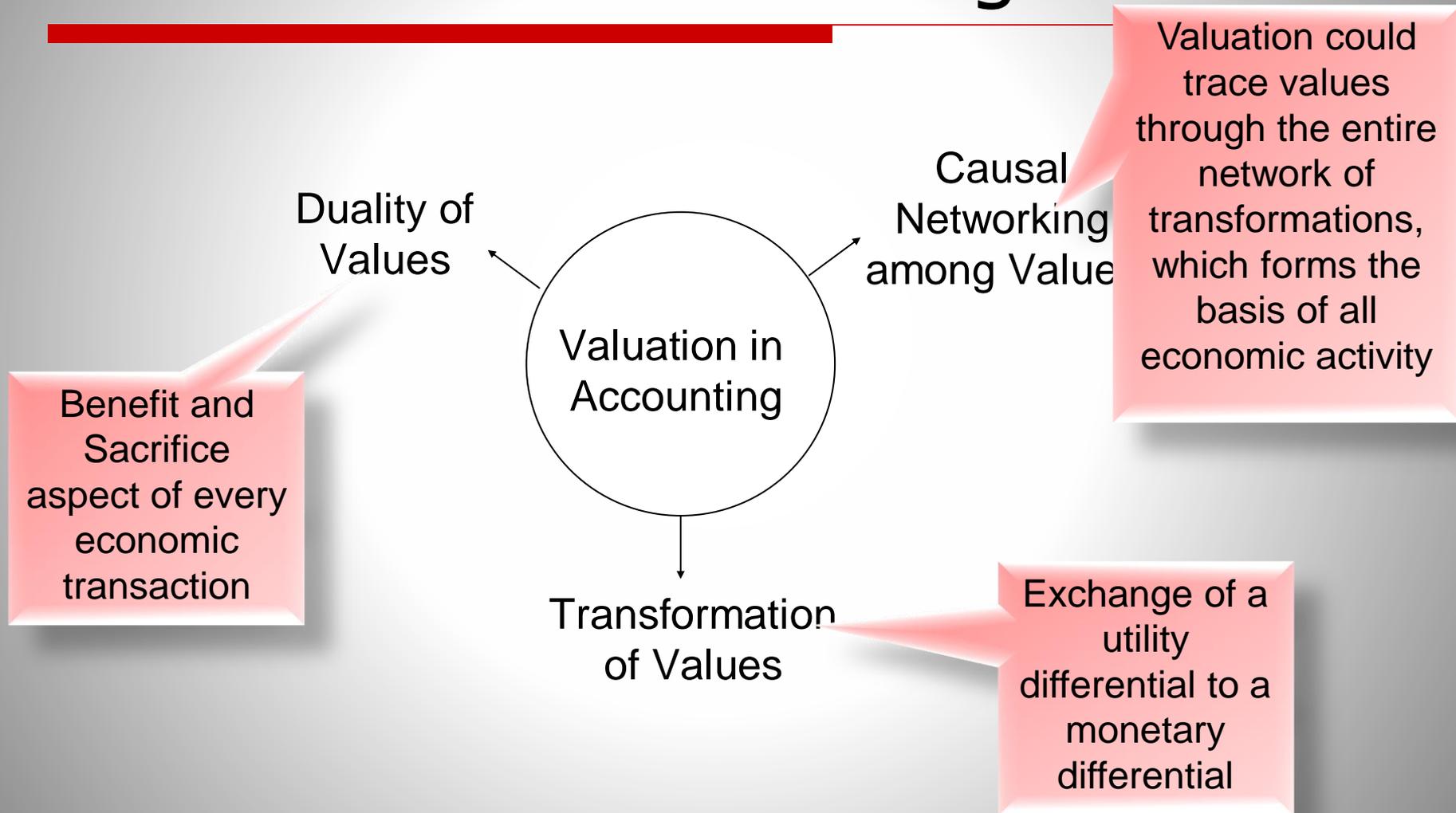
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- Multiple definitions exist

According to *American Institute of Certified Public Accountants* (AICPA) –

“accounting is the art of recording, classifying and summarizing in a significant manner and in terms of money, transactions, and events, which are, in part at least, of a financial character, and interpreting the results thereof.”

# Valuation in Accounting





# Illustration – Valuation of a Machine

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Keshubhai, a cotton yarn manufacturer, purchased a machine paying cash Rs. 70,000. At which value do you record this transaction?

- **Historical Cost**
  - **Current (Replacement) Cost**
  - **Net Realizable Value**
  - **Present Value**
- Due to its many advantages, historical cost is the most used in the field of accounting



# 4 Types of Business Entities

	Sole Proprietorship	Partnership	Limited Liability Partnership	Company
Examples	M/s Ladduram & Sons	Balaji Industries	International Aviation & Airport Services LLP	Mukand Initiatives Private Limited; Tata Steel Limited
Owner	Sole Proprietor	Partners (only Individuals)	Partners (Individuals and corporate bodies)	Shareholders
No. of Shareholders	One Person	Minimum: 2	Minimum: 2	Min: 2 (Pvt); 7 (Public)
		Maximum: 100	Maximum: No Limit	Max: 100 (Pvt); No Limit (Public)

# Basic Framework of Accounting

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- ❑ Concept refers to an idea, a general notion, thought or assumption.
- ❑ Standards are something established for use as a rule, intended to act as a basis of comparison and reference in measuring, quantity, and or quality and assigning value
- ❑ Postulates are assumptions; they are taken to be true or real
- ❑ Principles refer to a law, the method or a rule of conduct.

Concepts  $\longleftrightarrow$  Standards  $\longleftrightarrow$  Postulates  $\longleftrightarrow$  Principles

# Generally Accepted Accounting Principles - GAAP

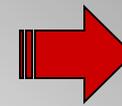
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- ❑ Combination of authoritative standards (set by policy boards) and the accepted ways of doing accounting
- ❑ Differs from country to country based on the accounting principles and standards adopted in that country
- ❑ Rules that business entities are expected to follow while preparing their financial statements



# Accounting Standards-setting Organization in Selected Countries

Country	Policy Setting Board
Australia	Australian Accounting Standards Board (AASB) sets GAAP
Canada	Canadian Accounting Standards Board (CASB) of the Canada Institute of Chartered Accountants (CICA) sets GAAP in Canada
India	Accounting Standards Board (ASB) of the Institute of Chartered Accountants of India (ICAI) is the body entrusted with the work of preparing the standards.
U.K.	Accounting Standards Board (ASB) is comprised of nine members drawn from different user groups.
U.S.A.	Financial Accounting Standards Board (FASB) is the body solely in charge of issuing standards.



## Interpreting GAAP and Accounting Standards

GAAP	Accounting Standards
Accounting practices holding sway in a country.	Authoritative standards (set by policy boards)
Country specific	International standards exist

Indian GAAP is to be followed in the pecking order of:

1. Postulates & Standards laid down by ICAI
2. Statements issued by the ICAI.
3. Guidance notes issued by the ICAI.
4. Expert Advisory opinions & monographs issued by the ICAI.

# Conceptual Basis

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- ❑ Concepts are essential ideas that permit the identification and classification of phenomena or other ideas
- ❑ A concept must state all that the given class includes and all that it excludes
- ❑ Formed primarily by observation and established through agreement

# Basic concepts of accounting – accepted as principles

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## □ Property Rights

- the right of accounting entities to possess and alienate property – value

## □ Business Entity

- the entity is separate and distinct from the owners and the entity is liable to the owner
- Hence, in a limited liability company, the enterprise is liable to the owner (shareholder) based on the proportion of the capital investment (share capital) made by the latter

# Concepts ...

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## □ Going Concern

- entities have a life of infinite duration, unless facts are known that indicate otherwise
- the basis of valuation of resources is influenced more by their future utility to the business entity than by their current market valuation

## □ Money Measurement

- Representation in a common denominator and amenable to summarization by addition & subtraction

# Accounting Concepts

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## Matching

- Determining the profits after charging the expenses of a period with the revenues earned in the same period

## Realization

- Determines the point of time when revenue and hence returns (or profits) can be recognized objectively, unbiased, and with certainty

## Consistency

- Once a choice is made for the treatment of a transaction, the same is consistently followed

# Concepts ...

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## □ Diversity among Independent Entities

- There are wide variations in the organization and operations of entities → requirements and demands are different

## □ Conservatism/ Prudence

- “Anticipate no gains, but provide for all possible losses” and “if in doubt, write it off”
- Results in an understatement of profits and values
- Close nexus with idea of ‘capital maintenance’

# Concepts ...

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## **Dependability of Data**

- Accounting entities ensure the standard of internal controls to ensure that the data used as the basis of accounting records are controlled to ensure their quality

## **Materiality**

- Necessitated by practicability and feasibility

## **Timeliness**

- The idea of accounting periods is used so as to ensure regularity and timeliness of reporting

# Accounting Policies

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- ❑ Specific accounting principles and the methods of applying these principles for the preparation and presentation of financial statements of an enterprise
- ❑ based upon the accounting concepts followed by the enterprise
- ❑ Areas of applicability
  - Valuation of Inventories, Fixed Assets, Investments
- ❑ Role of ICAI
  - Guidance Notes

# Objectives of Accounting

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- **Income determination**
  - For rational economic decision-making
- **Financial reporting**
  - Summarized as all those things of value owned by the entity and all the claims against these possessions
- **Disclosure**
  - All the relevant & pertinent information is supplied to the information users

# Purposes Of Accounting Information

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## Purposes of Accounting Information

```
graph TD; A[Purposes of Accounting Information] --> B[Score Keeping]; A --> C[Attention Directing]; A --> D[Problem Solving]; B --- B_desc[Reporting on the financial health]; C --- C_desc[Signaling the user about the need to take a decision]; D --- D_desc[Provision of such information that would enable to find solutions];
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Score  
Keeping

Reporting on  
the financial  
health

Attention  
Directing

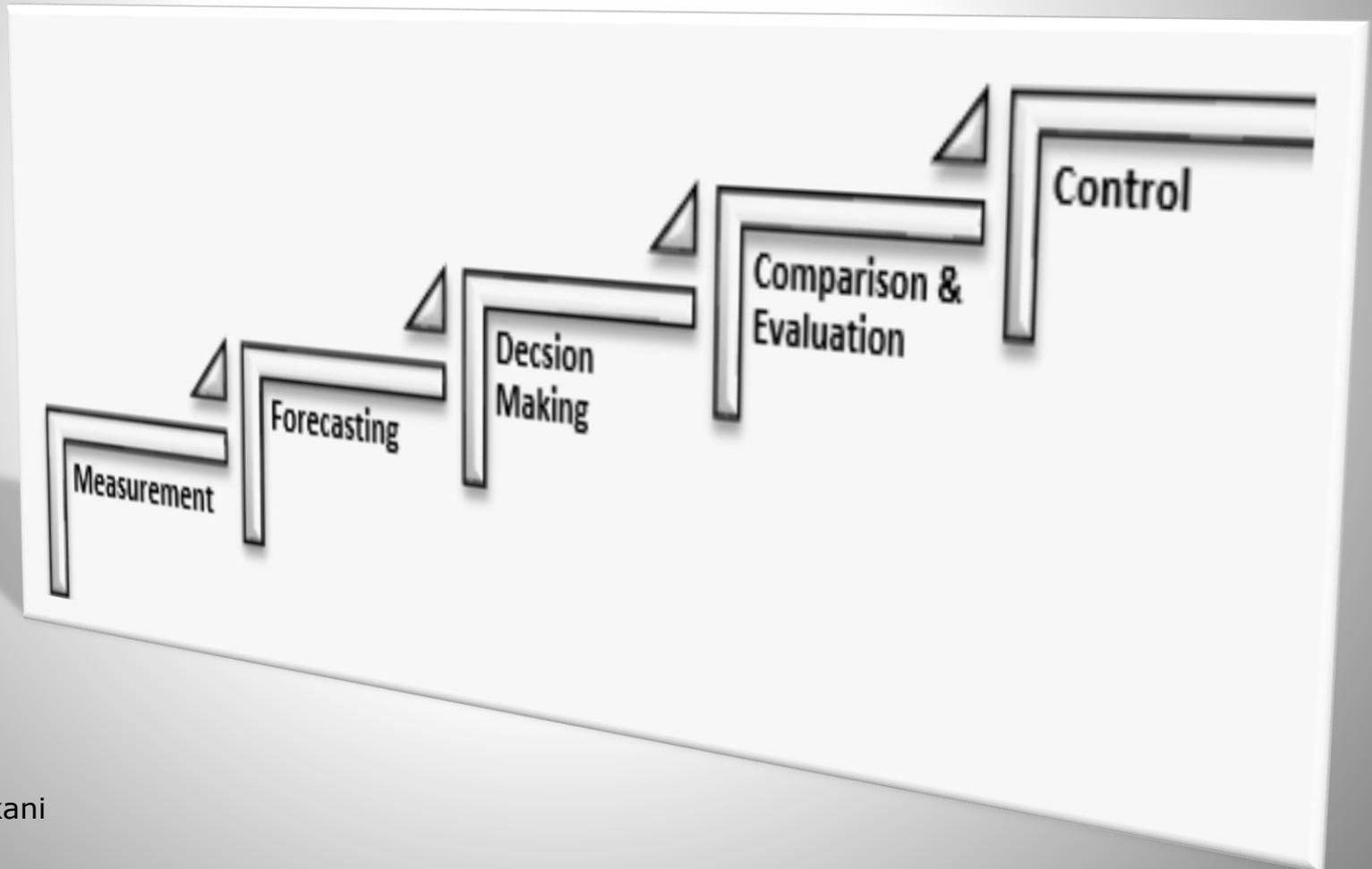
Signaling the user about  
the need to take a  
decision

Problem  
Solving

Provision of such  
information that would  
enable to find solutions

# Functions of Accounting

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# Accounting & Management Control

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- Control means the process of keeping the organization in course
  - This involves measurement through the control system
  - The controller (accountant) and managers obtain information, which enables them to diagnose the situation

# Illustration on using Accounting Information

- A firm sells three products P1, P2, P3. Profit of the firm is declining

	Year 1	Year 2
Sales	Rs 1,000	Rs 1,000
Less: cost of goods sold	400	500
Gross margin	600	500
Less: Depreciation	200	200
Other operating expenses	100	100
Profit	Rs 300	Rs 200



# Illustration...

## The Problem:

- Decrease in profits during the period - as a result of overall increase in the cost of goods sold

## Now, which product is losing money?

	Year 1			Year 2		
	P1	P2	P3	P1	P2	P3
Sales	300	300	400	400	400	200
Less: COGS	150	150	100	200	200	100
<b>Gross margin</b>	<b>150</b>	<b>150</b>	<b>300</b>	<b>200</b>	<b>200</b>	<b>100</b>

Sales of P3 have decreased.

Cost of sales to sales of P3 has doubled

# Accounting Information users

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- Stakeholders are the ones who have an interest in what happens as a result of the entities activities
- Stakeholders classified as
  - Internal users viz., managers
  - External users viz., creditors, equity investors, government, and society

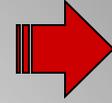
# Class Discussion...

<b>Stakeholder</b>	<b>Area of interest</b>
<b>Government</b>	Tax liabilities of the firm
<b>Unions &amp; staff</b>	Potential for pay awards and bonus deals
<b>Public/Society</b>	Ethical & environmental activities of the firm
<b>Lenders</b>	Whether the firm is has a long-term future
<b>Shareholders</b>	Profitability and share performance
<b>Customers</b>	Ability of the firm to carry on providing a service or producing a product

Note: These should not be regarded as the 'only' answers

# Flipkart and its Stakeholders

<b>Stakeholder</b>	<b>Would be interested due to</b>
Government & its agencies	Income tax & other tax liabilities
Top Managers, Workers, Unions	Potential for pay hikes, bonus, and incentives
Public	Ethical and environmental activities
Long-term Lenders, Present & Potential Shareholders	Whether the firm has a long-term future
Fund managers & Analysts	Profitability & share performance
Customer	Ability to take a bigger order, etc
Supplier & Other Creditors	Whether to offer the firm credit and if so, terms



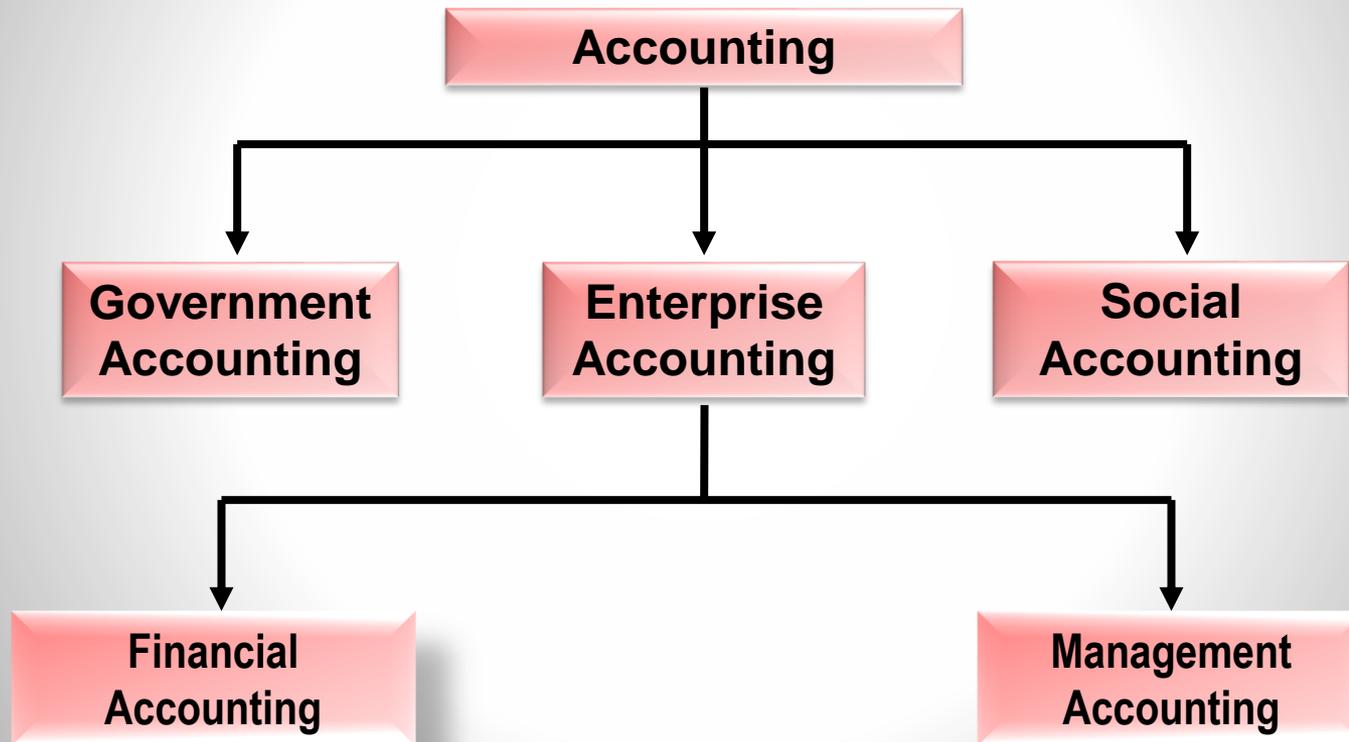
# IASB and Need for IFRS

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- ❑ In last three decades, efforts to make accounting information more useful have increased ...
- ❑ Leading to the creation of IASB ... a body consisting of members from many countries.
- ❑ The IASB proposed a 'convergence' concept with a hope that similar economic transactions should result in similar accounting approach (across different jurisdictions)
- ❑ Leading to a series of standards, known as, the IFRS
- ❑ As per the notification of the Gol, Ministry of Corporate Affairs in Feb. 2015, Ind AS shall come into force on 1 April 2015 but is optional for adoption whereas made mandatory from 1 April 2016.

# Branches of Accounting

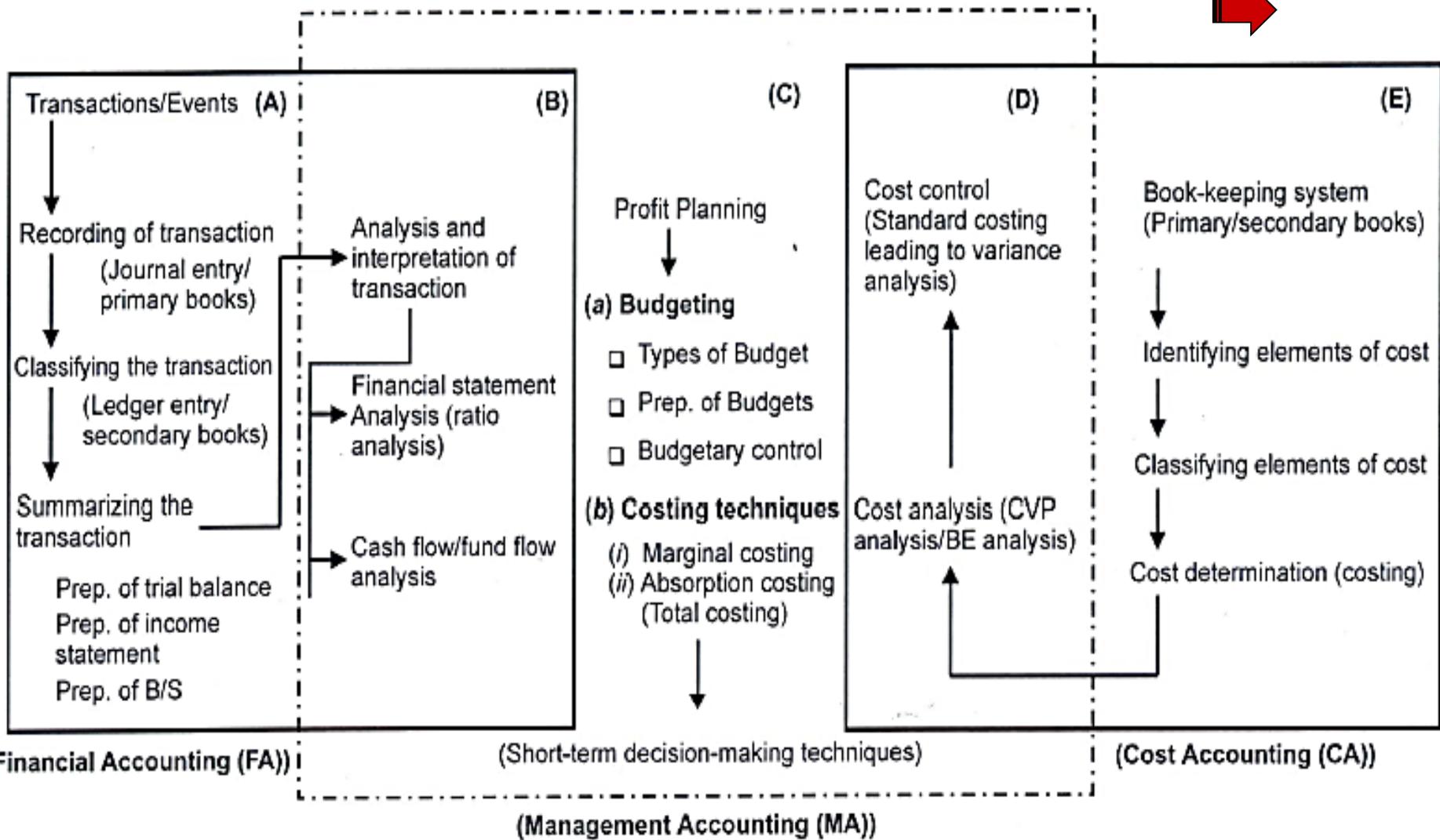
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# Enterprise Accounting

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- Specifically addresses issues of measurement and valuation in the context of business enterprises
- Has evolved into two disciplines
  - Financial Accounting
    - Providing financial information relating to the entity to 'outsiders'
  - Management/Cost Accounting
    - Reporting the activities of the entity to managers so as to enable them to plan and control the activities of the entity vis-à-vis other competing entities



- (A): Information flow exclusive to financial accounting
- (B): Information flow common to both financial accounting and management accounting
- (C): Information flow exclusive to management accounting
- (D): Information flow common to both management accounting and cost accounting
- (E): Information flow exclusive to cost accounting

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Thank You

