Vietsourcing
Vượt trội để thành công

CHAPTER 1

Introduction to accounting

INTRODUCTION TO ACCOUNTING

Topic list

- The purpose of accounting information
- The regulation of accounting
- The main financial statements
- Capital and revenue items
- Qualitative characteristics of useful accounting information
- Accounting concepts and conventions
- Sustainability standards
- Ethical consideration

INTRODUCTION TO ACCOUNTING

What is accounting?

Accounting is a way of **recording**, **analyzing** and **summarizing** transactions of an entity

Transactions

recorded in books of original entry

analyzed and posted to the ledgers

summaried in the financial statements

INTRODUCTION TO ACCOUNTING

Types of business

- Types of business organization
  - Sole traders
  - Partnerships
  - Limited liability companies

INTRODUCTION TO ACCOUNTING

Types of business

- Sole trader: who work for themselves
- Partnerships: two or more people decided to share the risks and rewards of a business together
- Limited liability companies: incorporate to take advantage of: limited liability for their owners

INTRODUCTION TO ACCOUNTING

Types of business – Partnership

INTRODUCTION TO ACCOUNTING

Types of business - Soles trader

Advantages	Disadvantages
• It leaves full control in the hand of the owner	• Limited means of financing
• The sole proprietor receives all profits left after expenses are paid.	• Limited ideas
• The sole proprietor receives all profits from his business. This gives him more incentives to make his business grow	• The sole proprietor is responsible for all losses
	• The sole proprietor faces unlimited liability

INTRODUCTION TO ACCOUNTING

Types of business - Partnerships

Advantages	Disadvantages
The ability to raise more money	The need to obtain the agreement of many if not all partner for the obligations of the company
More potential for ideas and innovation	Limited liability of the partners for the obligation of the company
The ability to divide losses among all of the partners	It may lead to dissolution • death of partner • bankrupt • insanity
The ability to share workload among all of the partners	Partnership lacks stability. To continue its operation, a complete reorganization is needed

INTRODUCTION TO ACCOUNTING

Types of business - Limited company

Advantages

- Status
- More money
- Employees receive benefits
- Exist after the owner has passed
- Limited liability

Disadvantage

- Expensive to start up
- Employees income is more heavily taxed
- Shareholders pay taxes

INTRODUCTION TO ACCOUNTING

Objective of financial statements

- Provide information about:
  - financial position, financial performance,
  - cash flow statement, and changes in equity of an enterprise.
- The information contained in financial statements are useful to a wide range of **users in making economic decisions**.
  - The economic resources of an entity (eg, its cash and other assets), claims against the entity (eg, its liabilities) and changes in those resources and claims.
  - How efficiently and effectively the entity's management have discharged their responsibilities relating to the management of the entity's resources
  - HMRC will receive information to make tax assessments.
  - A bank might demand a cash flow forecast as a pre-condition of granting an overdraf

INTRODUCTION TO ACCOUNTING

User of financial statement

- The public
- Lenders
- Other creditors
- Government agencies
- Bodies
- Financial analysts & advisers
- Employees
- HM Revenue & Customs (HMRC)
- Finance provider
- Trade contacts
- Owners
- Managers/ Director

Interactive question 1: Accounting information

INTRODUCTION TO ACCOUNTING

Interactive question 1: Accounting information

It is easy to see how 'internal' stakeholders access accounting information. A manager, for example, can just go along to the accounts department and ask the staff there to prepare whatever accounting statements she needs, but external users of accounts cannot do this.

Requirement

How, in practice, can a business contact or a financial analyst access accounting information about a company ?

INTRODUCTION TO ACCOUNTING

The regulation of accounting

- In the UK, all companies must comply with the provisions of the Companies Act.
- In the UK, financial statements must be prepared in accordance with either the UK GAAP or IFRS Standards. They must also give a true and fair view of the performance and position of the company.

GAAP	Legislation	Accounting standards
IFRS	UK GAAP	Taskforce on Climate-related Financial Disclosures

INTRODUCTION TO ACCOUNTING

International Financial Reporting Standards (IFRS)

The standards that are issued by the IASB comprise

- International Financial Reporting Standards (IFRS Standards)
- International Accounting Standards (IAS) The interpretations that are issued by the IFRS Interpretations Committee are:
  - IFRIC Interpretations
  - SIC Interpretations

INTRODUCTION TO ACCOUNTING

UK GAAP - UK terminology

International term	UK GAAP term
Statement of profit or loss	Income statement or Profit and loss account
Statement of financial position	Balance sheet
Non-current asset	Fixed asset
Carrying amount	Net book value
Inventories	Stock
Receivables	Debtors
Irrecoverable debt	Bad debt
Irrecoverable debt expense	Bad and doubtful debt expense
Allowance for receivables	Allowance for doubtful debt
Retained earnings	Retained profits (reserve)
Payables	Creditors
Non-current liabilities	Creditors: amounts falling due after more than one year
Current liabilities	Creditors: amounts falling due in less than one year
Revenue	Turnover
Finance costs	Interest payable
Property, plant and equipment	Tangible fixed assets

INTRODUCTION TO ACCOUNTING

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True and fair view/faithful representation

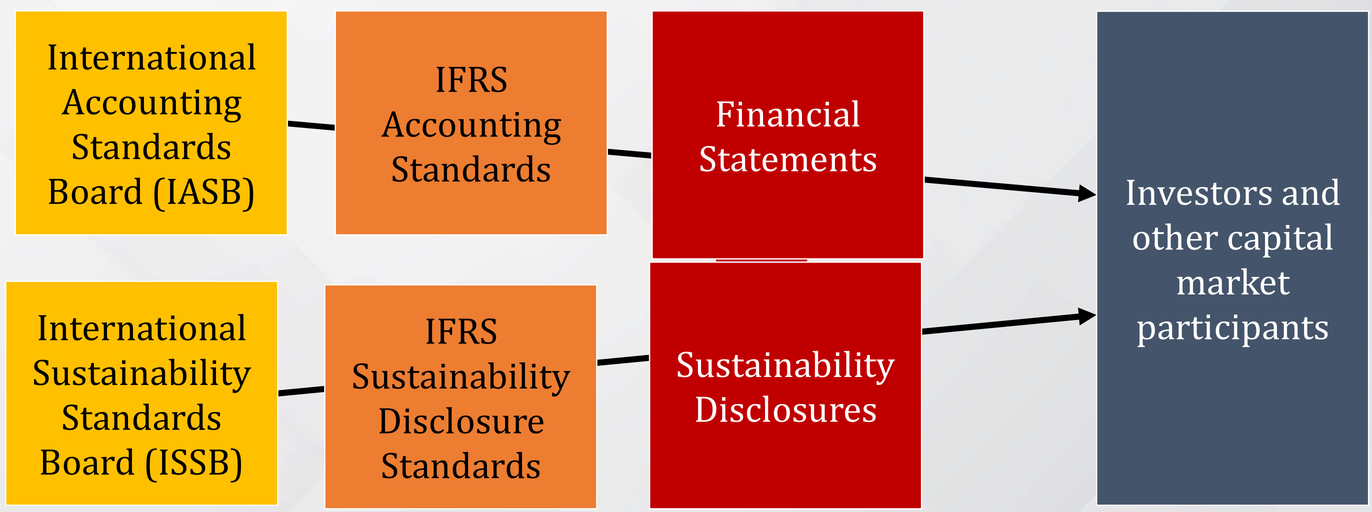
True and fair view means that Financial statements are required to give a true and fair view or present fairly in all material respects the financial results of the entity.

- Conceptual Framework states that if financial information is to be useful, it must be relevant and faithfully represent what it purports to represent (.
- The Companies Act 2006 requires that the financial statements should give a true and fair view of the financial position of the entity at a particular point in time.
- In terms of IAS 1, Presentation of Financial Statements, financial statements should present fairly the financial position and performance, and the cash flows, of the entity. This requires faithful representation of the effects of transactions.

INTRODUCTION TO ACCOUNTING

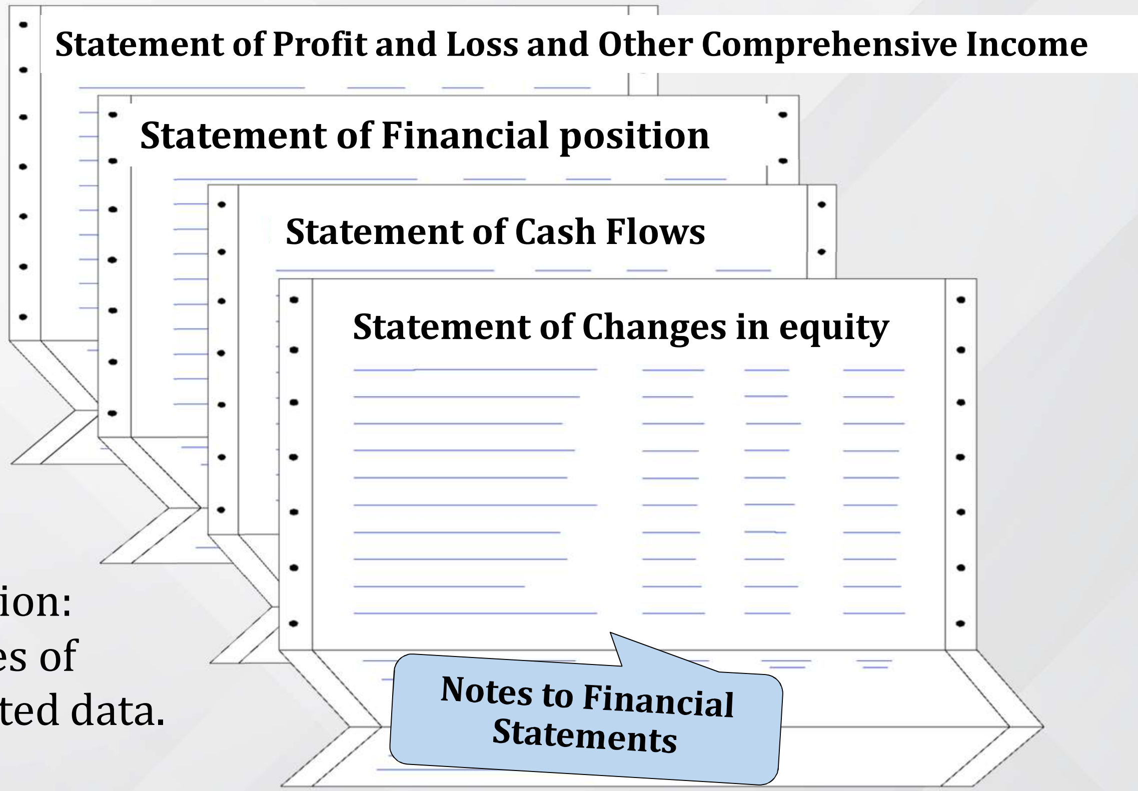
Sustainability standards

- The aim is to provide the users with the information they require to understand the entity's environmental, social and governance risks and its responses to them.
- The ISSB was formed in 2021 with responsibility for developing sustainability disclosure standards
- IFRS Sustainability Disclosure Standards were issued in June 2023 effective for accounting periods beginning on or after 1 January 2024



INTRODUCTION TO ACCOUNTING

The main financial statements



Presentation: summaries of accumulated data.

INTRODUCTION TO ACCOUNTING

Bob's Donut Shoppe, Inc. Statement of Financial Position As of the 31st January 2020		
Fixed assets	$	$
Renovation and improvements	25,000	
Less: accumulated depreciation	(500)	
Net fixed assets		24,500
Current assets		
Cash	49,600	
Accounts Receivable	3,000	
Prepaid Rent	750	
Inventory	18,800	
Total current assets		72,150
Total assets		**96,650**
Liabilities		
Accounts payable	19,000	
Accrued expenses	700	
Unearned income	9,000	
Long-term liabilities	24,500	
Total current plus long-term liabilities		53,200
Equity		
Common stock	50,000	
Net income	(6,050)	
less: Dividends	(500)	
Total shareholder's equity		43,450
Total Liabilities and shareholder's equity		**96,650**

Bob's Donut Shoppe, Inc. Cashflow Statement As of the 31st January 2020		
	$	$
Net Income	(6,050)	
Add back: depreciation expense	500	
		(5,550)
Changes in working capital		
Increase in accounts receivable	(3,000)	
Increase in prepaid rent	(750)	
Increase in inventory	(18,800)	
Increase in accounts payable	19,000	
Increase in accrued expenses	700	
Increase in unearned income	9,000	
Net changes in working capital		**6,150**
Total Cash from Operations		**600**
Investing Cashflow		
Renovations and improvements	(25,000)	
Cash from investing		**(25,000)**
Financing Cashflow		
Issuance of common stock	50,000	
Issuance of long-term liability	24,500	
Dividends paid	(500)	
Cash from investing		**74,000**
Net Increase / decrease in cash flow		49,600
Opening cash		-
Closing cash		**49,600**

INTRODUCTION TO ACCOUNTING

Bob's Donut Shoppe, Inc. Profit and Loss statement for the month ending 31st January 2020	
	$
Revenues	3,600
Less: cost of goods sold	(1,200)
Gross Profit	**2,400**
Less: selling, general and admin expenses	
Office rent expense	(750)
Supplies expense	(3,000)
Utilities expense	(700)
Wages expense	(3,000)
Earnings before interest expense, taxes, depreciation and amortization (EBITDA)	**(5,050)**
Less: Depreciation and amortization	(500)
Earnings before interest expense and taxes (EBIT)	**(5,550)**
Less: interest expense	(500)
Earnings before Taxes (EBT) / Net income	**(6,050)**

INTRODUCTION TO ACCOUNTING

Company XYZ Comprehensive Income Statement for the year ending 31st December 2020		
	$	$
Net income		10,000
Other comprehensive income		
Unrealized gain on available for sale security	2,000	
Unrealized loss on derivative contracts	(500)	
Foreign currency adjustments	1,000	2,500
Comprehensive Income		**$12,500**

INTRODUCTION TO ACCOUNTING

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Statement of Change in Equity

for the period ending December 31, 2023

	Share Capital	Retained Earnings	Revaluation	Total
At Jan. 01, 2023	$55,000	-	-	$83,423
Changes in accounting policy	-	-	-	-
Prior period error correction	-	-	-	-
Add: New Paid in Capital	$10,000	-	-	$10,000
New Profit for the year	-	$15,328	-	$15,328
Revaluation gain	-	-	$500	$500
Deduct: Owner's Withdrawal	-	$5,000	-	$5,000
As of Dec. 31, 2023	**$65,000**	**$38,751**	**$500**	**$104,251**

INTRODUCTION TO ACCOUNTING

The main financial statements

Statement of financial position

A list of all the **assets controlled** and all the **liabilities owed by a business** as at a particular date: Monetary amounts are attributed to assets and liabilities.

It also quantifies the amount of the owners' interest in the company: equity.

Equity

the residual interest in the assets of the entity after deducting all its liabilities

INTRODUCTION TO ACCOUNTING

Statement of financial position

Factor affecting a company financial position:

- The economic resources it controls (cash, labor, materials, machinery, skills)
- Its financial structure (whether it is funded by owners, lenders, suppliers, or by all three)
- Its liquidity (short-term availability of cash) and solvency (long-term access to funds)
- its adaptability to changes in its operating environment

By gaining knowledge of the economic resources, user will be in a better position to predict the entity’s ability to generate cash in the future.

  - the entity's liquidity and solvency
  - the entity's need for additional financing
  - how successful the entity is likely to be in obtaining that financing

INTRODUCTION TO ACCOUNTING

Statement of financial position

- By gaining knowledge of the economic resources a business controls, users will be in a better position to predict the entity's ability to generate cash in the future.
- Information about an entity's financial structure and liquidity/solvency can also help financial statement users.

Factor	Information on this helps users:
Financial structure	• to predict future borrowing needs • to predict how future profits and cash flows will be distributed among owners and lenders • to predict how successfully it will be able to raise future finance
Liquidity/solvency	• to predict its ability to meet financial commitments as they fall due

INTRODUCTION TO ACCOUNTING

The main financial statements

Statement of Profit or Loss

- A statement displaying items of income and expense in a reporting period as components of profit or loss for the period.
- The statement shows whether the business has had more income than expense (a profit for the period) or vice versa (a loss for the period)

The link between the **statement of financial position** and the **statement of profit or loss** is provided by the **statement of cash flows** and the **statement of changes in equity**

INTRODUCTION TO ACCOUNTING

Statement of profit or loss

Information about the business's financial is needed by users.

- To understand the return that the entity has produced on its economic resources
- To assess management's stewardship of the entity's economic resources
- To help predict the business's future returns on its economic resources

INTRODUCTION TO ACCOUNTING

Capital and revenue items

Capital expenditure:

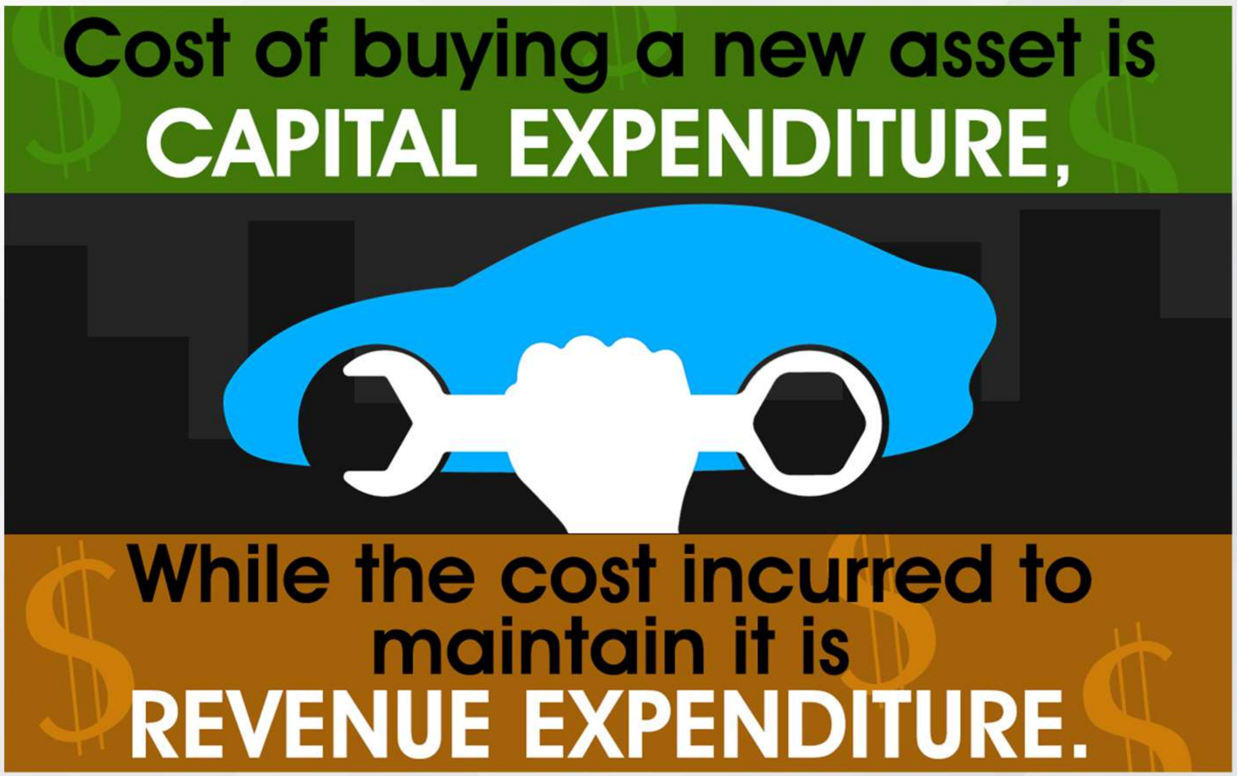
- Expenditure which results in the **acquisition** of long-term assets, or an **improvement** or enhancement of their earning capacity.

Revenue expenditure: Expenditure which is incurred either:

- For **trade purposes**. This includes purchases of raw materials or items for resale, expenditure on wages and salaries, selling and distribution expenses, administrative expenses and finance costs, or
- To **maintain** the existing earning capacity of long-term assets.

INTRODUCTION TO ACCOUNTING

Capital and revenue items



INTRODUCTION TO ACCOUNTING

Capital and revenue income

Capital income	• Proceeds from the sale of non current assets.
Revenue income	• The sale of trading assets, such as goods held in inventory • The provision of services • Interest and dividends received from business investments

INTRODUCTION TO ACCOUNTING

Worked example: Revenue expenditure

If a business buys 10 steel bars for £200 (£20 each) and sells eight of them during a reporting period, it will have two steel bars left at the end of the period. The full £200 is revenue expenditure but only £160 is the cost of the goods sold during the period. The remaining £40 (cost of two units) will be included in the statement of financial position as 'inventory' valued at £40

INTRODUCTION TO ACCOUNTING

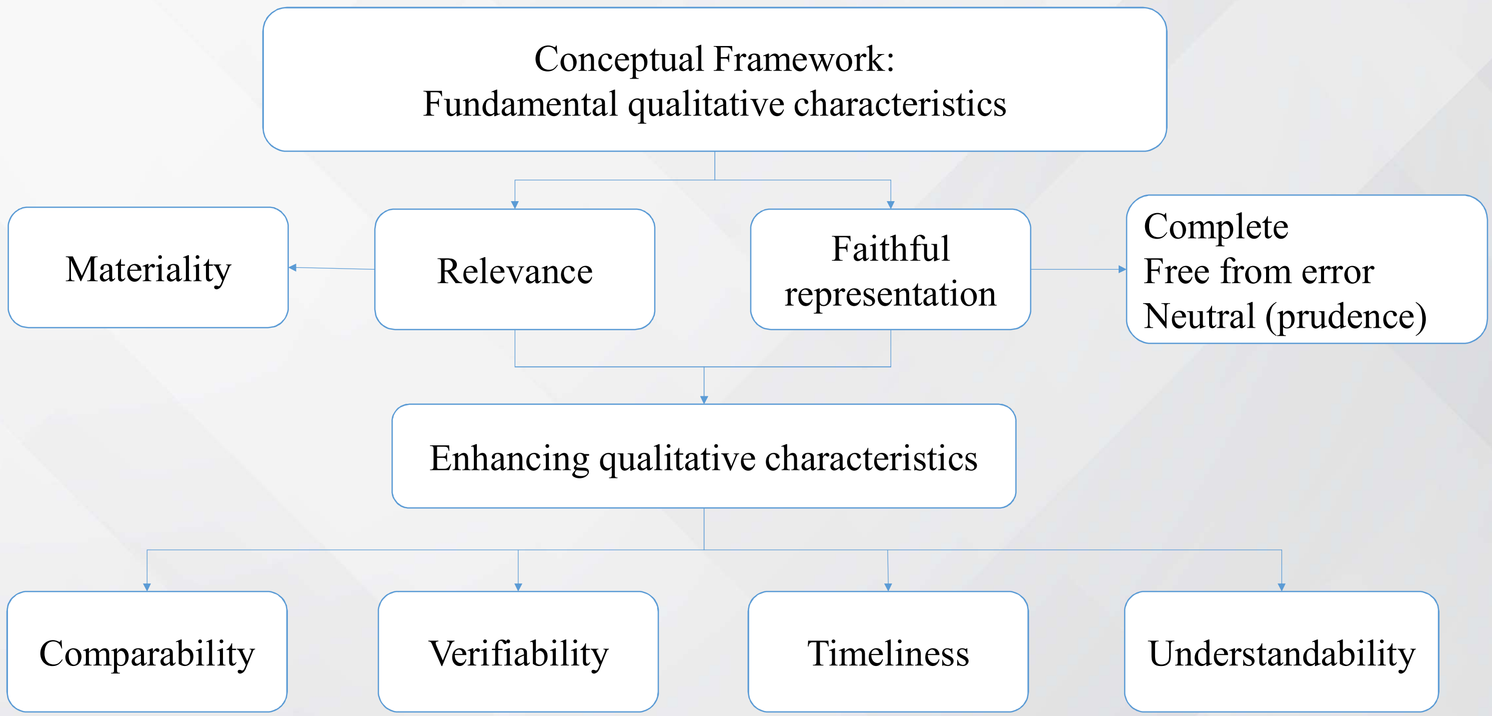
Worked example: Capital expenditure

A business purchases a building for £300,000. It then adds an extension to the building at a cost of £100,000. After a few months the building needs to have a few broken windows mended, its floors polished and some missing roof tiles replaced. These cleaning and maintenance jobs cost £900.

How much are capital expenditure and revenue expenditure?

INTRODUCTION TO ACCOUNTING

Qualitative characteristics of accounting information



INTRODUCTION TO ACCOUNTING

Accounting concepts and convention - Accounting Principles

Accounting Concepts

- Fair presentation
- Going Concern
- Accrual
- Consistency of presentation
- Materiality and aggregation
- Offsetting
- Reporting Entity
- Cost concept
- Comparability: consistency
- Verifiability
- Understandability

Accounting Conventions

- Convention of Disclosure
- Convention of Conservatism

INTRODUCTION TO ACCOUNTING

Accounting concepts and convention

Fair presentation - IAS 1

- Selection and application of accounting policies
- Presentation of information in a manner which provides relevant, reliable, comparable & understandable information
- Additional disclosures where required to enable users to understand the impact of particular transactions, events and conditions on the entity's financial position and performance.

INTRODUCTION TO ACCOUNTING

Accounting concepts and convention

is the underlying assumption for financial framework

GOING CONCERN

+

ACCRUAL BASIS

BASIS FOR PREPARING FS

is not an underlying assumption, but FS should be prepared on an accrual basis.

INTRODUCTION TO ACCOUNTING

Going concern concept

Concept assumes The entity is reviewed as **continuing in operation for the foreseeable future**. It is assumed that the entity has neither the intention nor the necessity of liquidation or ceasing to trade

Preparing a **normal** set of accounts

Unless:

(i) the entity **is being liquidated** or has ceased trading, or

(ii) the directors either **intend to liquidate** the entity or to cease trading

(iii) Scale down operations in a **material** way.

BREAK-UP BASIS

Must disclosure: The basic on which FS are prepared
The reasons why the entity not consider to be a going concern

Interactive question 3

A retailer commences business on 1 January and buys 20 washing machines, each costing £100. During the year he sells 17 machines at £150 each.

How should the remaining machines be valued at 31 December in the following circumstances:

- He is forced to close down his business at the end of the year and the remaining machines will realize only £60 each in a forced sale.

- He intends to continue his business into the next year.

INTRODUCTION TO ACCOUNTING

Accounting concepts and convention
Accrual basic

The effects of transactions and other events are recognized when they occur (and not as cash or its equivalent is received or paid) and they are recorded in the accounting records and reported in the FSs of the periods to which they relate.

Entities record when revenues or expenses are **earned or incurred** in the accounting period, to which they relate, **not as the cash is paid or received**

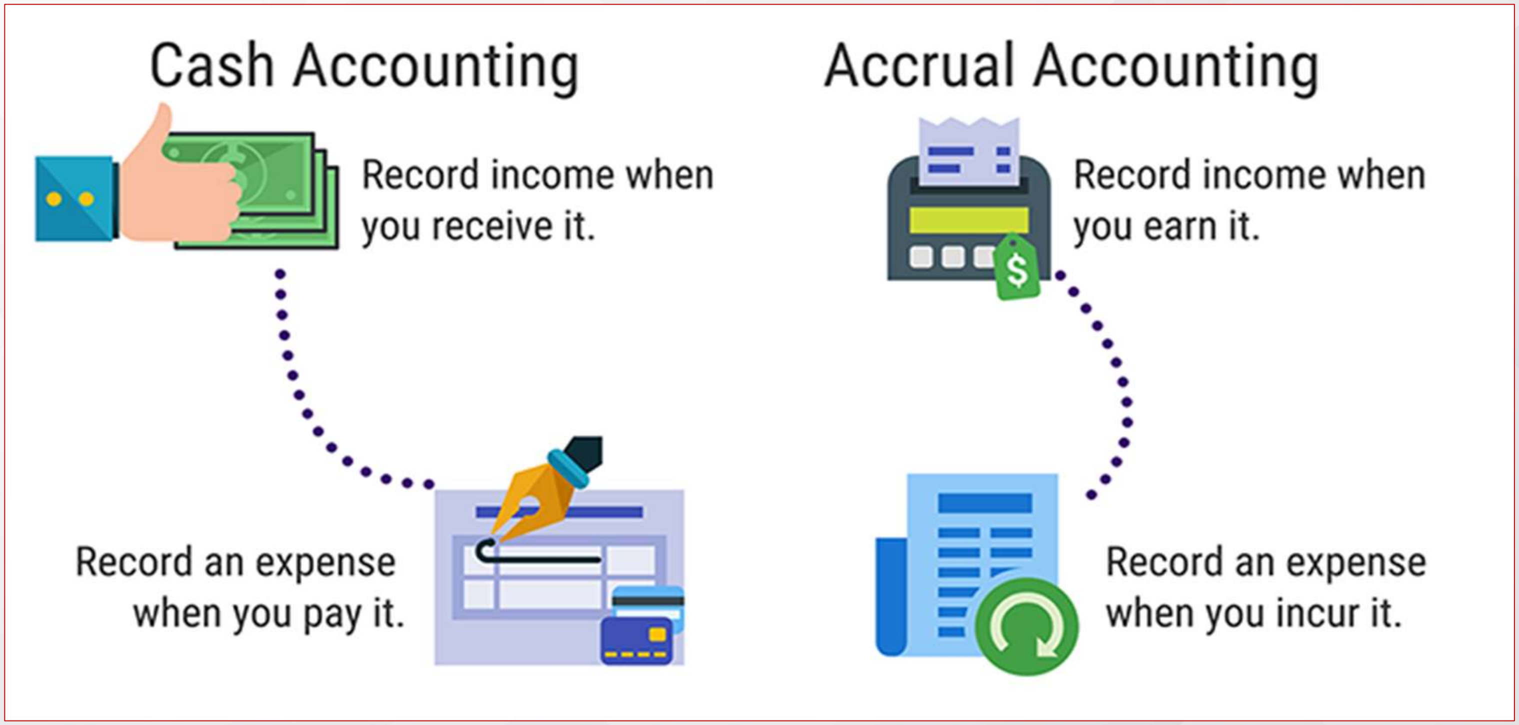
Accrual assumption profit/revenue earned must be matched against the expenditure incurred in earning it. This is the **matching convention**

INTRODUCTION TO ACCOUNTING

Accounting concepts and convention

- **Cash accounting basis of accounting**: Company records customer receipts in the period that they are received, and expenses in the period in which they are paid.
- It is easier to use and can be useful for a smaller company, especially for tax purposes where cash flow may be an issue.
- Under the accruals basis, a company may have to pay tax on profits before the cash is actually received.

INTRODUCTION TO ACCOUNTING



INTRODUCTION TO ACCOUNTING

Worked example – accrual accounting

A sole trader purchases 20 T-shirts in their first month of trading (May) at a cost of £5 each on credit. They sell all of them on credit for £10 each. The sole trader has therefore made a profit of £100, by matching the income (£200) earned against the cost (£100) of acquiring them.

If, however, the sole trader only sells 18 T-shirts, it is incorrect to charge their statement of profit or loss with the cost of 20 T-shirts, as they still have two T-shirts in hand. If they sell them in June, they are likely to make a profit on the sale. Therefore, only the purchase cost of 18 T-shirts (£90) should be matched with the sales income (£180), leaving a profit of £90. The sole trader's statement of financial position will look like this at the end of May:

INTRODUCTION TO ACCOUNTING

Worked example – accrual accounting

	£
Assets	
Inventory (two T-shirts at cost, ie, 2 × £5)	10
Receivables (18 × £10)	180
	190
Capital and liabilities	
Proprietor's capital (profit for the period)	90
Payables (20 × £5)	100
	190

INTRODUCTION TO ACCOUNTING

Worked example – cash accounting

Applying the cash accounting basis to the above example, no profit or expenses would be recorded until cash changed hands. Therefore, if the sole trader had bought 20 T-shirts on credit for £5 each and sold them on credit for £10 each in May, no profit or loss would be recorded in May. If, in June, they received payment for the T-shirts that had been sold on credit, and in July they paid for the Tshirts that had been purchased on credit, a profit of £200 would be recorded in June, and a loss of £100 would be recorded in July.

INTRODUCTION TO ACCOUNTING

Accounting concepts and convention

Materiality and aggregation:

- Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions of users taken on the basis of the financial statements.
- Financial statements result from processing large numbers of transactions or other events that are then **aggregated** into classes according to their nature or function, such as 'revenue', 'purchases', 'trade receivables' and 'trade payables'.

INTRODUCTION TO ACCOUNTING

Accounting concepts and convention

The business entity concept requires that activities of the entity be kept separate and distinct from the activities of its owner and all other economic entities.

Offsetting:

- **Assets** and **liabilities**, and **income** and **expenditure** must be presented **separately** in the financial statements.
- **Income and expenses** can be offset only when:
  - An IFRS requires or permits it, **or**
  - Gains, losses and related expenses arising from the same/similar transactions are not material (in aggregate).

INTRODUCTION TO ACCOUNTING

Accounting concepts and convention

Consistency of presentation: the presentation and classification of items in the financial statements should stay the same from one period to the next, unless:

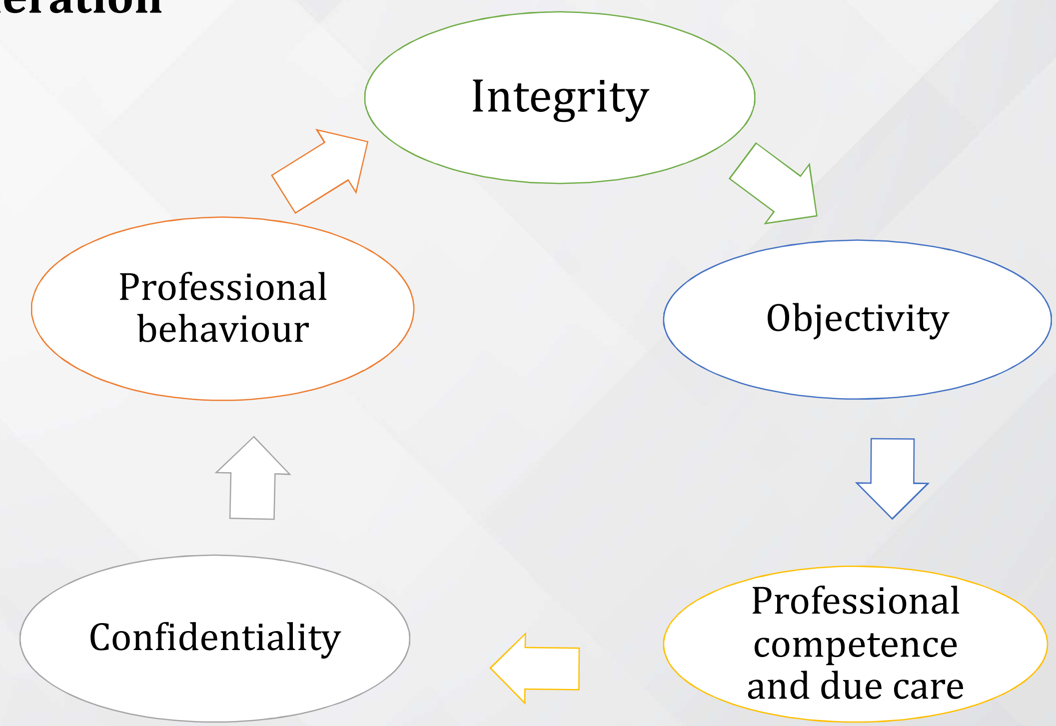
- There is a significant change in the nature of the operations, or a review of the financial statements indicates a more appropriate presentation.
- A change in presentation is required by an IAS.

Historical cost: Transactions are recorded at their cost when they incurred.

 A basic principle of accounting is that the monetary amount at which items are normally measured in financial statements is at historical cost.

INTRODUCTION TO ACCOUNTING

Ethical consideration



IESBA Code of Ethics

INTRODUCTION TO ACCOUNTING

Interactive question: Ethics

Susan works as an auditor for a client called Screens Ltd. During the audit, the CEO Screens Ltd offers Susan their newest model of OLED television, which is about to be released on the market, for free as a thank you for carrying out of the audit

Requirement

If Susan accepts the television, which of IESBA's fundamental principles of professional ethics may be threatened?

INTRODUCTION TO ACCOUNTING

Ethical consideration

The ICAEW Code states that "Chartered Accountants are expected to demonstrate the highest standards of professional conduct and to take into consideration the public interest and to maintain the reputation of the accounting profession".

INTRODUCTION TO ACCOUNTING

Ethical consideration

Principles based system

- System places the onus on the individual
- Prevents individuals interpreting legalistic requirements narrowly
- System allows for the variations that are found in every individual situation
- Can accommodate a rapidly changing environment
- Can contain prohibitions where these are necessary as safeguards are not feasible