The Accountant: *the other guys*

BM40002: IFM

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It's about money, honey!

Flow of resources...

The *Utopian* story:

- Investors channelize their savings to business through markets;
- Businesses take up profitable projects, and share profits with investors;
- Investors get more money.

All of this look good until...

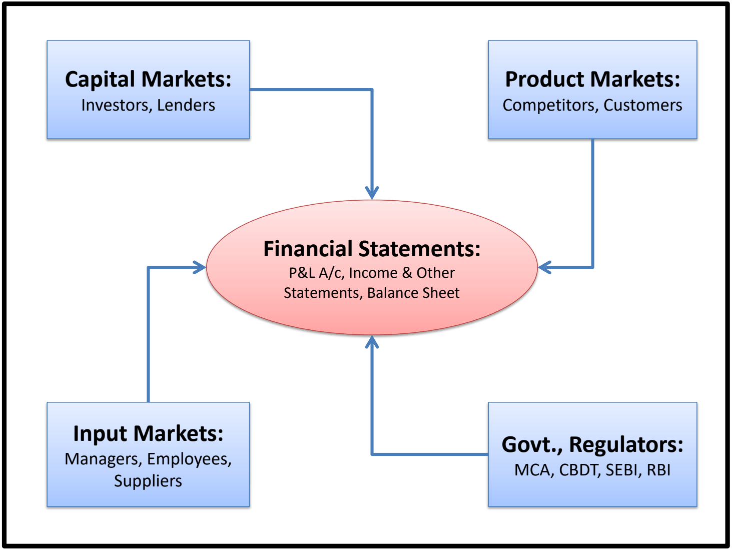
- Business manipulate their reporting of incomes and expenses;
- Markets don't function the way they should be functioning.

e.g., The Warner Bros.' *Harry Potter and the Order of the Phoenix* (2007) grossed $938 million, yet reported a loss of $167 million.

The questions are...

- To what extent are we able to **identify** the flow (and the associated information)?
- How do we **record** (or, treat) cash (*in*- and *out*-) flows?
- How do we **report** (or, reveal) the business information?
- How do we **summarize** (and **present**) the information obtained so far?
- Who're we - the accounting people - *working* for?

The Stakeholders



Why accounting information?

- Investors require more information that managers don't want to reveal due to the presence of competitors;
- Regulators want information in standard format, while managers need precise information to make decisions;
- Suppliers wish to know financial status of a company that otherwise might be debt-ridden.

Economic decision making!

Accounting Information System

Inputs:

- *Business transactions* (buys, sells, cash receipts & payments, consumption of materials, etc.)
- *External events* (govt. rules, tax laws, global events, etc.)

Processes:

- Accounting principles & standards
- Accounting conventions
- Managements estimates & policies
- Laws & regulations

Outputs:

- Statement of profits & loss
- Balance sheet
- Cash flow statement
- Statement of change in capital
- Tax returns
- Regulatory filings

Users:

- *Internal users* (shareholders, employees, managers, etc,)
- *External users* (potential investors, analysts, suppliers, customers, govt., regulators, etc.)

Source: Narayanswamy, 2015

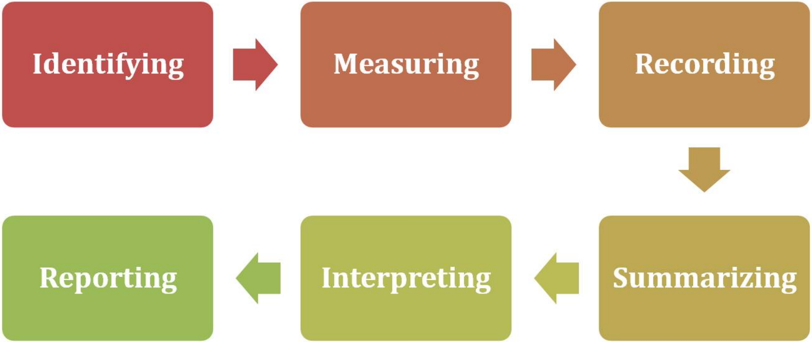
What is *accounting*?

Inputs: *business transactions*

- Mr. eGuy started a business with a capital of Rs.100,000.
- A license fee of Rs.25,000 paid to start the operations.
- A computer purchased for Rs.25,000.
- Salary of Rs.10,000 paid.
- First client Ms. DoGood secured.
- Sales of Rs.50,000 made and cash received.
- Mr. eGuy awarded the Entrepreneur of the Year 2020.
- Taxes paid: Rs.10,000
- Another sales worth Rs.50,000 made to Mr. Kangaal; amount due.

Accounting is...

... identifying → measuring → recording → summarizing → interpreting → reporting of *business transactions*.



Identifying

Typically a business transaction involves *two* or more parties:

- **Persons:** a giver(s) and a receiver(s)
- **Non-person:**
  - **Real:** Something coming in and/or going out;
  - **Unreal:** Something as loss or gain, virtual.

Measuring

- Only measurable *in monetary units* transactions shall be considered;
- Units of measurement be consistent;
- Something un-real/virtual be measured in monetary units before recording.
  - e.g., goodwill, brand, logo, copyright, etc.

Recording

- Double entry system of accounting: *Luca Pacioli*, Italy (1490s)
  - Asset: what business *owns*;
  - (External) Liabilities: what business *owes* to outsiders;
  - (Internal) Liabilities: what business *owes* to owners;
- Accounting equation:
  - **Asset = Liabilities + Equity**

  What a business *owns* is raised from what the business *owes* to external (liabilities) and internal (equities) parties.

Accounting Concepts

- Business entity concept: *owners and business are separate entities.*
- Going concern concept: *business will continue forever.*
- Dual aspect concept: *for every debit, there must be a credit.*
- Cost concept: *assets recorded in books of account at purchase value.*
- Money measurement concept: *what can be measured in monetary terms must be recorded.*
- Realization concept: *revenue recognition at accrual and substantially realization.*
- Matching concept: *costs be matched with revenues.*
- Periodicity concept: *in the long run, we're all dead.*

Accounting Conventions

- Convention of Conservatism
- Convention of Consistency
- Convention of Material Disclosure

Accounting Equation

Assets = Liabilities + Equity

- Revenue
- Expenses
- Owner's drawings, if any

Assets = Liabilities + [Equity + (Revenue - Expenses = Net Income) - Owner's drawings/dividends]

The Golden Rule

Recording of business transactions:

- **Personal accounts:** *Debit* the receiver, *Credit* the giver.
- **Real accounts:** *Debit* what comes in, *Credit* what goes out.
- **Nominal accounts:** *Debit* all losses and expenses, *Credit* all incomes and gains.

Accounting terminologies

- Debit (Dr.) and Credit (Cr.)
- Balance and carry forward
- Closing and Opening balances
- Outstanding and prepaid (incomes and expenses)
- Depreciation, amortization, and writing off