

Financial Training College Pakistan

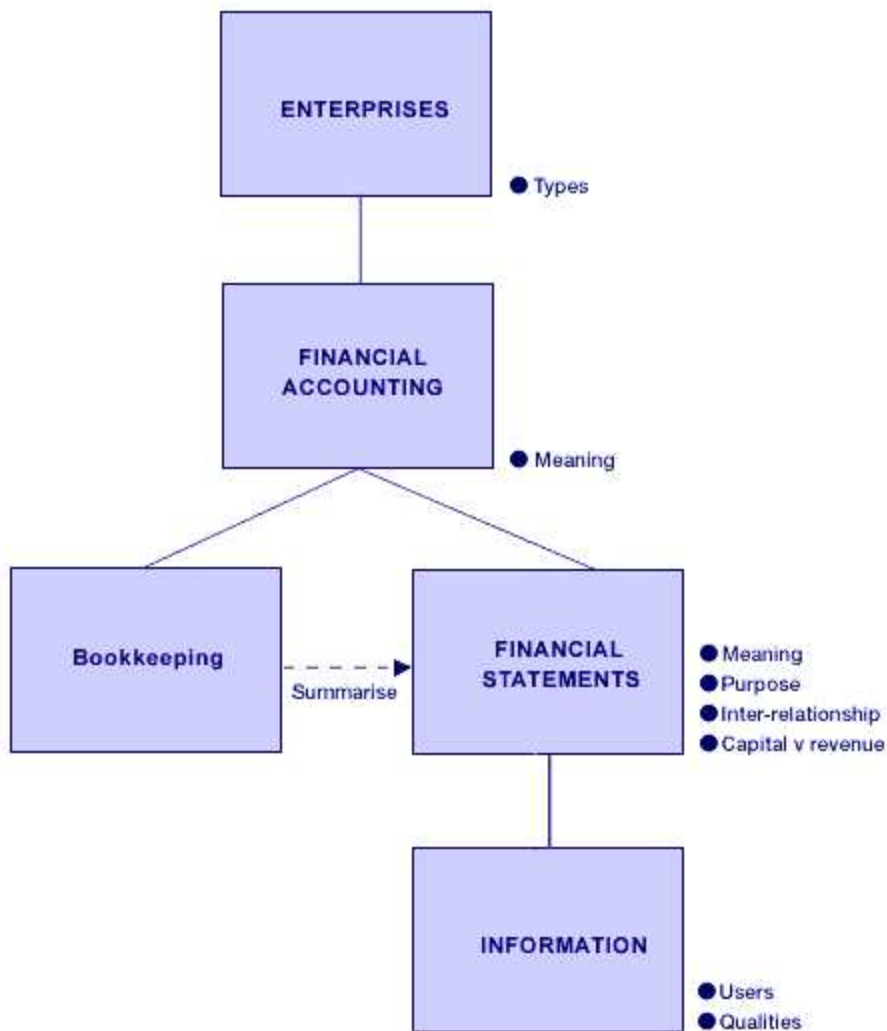
Lecture Notes on C-1 & 1.1 - Introduction to Accounting

Developed by FT Faculty Experts for ACCA & CAT Students

INTRODUCTION TO ACCOUNTING

Overview

- To introduce users of financial accounting information.



Enterprises

- Sole trader: An enterprise owned and run by the same single person.
- Partnership: An enterprise owned and run by more than one person with a common view to making profit.
- Incorporated ("Company"): A separate legal entity owned by *shareholders* who appoint directors (managers) to run it. Is subject to statutory regulation (eg Companies Acts)

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Financial Accounting

Meaning

- | Classification and recording of actual transactions in monetary terms.
- | Presentation of the results of transactions and financial position in accordance with established concepts, principles, accounting standards and statutory requirements.

Financial Statements

Meaning

Components

- | Balancesheet (BS) – a statement of assets and liabilities
- | Income statement (IS) (or income and expenditure account or profit and loss account) – a summary of transactions and events
- | A statement of changes in equity
- | Cash flow statement (CFS) – a classification of cash flows
- | Accounting policies and explanatory notes.

Non-financial statements

Financial review (by management)
Chairman's statement
Directors' report
Employee reports
Five-year financial record
Analysis of commercial properties
Environmental reports
Value-added statements.

Purpose

- | To provide *information* about
 - Financial position (eg solvency) \Rightarrow BS
 - Financial performance (eg profitability) \Rightarrow IS
 - Cash flows \Rightarrow CFS
- } *Most relevant to IBK*

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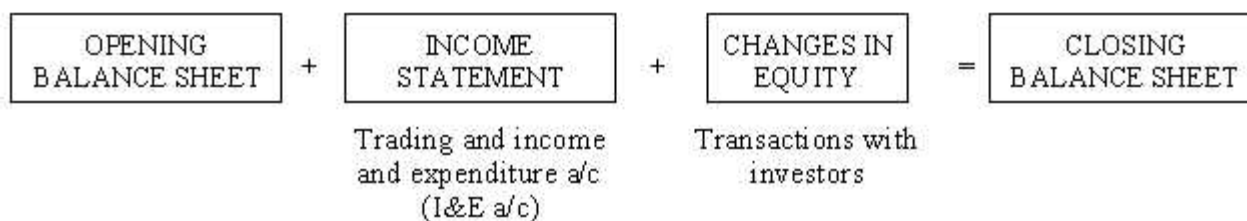
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- | Financial statements also show the results of management's stewardship (ie management's accountability for the resources entrusted to it).
- | To meet this objective financial statements provide information about
 - assets
 - liabilities
 - equity
 - income and expenses
 - cash flows.

Inter-relationship



Capital Expenditure V Revenue Expenditure



- Incurred in acquiring property and plant intended for long-term use (benefits future accounting periods) increasing revenue-earning capacity of existing non-current asset (by increasing efficiency or useful life).
- Incurred in daily running of business, eg in buying or manufacturing goods and providing services selling and distributing goods administration repairing long-term assets.

Example

Classify the following items of expenditure as capital or revenue:

- (i) \$27,000 on a new car
- (ii) \$1,800 road tax incorporated in the purchase price of (i)
- (iii) \$10,000 on a second hand delivery van

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- (iv) \$12,000 on refurbishing (iii)
- (v) \$1,000 monthly rental of a vehicle.

Solution

- (i) Capital
- (ii) Revenue – road tax is an annual running cost
- (iii) Capital – that the asset acquired is second hand is irrelevant
- (iv) Capital – "refurbish" means renovate which suggests that the useful life of the existing asset is increased. In this case the expenditure may be incurred to bring the asset to use in the business (certainly capital).
- (v) Revenue – a rented asset is not owned.

Information

Uses

- | Investors (owners) and their advisers
- | Employees and their representatives
- | Lenders (eg banks)
- | Suppliers and other trade creditors
- | Customers
- | Governments and their agencies (eg tax authorities)
- | Public
- | Management

Information needs

- | Providers of capital are concerned with the risk and return of their investment. They need information for decision-making (buy, hold or sell?) to assess the enterprise's ability to pay dividends
- | Stability and profitability of employers
Ability to provide remuneration, retirement benefits and employment opportunities
- | Whether loans and interest will be paid when due
- | Whether amounts owing will be paid when due
- | Continuance – important for long-term involvement with, or dependence on, the enterprise
- | Allocation of resources and, therefore, activities of enterprises
Information to regulate activities, determine taxation policies and as the basis for national income and similar statistics
- | Contribution to local economy including number of employees and patronage of local suppliers
Trends and recent developments in prosperity and range of activities
- | To plan, make decisions and control operational activities.

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Qualities

- | Relevant – otherwise it is useless
- | Reliable – ie complete, accurate and objective (*see below*)
- | Complete – for the purpose(s) for which it is intended
- | Accurate – so that users have confidence in it
- | Objective – without bias
- | Comparable – essential for making comparisons
- | Cost effective – cost of preparation should be less than value obtained from it
- | User-friendly – understandable and clear
- | Concise – discriminating and ignoring trivia
- | Timely.