# Accounting

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## 1 Basic Assumptions of Accounting

### 1.1 Business is a Separate Legal Entity

### 1.2 Going concern or continuity concept

The business/company has **indefinite** life. This assumption is mandatory for acquiring resources.

### 1.3 Money Measurement Concept

All the transactions/activities of monetary nature are recorded and reported. This is the case because money is a common denominator.

### 1.4 Accounting Period Concept

Every year, a business has to file for tax return. Therefore, the business needs to know whether it's making profit or loss at the end of a specified period (financial year).

### 1.5 Accural Concept

It's based on the recognition of both cash and credit transactions. In essence, the company needs to record all the transactions (either buying or selling resources) which take place via cash or credit.

## 2 Accounting terms

### 2.1 Book keeping

- keeping is the process of recording business transactions into a set of

books.

- Only transactions of monetary value are found in this book.
- These transactions represent the transfer of economic value from one entity to another.
- It is also referred to as a set of primary records.
- It is an *art*.

### 2.2 Financial Accounting

According to Indian General Accepted Accounting Principles(GAAP),it is the procedure of recording, reporting transactions of monetary nature for statutory requirements.

#### 2.2.1 General procedure

1. All business transactions are recorded in the form of **Journal Entries** on the basis of the golden rule of accounting.
2. Transactions of similar nature are grouped together and compiled into a **Ledger**.
3. Since there are a lot of transactions in the ledger, the ledger is then summarized into a **Trial Balance** and then reported in the form of **Financial Statements**.

#### 2.2.2 Composition of Financial Statement

It comprises of 3 statements:

1. Statement of Income and Gains & Expenditures and Losses (PnL Report).
   - Recorded for a **financial year** ($1^{st}$ April to $31^{st}$ March in India)
2. Statement of Sources & Application of Funds (Balance Sheet).
   - Recorded since the start of the company.

3. Fund flow statement.
    - It analyses a company's Balance Sheet of two years to validate the movement of funds from the previous financial year to the current year. (copied this definition from the internet)
    - It compares the source of inflow and outflow of funds during the concerned accounting period and analyses how it affects the working capital of an organization.

#### 2.2.3 Golden Rule of Accounting

Debit what comes in, credit what goes out. Debit the receiver, credit the giver.

### 2.3 Cost Accounting

Cost accounting is the technique of recording and analyzing the goods and services produced and reporting it to the internal decision makers.

### 2.4 Management Accounting

The **set of tools** required to assess certain parameters to determine the business performance, in order to report it to the internal decision makers(management) for planning, evaluating and controlling their resources.

### 2.5 Accounting cycle

Recordings transactions → Journal → Ledger → Trial Balance → Adjustment entries → Adjustment Trial Balance → Closing Entries → Financial Statement → Recording Transactions

## 3 Objectives of accounting

1. To obtain the amount of Profits and Losses made by the business.
2. To know the financial Position of the business.
3. To provide a record for compliance with statutes and applicable laws.
4. To disclose financial information to the internal and external decision makers.

## 4 Balance sheet terms

### 4.1 Liability

All the resources that a company owes to some entities are called liabilities.

### 4.2 Owner's Liability

The contributions made by the owner (equity shareholders) to the business.

#### 4.2.1 Owner's Capital

- The net profit made (residual assets) belong to the owners(equity shareholders),

since they are the residual claimers.

- These profits can be distributed amongst the shareholdes in the form of **dividends**, or retain the amount for future investments called **retained earnings**.

### 4.2.2 Net worth

net worth = equity capital provided by owners + reserves and surpluses

## 4.3 Creditor's Liability

### 4.3.1 Short Term/Current Liability

Loan is taken from bank and goods are bought on credit.

| **Owner's Liability** | **Creditor's Liability** |
|---|---|
| The business may not necessarily have to pay the original amount. | The business is obligated to repay the capital amount along with interest. |
| The interest amount may vary, or there may be no interest at all. | The interest amount is specified at the time of the original investment. |

A liability shall be classified as current when it satisfies any one of the following:

1. It is expected to be settled in the company's **normal operating cycle**. (generally $<$1 year)
2. It is held mainly for the purpose of **trading**.
3. It is due to be settled within 12 months after the reporting date.
4. The company does not have an unconditional right to defer settlement of the liability for *atleast* 12 months after the reporting data.

1. Significance
   - It shows the liquidity position of the company (ability to pay vs. willingness

   to pay)
   - **Example**: Account payable; expense outstanding.
2. Note It is not necessary that if the current liabilities of the company are increasing, then the liquidity position of the company is bad. There are many instances wherein the **bargaining power** of the company proves to be a valuable resource for the company.

### 4.3.2 Long Term/Non-current Liability

All other liabilities fall under this category. E.g. Loan taken for 5 years, Debentures issued, etc.

## 4.4 Contingent Liability

It represents a **potential obligation** that could be created depending on the outcome of an event.