DEPARTMENT OF COMMERCE AND FINANCIAL STUDIES
BHARATHIDASAN UNIVERSITY, TIRUCHIRAPPALLI – 620024
MBA (Financial Management)

Course Code and Name: FMCC1-ACCOUNTING FOR DECISION MAKING

Unit –I/Topic: INTRODUCTION TO FINANCIAL ACCOUNTING

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Introduction to Financial Accounting (Content)

-Accounting Principles

-concepts and conventions

-Journal

-Ledger

-Trial Balance

-Adjustments

-Final accounts of a Sole Trader

-Profit and Loss Account

-Balance Sheet

-Company Final Accounts as per the New Companies Act Schedule III

Accounting Principles

What is an account?

An account is a clear record of transactions affecting a person, an asset, a liability, an expense or an income.

How will you classify a/cs?

Accounts may be classified into (i)Personal and (ii)Impersonal accounts. It can again be classified into (a)Real a/c and (b)Nominal a/c.

(i)personal a/c:- Accounts of Individuals, business firms, bank and proprietor will come under this class.

Example:-Rama's a/c ; Krishna's a/c ; Indian bank a/c ; Proprietor's capital a/c ; proprietor's Drawings a/c ; BHEL a/c;

(ii)Real a/c:- This includes accounts of assets-i.e, properties-

Example:- Land and Buildings a/c, cash a/c ; Plant and machinery a/c, Furniture a/c

(iii)Nominal a/c:- This includes the accounts of all expenses and incomes

Example:- Salaries a/c; wages a/c, Rent paid a/c ; Rent received a/c; Interest received a/c

Format of an Account

Give the format of an account.

An a/c has two sides-debit side- noted by Dr. and credit side- noted by Cr.

The proforma of an a/c is as follows:-

Dr. Cr.

Date	Particulars	Journal Folio(JF)	Amount Rs.	Date	Particulars	Journal Folio(JF)	Amount Rs.

Definition of Accounting.

The term Accounting may be defined as “The art of classifying. recording, and summarizing the business transactions in a set of books according to the set principles of accounting.”

Rules for journalising the transactions

Rules of Journalising the transactions are:-

Type of a/c	DEBIT	CREDIT
Personal a/c	The receiver	The giver
Real a/c	What comes in	What goes out
Nominal a/c	Expenses and Losses	Incomes and Gains

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Journal, Ledger, Accounting Concepts, Conventions

Journal:

Journal is a book of prime entry. All business transactions are first recorded in this book only.

Ledger:

A Ledger is a book which contains many accounts

Accounting Concepts and Accounting Conventions

Accounting concepts :-

1.Separate Entity concept

2.Money Measurement concept

3.Going concern concept

4.Cost concept

5.Dual aspect concept

6.Realisation concept

7.Accounting period concept

8.Matching cost and revenue concept 9. Accrual Concept, 10. Legal aspect concept

Accounting conventions:-

1.Convertism 2.Materiability 3.Disclosure4.Consistency.

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Generally Accepted Accounting Principles

It refers to a specific set of guidelines for publicly-traded companies financial statements. It is made up of 10 basic accounting principles. They are:

1.Economic Entity Assumption
2.Monetary Unit Assumption
3.Time Period Assumption
4.Cost Principle
5.Full Disclosure Principle
6.Going Concern Principle
7.Matching Principle
8.Revenue Recognition Principle
9.Materiality
10.Conservatism

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Generally Accepted Accounting Principles

1. The **economic entity assumption** means any activities of a business must be kept separate from the activities of the business owner.

2. The **monetary unit assumption** means only activities that can be expressed in amounts can be included in accounting records.

3. The **time period assumption** means business activities can be reported in distinct time intervals. These intervals may be in weeks, months, quarters, or in a fiscal year. Whatever the time period is, it must be identified in the financial statement dates.

4. The **cost principle** refers to the historical cost of an item that is reported on the financial statements. Historical cost is the amount of money that was paid for an item when purchased and is not changed to account for inflation.

5. The **full disclosure principle** means all information that is relative to the business be reported either in the content of the financial statements or in the notes to the financial statements.

6. The **going concern principle** refers to the intent of a business to continue operations into the foreseeable future and not to liquidate the business.

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Generally Accepted Accounting Principles

7. The **matching principle** refers to the manner in which a business reports income and expenses. This principle requires that businesses use the accrual form of accounting and **match business income to business expenses in a given time period. For example, a sales** expense should be recorded in the same accounting period that sales income was made.

8. The **revenue recognition principle** addresses the manner in which revenue, or income, is recognized. This standard requires that revenue be reported on the income statement in the period in which it is earned.

9. The **materiality principle** refers to the measure of importance of a misstatement in accounting records. This is a gray area in accounting standards that requires professional judgment to be used.

10. The last principle is **conservatism**. Conservatism is the principle that calls for potential expenses and liabilities to be recognized immediately if you are unsure whether they will actually occur or not, but potential revenue not to be recognized until it is actually received.

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Trial balance, Trading a/c, Profit and Loss a/c

- ❑A Trial balance is a list of balances of ledger a/cs and cash book of a concern as on a given date.
- ❑A trading a/c is an account which shows the sales, cost of goods sold and Gross Profit.
- ❑Profit and Loss a/c is an account prepared at the end of an accounting period to know the profits earned or loss sustained in a business.

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Balance Sheet, Schedule III

A Balance sheet is a statement showing the assets and liabilities of a business as on a given date.

Schedule III of the Company's Act, 2013 shows the format of a Company's Balance Sheet and statement of Profit and Loss a/c. All listed companies have to submit their financial statements only ONLINE by using a software language called XBRL.

Adjustments

An **accounting adjustment** is a business transaction that has not yet been included in the **accounting** records of a business as of a specific date. Most transactions are eventually recorded through the recordation of (for example) a supplier invoice, a customer billing, or the receipt of cash.

Final accounts of a sole trader

We are now at the stage where we can draw up the **final accounts of a sole trader** from the trial balance. The **final accounts** are the profit and loss **account** and the **balance sheet**. This is a crucial stage in the **accounting** process.

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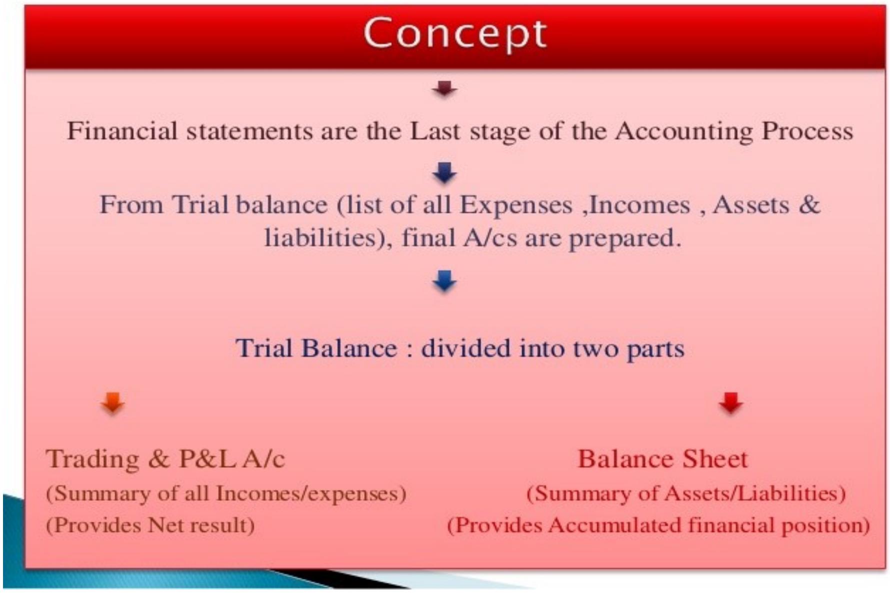

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Profit and Loss Account

An account in the books of an organization to which incomes and gains are credited and expenses and losses debited, so as to show the net profit or loss over a given period.

A financial statement showing a company's net profit or loss in a given period.

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'Profit and Loss Statement (P&L)'

- The profit and loss statement is a financial statement that summarizes the revenues, costs and expenses incurred during a specified period, usually a fiscal quarter or year.
- P&L statement is synonymous with the income statement. These records provide information about a company's ability or inability to generate profit by increasing revenue, reducing costs or both.
- Some refer to the P&L statement as a statement of profit and loss, income statement, statement of operations, statement of financial results or income, earnings statement and expense statement

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Balance sheet

A statement of the assets, liabilities, and capital of a business or other organization at a particular point in time, detailing the balance of income and expenditure over the preceding period.

The balance sheet is one of the three fundamental financial statements and is key to both financial modeling and accounting. The balance sheet displays the company's total assets, and how these assets are financed, through either debt or equity. It can also sometimes be referred to as a statement of net worth, or a statement of financial position. The balance sheet is based on the fundamental equation: **Assets = Liabilities + Equity**.

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Example Balance Sheet

Below is an example of Amazon's 2017 balance sheet. As you will see, it starts with current assets, then non-current assets and total assets. Below that is liabilities and stockholders' equity which includes current liabilities, non-current liabilities, and finally shareholders' equity.

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AMAZON.COM, INC.
CONSOLIDATED BALANCE SHEETS
(in millions, except per share data)

	December 31, 2016	December 31, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	$ 19,334	$ 20,522
Marketable securities	6,647	10,464
Inventories	11,461	16,047
Accounts receivable, net and other	8,339	13,164
Total current assets	45,781	60,197
Property and equipment, net	29,114	48,866
Goodwill	3,784	13,350
Other assets	4,723	8,897
Total assets	$ 83,402	$ 131,310
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 25,309	$ 34,616
Accrued expenses and other	13,739	18,170
Unearned revenue	4,768	5,097
Total current liabilities	43,816	57,883
Long-term debt	7,694	24,743
Other long-term liabilities	12,607	20,975
Commitments and contingencies (Note 7)		
Stockholders' equity:		
Preferred stock, $0.01 par value:		
Authorized shares — 500		
Issued and outstanding shares — none	—	—
Common stock, $0.01 par value:		
Authorized shares — 5,000		
Issued shares — 500 and 507		
Outstanding shares — 477 and 484	5	5
Treasury stock, at cost	(1,837)	(1,837)
Additional paid-in capital	17,186	21,389
Accumulated other comprehensive loss	(985)	(484)
Retained earnings	4,916	8,636
Total stockholders' equity	19,285	27,709
Total liabilities and stockholders' equity	$ 83,402	$ 131,310

See accompanying notes to consolidated financial statements.

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Company Final Accounts as per the new Companies Act Schedule III

Schedule III (See section 129) GENERAL INSTRUCTION FOR PREPARATION OF BALANCE SHEET AND STATEMENT OF PROFIT AND LOSS OF A COMPANY

GENERAL INSTRUCTIONS

- Where compliance with the requirements of the Act including Accounting Standards as applicable to the companies require any change in treatment or disclosure including addition, amendment, substitution or deletion in the head or sub-head or any changes, in the financial statements or statements forming part thereof, the same shall be made and the requirements of this Schedule shall stand modified accordingly.

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Accounting Standards

- Accounting Standards are written policy document issued by expert accounting body or by government or regulatory body covering the aspects of recognition, treatment, measurement, presentation and disclosure of accounting transaction and events in the financial statements.
- Accounting Standards (ASs) provide framework and standard accounting policies so that financial statements of different enterprises become comparable.

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Accounting Standards

- The Accounting Standards seek to ensure that the financial statements of an enterprise should give a true and fair view of its financial position and working results.
- The Accounting Standards not only prescribe appropriate accounting treatment of complex business transactions but also foster greater transparency and market discipline.

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Purpose of Accounting Standards

- Uniformity.
- Rationalization.
- Comparability.
- Transparency

Accounting Standards in India

- The Institute of Chartered Accountants of India (ICAI) being apex accounting body in India, constituted the Accounting Standards Board (ASB) on 21st April, 1977, with a view to harmonies the diverse accounting policies and practices in use in India.
- In accordance with India's assurance to converge with IFRS, the Ministry of Corporate Affairs (MCA) issued a press release on 25 February 2011, notifying the Ind AS (Indian Accounting Standards).

- Ind AS 101: First-time Adoption of Indian Accounting Standards.
- Ind AS 102: Share based Payment.
- Ind AS 103: Business Combinations.
- Ind AS 104: Insurance Contracts.
- Ind AS 105: Non current Assets Held for Sale and Discontinued Operations.
- Ind AS 106: Exploration for and Evaluation of Mineral Resources.
- Ind AS 107: Financial Instruments: Disclosures.
- Ind AS 108: Operating Segments.

- Ind AS 1: Presentation of Financial Statements.
- Ind AS 2: Inventories.
- Ind AS 7: Statement of Cash Flows.
- Ind AS 8: Accounting Policies, Changes in Accounting Estimates and Errors.
- Ind AS 10: Events after the Reporting Period.
- Ind AS 11: Construction Contracts.
- Ind AS 12: Income Taxes.
- Ind AS 16: Property, Plant and Equipment.
- Ind AS 17: Leases.
- Ind AS 18: Revenue.
- Ind AS 19: Employee Benefits.
- Ind AS 20: Accounting for Government Grants and Disclosure of Government Assistance.

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- Ind AS 21: The Effects of Changes in Foreign Exchange Rate.
- Ind AS 23: Borrowing Costs.
- Ind AS 24: Related Party Disclosures.
- Ind AS 27: Consolidated and Separate Financial Statements.
- Ind AS 28: Investments in Associates.
- Ind AS 29: Financial Reporting in Hyperinflationary Economies.
- Ind AS 31: Interests in Joint Ventures.
- Ind AS 32: Financial Instruments: Presentation.
- Ind AS 33: Earnings per Share.
- Ind AS 34: Interim Financial Reporting.
- Ind AS 36: Impairment of Assets.
- Ind AS 37: Provisions, Contingent Liabilities and Contingent Assets.
- Ind AS 38: Intangible Assets.
- Ind AS 39: Financial Instruments: Recognition and Measurement.
- Ind AS 40: Investment Property.

International Accounting Standards

- International Accounting Standards (IAS) International Accounting Standards Committee (IASC) was constituted in 1973 to formulate accounting standards.
- Barring Canada, Japan and US all countries have accepted these standards.
- To give proper direction and interpretations Standards Interpretations Committee was formed in 1997.
- IASB was constituted in 2001 to prescribe norms for treatment of several items on preparation and presentation of Financial statements.

International Accounting Standards

- ISAB adopted all 41 standards issued by IASC. The US Financial Accounting Standards Board (FASB) and IASB are in process of eliminating differing in some standards.
- IASB publishes its Standards in a series of pronouncements called International Financial Reporting Standards (IFRSs).
- It has also adopted the body of Standards issued by the Board of the International Accounting Standards Committee (IASC).
- Those pronouncements are designated "International Accounting Standards" (IASs).

IASs:

- IAS 1 Presentation of Financial Statements.
- IAS 2 Inventories.
- IAS 7 Cash Flow Statements.
- IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors.
- IAS 10 Events After the Balance Sheet Date.
- IAS 11 Construction Contracts.
- IAS 12 Income Taxes.

- IAS 16 Property,Plant and Equipment.
- IAS 17 Leases.
- IAS 18 Revenue.
- IAS 19 Employee Benefits.
- IAS 20 Accounting for Government Grants and Disclosure of Government Assistance.
- IAS 21 The Effects of Changes in Foreign Exchange Rates.
- IAS 23 Borrowing Costs.
- IAS 24 Related Party Disclosures.

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- IAS 26 Accounting and Reporting by Retirement Benefit Plans.
- IAS 27 Consolidated and Separate Financial Statements.
- IAS 28 Investments in Associates.
- IAS 29 Financial Reporting in Hyperinflationary Economies.
- IAS 31 Interests in Joint Ventures.
- IAS 32 Financial Instruments: Presentation.
- IAS 33 Earnings per Share.
- IAS 34 Interim Financial Reporting.
- IAS 36 Impairment of Assets.
- IAS 37 Provisions, Contingent Liabilities and Contingent Assets.
- IAS 38 Intangible Assets.
- IAS 39 Financial Instruments: Recognition and Measurement.
- IAS 40 Investment Property.
- IAS 41 Agriculture.

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GAAP

- To avoid confusion and to achieve uniformity, accounting process is applied within the conceptual framework of 'Generally Accepted Accounting Principles' (GAAP).
- The Financial Statements of entity cannot be said to be showing a true and fair view, unless these Financial Statements have been drawn up on GAAP.

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GAAP

- GAAP consist of four components.
- The requirements of law.
- The judgments by courts of law.
- Pronouncement by the governing bodies (Like ICAI, FASB in US).
- Requirements of regulatory authority (Like RBI, SEBI, SEC in US).
- GAAPs are the backbone of the accounting information system, without which whole system cannot even stand erectly.
- GAAPs and Accounting Standard are considered as the theory base of accounting.

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IFRS International Financial Reporting Standards

- This term refers to the financial standard issued by International Accounting standards Board (IASB).
- It is the process of improving the financial reporting internationally to help participants in the various capital markets of the world and Other Users.

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The International Accounting Standards Board (IASB)

- IASB is an independent body formed in 2001 with the sole responsibility of establishing the International Financial Reporting Standards (IFRS).
- It succeeded the International Accounting Standards Committee (IASC), which was earlier given the responsibility of establishing the international accounting standards.
- IASB is based in London. It has also provided the 'Conceptual Framework for Financial Reporting' issued in September 2010 which provides a conceptual understanding and the basis of the accounting practices under IFRS.

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IFRS Based financial Statements

- Following financial statements are produced under IFRS:
- 1. Statement of financial position: The elements of this statement are
- (a) Assets (b) Liability (c) Equity
- 2.Comprehensive Income statement: The elements of this statement are
- (a) Revenue (b) Expense
- 3. Statement of changes in Equity
- 4. Statement of Cash flow
- 5. Notes and significant accounting policies

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IFRS and IAS (Indian Accounting Standards)

- IFRS are principle based while IAS are rule based.
- IFRS are based on Fair Value while IAS are based on Historical Cost.

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Standard No.	Standard Title
IFRS 1	First-time Adoption of International Financial Reporting Standards
IFRS 2	Share-based Payment
IFRS 3	Business Combinations
IFRS 4	Insurance Contracts
IFRS 5	Non-current Assets Held for Sale and Discontinue Operations
IFRS 6	Exploration and Evaluation of Mineral Resources

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IFRS 7	Financial Instruments: Disclosures
IFRS 8	Operating Segments
IFRS 9	Financial Instruments
IFRS 10	Consolidated Financial Statements
IFRS 11	Joint Arrangements
IFRS 12	Disclosure of Interests in Other Entities
IFRS 13	Fair Value Measurement
IFRS 14	Regulatory Deferral Accounts

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IFRS 15	Revenue from Contracts with Customers
IFRS 16	Leases
IFRS 17	Insurance Contracts

FASB

- Established in 1973, the Financial Accounting Standards Board (FASB) is the independent, private- sector, not-for-profit organization based in Norwalk, Connecticut, that establishes financial accounting and reporting standards for public and private companies and not-for-profit organizations that follow Generally Accepted Accounting Principles (GAAP).

FASB

- The FASB derives its authority to set accounting standards from the U.S. Securities and Exchange Commission (SEC).
- The standards issued by the FASB are officially recognized as authoritative by the SEC, as well as the American Institute of Certified Public Accountants (AICPA).
- Investors, lenders, and other users of financial information rely on financial reporting based on U.S. GAAP to make decisions about how they allocate their capital and to help financial markets operate as efficiently as possible.

FASB

- The mission of the FASB is to establish and improve financial accounting and reporting standards to provide decision-useful information to investors and other users of financial reports.

Securities and Exchange Commission (SEC

- In the United States, the public capital markets are regulated primarily by the US Securities and Exchange Commission (SEC), a national government agency.
- The law gives the SEC the authority to prescribe the form and content of financial statements filed with the Commission.
- Historically, the Commission has looked to the private sector to develop financial reporting standards, though the Commission does prescribe financial statement presentation formats and disclosures and, sometimes, accounting recognition and measurement principles as well.

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SEC

- Accounting and auditing documents issued by the SEC include:
- Regulation S-X (17 C.F.R. Part 210) (governs financial statement presentation and disclosure in SEC filings)
- Staff Accounting Bulletins (SAB) (provide guidance on the SEC's views regarding the proper application of accounting standards in public company disclosures)
- Accounting and Auditing Enforcement Releases (documents related to administrative enforcement proceedings the SEC initiates against persons who have allegedly violated accounting standards in financial statements submitted to the SEC under the federal securities laws)

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Internal Revenue Service

- The Internal Revenue Service (IRS) is a U.S. government agency that is mainly accountable for getting taxes and putting in place tax laws (such as the wash sale rule).
- Founded in 1862 by President Abraham Lincoln, the agency works under the authority of the United States Department of the Treasury, and its principal purpose includes the collection of individual income taxes and employment taxes.
- The IRS also manages corporate, gift, excise, and estate taxes, including mutual funds and dividends.

IRS

- Headquartered in Washington, D.C., the IRS preserves the taxation of all American individuals and companies.
- For the 2019 financial year (October 1, 2018, through September 30, 2019), it prepared more than 250 million income tax returns and additional forms.
- During that time, the IRS collected more than $3.5 trillion in revenue and issued more than $452 billion in tax refunds.
- Individuals and corporations have the benefit to file income returns electronically, thanks to computer technology, software programs, and reliable internet connections.
- The amount of income taxes that use e-file has increased steadily since the IRS began the program, and now the remarkable majority are filed this way.

Accounting for Carbon Credit

- A Carbon Credit is equal to one ton of carbon dioxide expelled in the atmosphere.
- The concept came into existence as a result of increasing awareness on the need for pollution control.
- It became formal after the agreement among 141 nations known as KYOTO PROTOCOL.
- Carbon Credits are the certificates awarded to the countries taking active participation in reducing the emissions that cause global warming.

Accounting for Carbon Credit

- As per the KYOTO PROTOCOL, developing as well as the least developed countries are not bound by the emissions they produce.
- For the developed nation, to meet the assigned reduction targets, allowances have been issued equal to the number of emissions allowed.

Market Based Mechanism

- For attaining these objectives, three market-based mechanisms have been provided by the Kyoto protocol:
  - Joint Implementation
  - Clean Development Mechanism
  - International Emission Trading

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Joint Implementation

- Developed nations with the very high cost of domestic Green House Gases (GHG) reduction, have an option of the joint implementation.
- They can set up a project in another developed country which has a relatively lower cost.
- In this way, a developed country can earn carbon credits that can be applied during excessive emission targets.

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Clean Development Mechanism

- Developed nations can take up GHG reduction project activity in a developing nation.
- The cost of GHG reduction is usually much lower, and the developed country would be given carbon credit for meeting emission reduction targets.

International Emission Trading

- A developed country with emission reduction targets could trade in the international carbon credit market.
- Developed countries exceeding the emission limits can buy the carbon credit for those whose actual emissions are less than the emission limit.
- Carbon Credits can be exchanged between businesses in the international market at the prevailing market price.

- **What is Emissions Trading Scheme?**
- An ETS is a framework that works by setting a limit on emissions.
- It also requires emitters to obtain a permit for a level of emissions.
- The level of the limit here is a determining factor to the number of permits available.
- In this case, if emitters do not have a permit, it is required of them to cut back on the level of emissions.
- They could alternatively purchase a permit from someone, who must then stop the emissions.
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Emission Trading

- The cost of emissions in ETS equals the price of selling or buying a permit.
- It should, however, be noted that the level of emissions is determined by the cap, hence the price is caused by the cuts on emissions.
- The price does not cause the overall limits in emissions.

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