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CA FOUNDATION

The Institute of Chartered Accountants of India

PRINCIPLES AND PRACTICE OF ACCOUNTING

PART - I

SIERRA INNOVATIONS
Private Limited

CONTENTS

Basics of Accounting

Financial Accounting Meaning

- The American Institute of certified Public Accountants has defined the Financial Accounting as "The art of recording, classifying and summarizing in an significant manner and in terms of money transactions and events which in part, at least of a financial character, and interpreting the results there of".

- The main purpose of Accounting to be Ascertain profit or loss during a specified period, to show financial condition of the business on a particular date and to have control over the firm's property.

Objectives of Accounting :-

- The primary responsibility of accounting is to provide useful information for decision making.
- To Ensure reliability, it is necessary to keep systematic records of all financial transactions of a business Enterprise.
- Ascertainment of results by preparing profit and loss account for a particular period.

- Ascertain the financial position of Business by preparing Statement known as Balance Sheet
- To gave useful information to stockholders regarding concerns of business.

Function of Accounting :-

Functions of Accounting

- 1. Historical Functions
  - Recording
  - classifying
- 2. Managerial Functions
  - Summarizing
  - Interpreting

➤ Recording- The primary function of Accounting is to record the transactions in the journal as soon as they Occur.

➤ Classifying- After journalising the transactions these are classified and recorded in journal separately.

➤ Summarizing- After recording the transactions in the ledger these are closed by drawing balances.

➤ Interpreting- The accountants should Interpret the statements in amanner useful to action.

★ Book Keeping:-

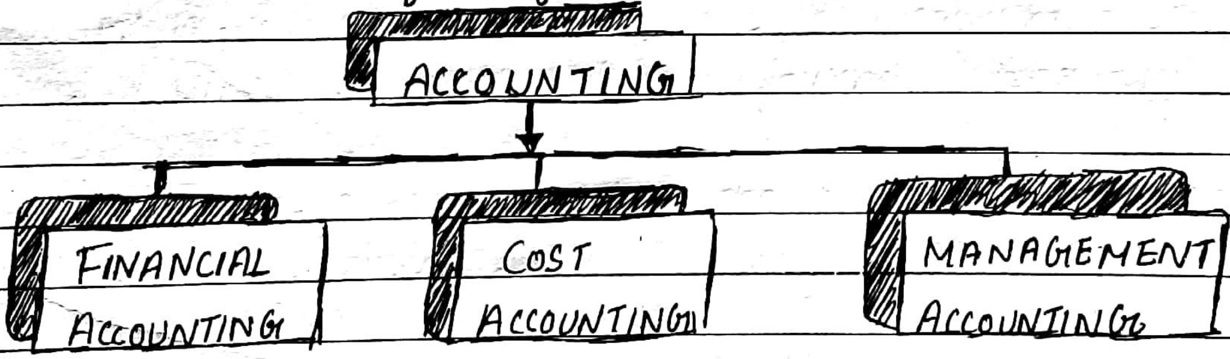
Book keeping is an activity concerned with recording and Classifying financial data related to business operation in Order of its occurance.

★ Book keeping involves:-

- Collection of Basic financial information.
- Identification of events and transactions with financial Character i.e. Economic transactions.
- Measurement of economic transactions in term of money.
- Classifying effect of Economic transactions
- Preparing Orgcnized statement known as trial balance.

★ Sub-Fields of accounting:-

The Various Sub field of accounting are:-



★ Financial Accounting:-
An Art of recording, classifying and summarizing in an significant manner and in terms of money transactions and events which in part, at least of a financial character, and interpreting the results thereof.

★ Cost Accounting:-
According to ICMAI, cost accounting is application of costing and cost accounting principles, methods and techniques to the science, art and practice of cost control and the ascertainment of profatibility as well as the presentation of information for the purpose of the managerial desicion making

★ Management Accounting:-
Management Accounting is concerened with the use of financial and cost Accounting information to Managers within Organisations, to provide them with the basis in making business informed business decisions that would allow them to be better equipped in their management and Control functions.

Limitations of Accounting:-
(1) Recording only Monetary Items.
(2) Time Value of money.
(3) Recommodation of Alternative Methods.
(4) Restrain of Accounting principles
(5) Recording of Past events.

6. Allocation of the problem.
7. Maintaining Secrery.
8. The tendency for secret reserves.
9. Importance of forms over substances.

Role of Accountant in Society:-

- Maintanance of Accounting Books:- An accountant is able to maintain a systamatic record of financial transactions entered into during a period and to state the financial position of the concern as at a particular state.

- Audit: Every limited Company is required to appoint a charted Accountant as an auditor who is statutorily required to report every year whether in his opinion the balance sheet shows a true and fair View or the state of affairs on the balance sheet date, and the profit and loss account shows a true and fair View of the profit or loss for the year.

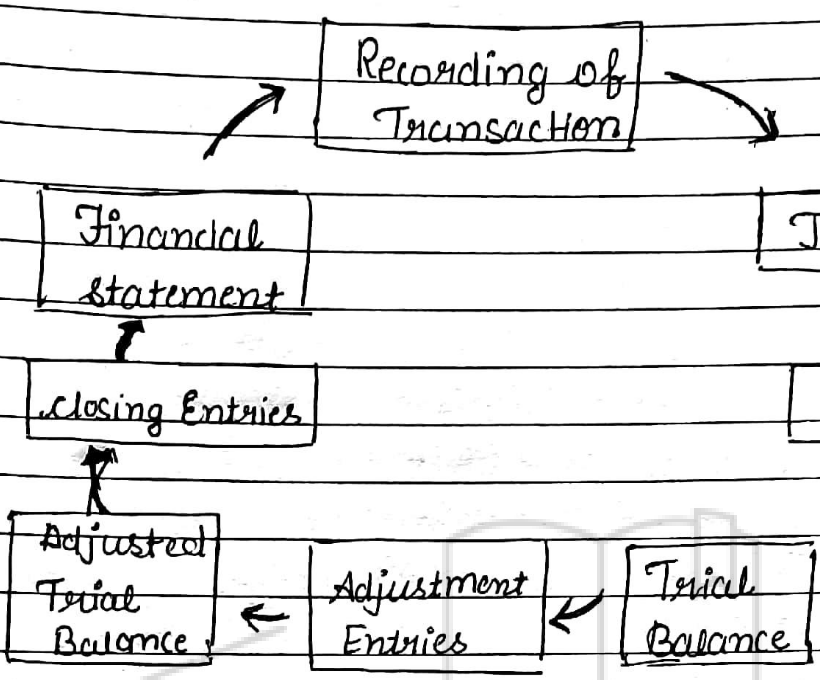
- Internal Audit:- It is a management tool whereby an Internal Auditor throughly Examine the accounting transactions and also the System according to which these has been recorded with a View of ensure the management that the accounts are being properly maintained and the system contains adequate safeguard to check any leakage of revenue or misappropriation of property or Assets and the operation have been Carried out in Conformity with the plans of management.

★ Taxation:- An Accountant Can ~~help~~ handle taxation matters of a business or a person and he Can represent that business or person before the tax authorities and settle the tax liability under the statue prevailling. He can also assist in avoiding or reducing tax burden by proper planning of tax affairs.

★ Consultancy Services:- Accountant performs an advisory function. He is largly responsible for internal reporting to the management for planning and controlling current operations, decision making on special matters and for formulating long range plans. His job to collect, Analyze, interpret and present all accounting Information which is useful to the management.

Accounting Procedure:-

➤ When Complete Sequence of accounting procedure is done which happens frequently and repeated in Same directions during an accounting period, the same is Called an accounting cycle.



Accounting Cycle

(a). Recording of Transaction:→ As soon as a transaction happens it is at first recorded in Subsidiary book

(b). Journal - The transactions are recorded in journal chronologically.

(c). Ledger:- All journals and posted into ledger chronologically and in a classified manner -

(d). Trial Balance:- After taking all the ledger account closing balances, a trial balance is prepared at the end of the period for the preparations of financial statements.

(E). Adjustment Entries:- All the adjustments entries are to be recorded properly and adjusted accordingly before preparing financial statements.

(F). Adjusted trial Balance:- An Adjusted trial Balance may also be prepared.

(G) Closing Entries:- All the nominal Accounts are to be closed by the tranfering to trading Account and profit and loss Account.

(H) Financial Statements:- Financial statements can now be easily prepared which will Exhibit the true financial position and operating results.

Accounting Concept and Convention:-

Theory Base of Accounting

Basic Assumptions	Basic principles	Modifying principles
(a) Basic principles.	(a) Revenue Realization Concept	(a) Materiality Concept
(b) Going concern Concept	(b) Matching Concept	(b) Consistency concept
(c) Money Measurement Concept	(c) Full disclosure concept	(c) Conservatism concept
(d) Accounting period Concept	(d) Dual Aspect	(d) Timeliness
(e) Accrual Concept	(e) Verifiable obj. Evidence.	(e). Industry practice.
	(f) Historical Cost concept	
	(g) Balance Sheet equation	

Basic Assumptions:-

(a) Business Entity concept →

This concept explains that the Business is distinct from the proprietor. Thus, the transactions of business only are to be recorded in the books of business.

(b) Going concern concept →

This concept Assumes that the business has a perpetual succession or Continued existence.

(c). Money measurement Concept →

According to this concept only those transactions which are expressed in money terms are to be recorded in accounting book.

(d). Accounting period Concept →

This Concept requires that the life of business should be segregated into Equal parts which are termed as Accounting periods. This concept requires consistency of Accounting periods.

(e) The Accrual Concept →

The Accrual concept is based on recognition of both cash and Credit Transactions.

Basic principles:-

(1) Relalization concept:-
This concept speaks about recording of only those transactions which are actually relalized.

(2) Matching concept:-
It is referr to as matching of Expenses against incomes. It means that all incomes and expenses relating to the financial period to which the accounts relate should be taken in to account without regard to the date of receipts or payment.

(3). Full discloser concept:-
As per this concept, all significant information must be disclosed. This principle emphasizes on the materiality, objectivity and consistency of accounting data which should disclose the true and fair view of the state of affairs of a firm.

(4) Duality concept:-
Acc. to this concept Every transaction has two aspects i.e. the benefit receiving aspects and benefit giving aspect. These two aspects are to be recorded in the books of Accounts.

(5) Verifiable objective Evidence Concept:-
Under the principle, according data must be verified In other words, documentry evidence of transactions must be made by which are capable of verification by an independent respect.

(6) Historical Cost Concept:-
Business transactions are always recorded at the actual cost of which they are actually undertaken The limitation of this concept is that the balance sheet does not show the market value of the assests owned by the business and accordingly the owner's equity will not reflect the real value. However, on an ongoing basis, the assests are shown at their historical costs as reduced by depreciation.

(7). Balance sheet Equation Concept:-
Under this principle; all which has been received by us must be equal to that has been given by us and needles to say that receipts are clarified as debits and giving is clarified as credits. The basic equation, appears are.-
DEBIT = CREDIT

★ Modifying Principles:-

(a). The concept of Materiality:-

The materiality concept refers to a situation where the financial Information of a company is considered to be material from the point of View of the preparation of the financial statements if it has the potential to alter the View or opinion of reasonable person.

(b). Consistency Concept:-

This concept says that the Accounting practises should not change or must remain unchanged Over a period of several years.

(c). Conservatism Concept:-

Conservatism Concept states that when alternative Valuations are possible, one should select the alternative which fairly represents Economic Substance of transaction but when such choice is not clear select the alternative that least likely to Overstate net assests and net Income.

(d). Timeliness Concept:-

Under this principle, every transaction must be recorded in proper time. Normally, when the transaction is made, the same must be recorded in the proper books of accounts.

e) Industry Practice-

As that are different types of Industries, each Industry has its own characteristics and features. There may be seasonal Industries also. Every Industry follows the principles and Assumption of accounting to perform their own activities.

⇒ Qualitative Characteristics of Financial Statements:-

The following are all Qualitative characteristics of financial statements:-

• Understability:-

The information must be readily understandable to users to the financial statements. This means that information must be clearly presented, with additional information supplied in the supporting foot notes to assist in clarification.

• Relevance:-

The information must be relevant to the needs of the users, which is the case when the information ~~sho~~ influences the Economic decisions of users. This may involve reporting particularly relevant information, or information whose Omission or misstatement could influence the economic decisions of users.

- **Reliability:-**

The information must be free of material error and bias, and not misleading. Thus, the information should faithfully represent transactions and other events, reflect the undelying substance of events, and prudently represent Estimates and uncertainities through proper dissolve.

- **Comparability:-**

The information must be comparable to the financial information presented for other accounting periods, so that users can identify trends in the performance and financial position of the reporting Entity.