Name: Vitalie Zegera

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MODULE 2 - ASSIGNMENT

1) **What are operating and non-operating profits?**

Operating profit = any income/loss from any activity of the organization during the usual, daily activities of the organization. Profit from the core activities of the organization.

Non-operating profit = any income/loss from activities or transaction which are clearly different from the day to day activities of the organization, which happen time to time and cannot planned with. (capital gain/loss, currency exchange gain/loss, discounts, pre-opening and restructuring costs, rental income, dividends, assets write-off, loses from lawsuits, uninsured losses due to natural calamities, etc.)

Definition: “The excess of operating incomes over operating expenses represents operating profit, whereas when operating expenses exceed operating income it results in operating loss. Operating incomes are those incomes which arise from operating activities in which the enterprise deals in. For a trading concern, revenue arising from sale of goods in which the enterprise deals in is treated as operating income” (Study Manual, Module two, p. 98)

2) **What do you understand by “Grouping” and “Marshalling” of assets and liabilities?**

Grouping = the assets and liabilities should be arranged in certain groups of items of similar nature in the Balance Sheet.

Marshalling = the assets and liabilities are arranged in a particular order in the Balance Sheet. In order of liquidity (the most liquid is shown first) or performance (the most liquid is shown last).

The Grouping and Marshaling is important especially for preparation and presentation of the Balance Sheet.

3) Write short notes on the following:

a) Outstanding of Expenses

Expenses, which have been incurred in a specific accounting period and are due to be paid, but the payment has not been done so far. The organization has received the benefit, but the payment has not been done. Such an expense should be treated as a payable for the organization. (outstanding rent, subscriptions, salaries, bills, etc.) This happens especially in December, if the accounting period finishes on December 31, but the payments have not been done. Outstanding expenses should be recorded in finance books at the end of accounting period to show the true picture of the finances of the organization. It should be treated as a liability and shown accordingly on a balance sheet, as current liability.

b) Accrued Incomes

These are incomes which has been earned/paid in a particular accounting period, but not received until the end of this period. It should be treated as an asset for the organization. It should be recorded in the accounting period in which it is earned. Such an income will be recorded as accrued income and a corresponding receivable will be created to account for the debit of the transaction. Examples: interest on investment, rent, etc. Accrued income is also known as income receivable, outstanding income, income earned but not received.

c) Intangible Assets

These are assets that are not physical in nature, they can't be touched as tangible assets, but they add value to the organization. They are long-term assets and can be divided into intellectual property (trademarks, brand, patents, licensing agreements, etc.) and goodwill assets (reputation of the organization, strategies, customer base, employee relations, etc.).

Intangible assets of an organization do not appear on the balance sheet and have no recorded book value, but can be of a huge value: what is a cost of a strong, recognized brand, trained and loyal employees, reliable vendors, functional website, in-house systems and processes?

Expenses for creating an intangible asset can be written off and recorded as expenses, but still the new intangible asset will have no book value. (Piper, 2013, p. 84)

d) Fictitious Assets

“These are the non-existent worthless items which represent unwritten off losses or cost incurred in the past which cannot be recovered in future or realized in cash. Examples of such assets are preliminary expenses (formation expense), Advertisement suspense, Underwriting - commission, discount on issue of shares and debentures, Loss on issue of debentures and debit balance of Profit and Loss Account. These fictitious assets are written off or wiped out by debiting to Profit and Loss Account.” (Study Manual, Module two, p. 72)

Actually, this mean fake assets, though they are shown on the balance sheet, but do not belong actually to the organization. These are the losses which are not fully written off, because they are spread over more than one year. Example of such fictitious assets are net loss of the organization, promotional, preliminary expenses, discounts, etc.)

The purpose of creating a fictitious asset is to account for expenses that cannot be placed under any normal accounting group. Fictitious assets should be written off as soon as possible.

e) Cost of Conversion

Cost of Conversion is part of the content of the financial statement of a manufacturing account. It is for businesses engaged in production of goods. The manufacturing account should show the cost of raw materials but also the cost of conversion of raw materials into finished products and the cost of goods produced. The cost of conversion includes direct expenses, freight or transportation, direct labor, indirect expenses such as rent, depreciation, insurance, repairs and maintenance, supervision, etc.
Formula of Cost of Conversion per unit: direct cost/labor + indirect costs / Nr. of units.

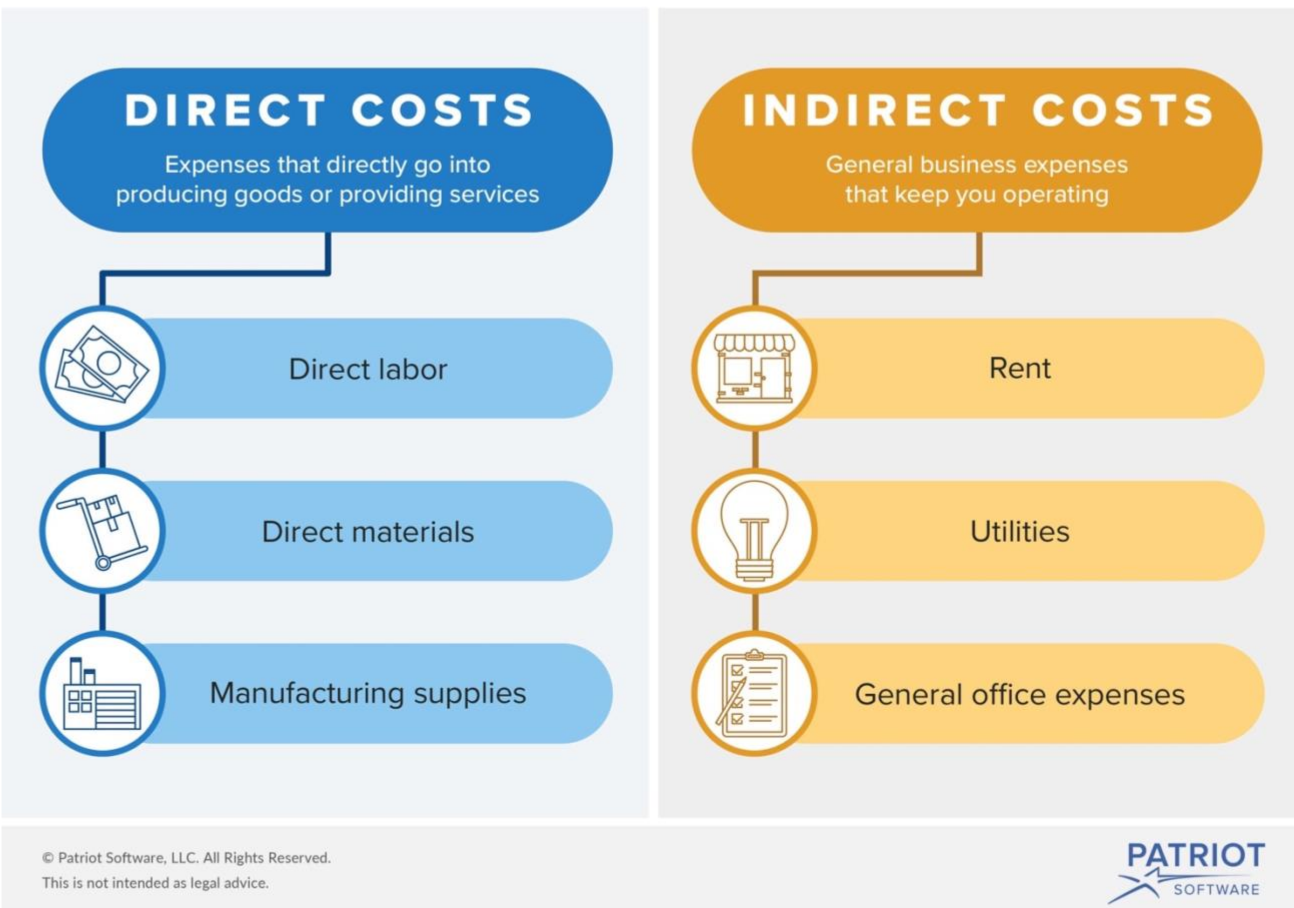
f) Cost of Goods Sold

Cost of goods sold (COGS) refers to the direct costs of producing a product of the organization. This amount includes only the cost of the material and the direct labor cost. It excludes indirect costs. Formula: Cost of goods sold = opening stock + purchases (less returns) + direct expenses – closing stock. Why this cost is important? Because it shows the cost of doing business, how efficient the organization is. If COGS increase the net income will decrease.
(https://www.investopedia.com/terms/c/cogs.asp)

g) Direct vs. Indirect Expenses

It is important to have a clear understanding of the distinction between direct and indirect costs. This will help the organization to know the true cost of its activities/products and help to plan more efficiently. It is important also for tax returns, because certain costs, both direct and indirect are tax deductible.

Direct costs are clearly traceable to a specific service, a production of a specific product. The word "specific" is very important. Indirect costs are also necessary to the products and services of the organization, but they are not clearly traceable to the act of production or service. Indirect costs are those necessary to keep the organization in operation. They are the prerequisites for any production of goods or service delivery.



(https://www.patriotsoftware.com/blog/accounting/direct-vs-indirect-costs-difference/)

4) What are the objectives of Accounting? Name the different parties interested in accounting information and state why they want it.

According to the Study Manual (p. 7-10) the basic objectives of accounting are to provide necessary information to the persons interested, who will make relevant decisions and form judgment. The objectives can be classified as following:

a) *To keep systematic records of the organization*, of all financial transactions, of all assets and liabilities.
b) *To determine profit or loss of the organization during a particular period*, usually for one year. This helps the management to take decisions accordingly.
c) *To establish the financial situation of the organization*, by preparing a Balance Sheet. This statement provides information about the financial health of the organization. Management needs to know what is happening with the organization at a specific point of time.
d) *To provide accounting information to interested parties* in a form of an annual report

Many people can be interested in examining the financial information provided in the financial statements. These are the major interested parties:

a) *Owners/Shareholders* – obviously the are interested to know the financial situation of the organization, because they want to see how much their profit or loss is, but also to evaluate the performance of the management.
b) *Future Partners/Investors* – they want to know how safe and rewarding is to partner with this organization.
c) *Donors/Lenders* – they want to know about the solvency of the organization so as to satisfy themselves that their money will be used properly, and the organization can achieve what it said would do.
d) *Creditors* – the ones who supply goods and services to the organization. They want to know if the organization is able to pay for their goods and services.
e) *Management* – it helps the management to plan, control and evaluate the activities of the organization. It helps also in making right decisions for the organization.
f) *Government* – in order to calculate the correct taxation and to assess the tax liability of the organization.
g) *Employees* – to know how safe their job is, to know about the perspectives of personal growth and for future personal decisions regarding working in this organization.

5) **Briefly explain the accounting concepts which guide the accountant at the recording stage.**

Accounting is the process of recording, classifying, summarizing, analyzing and interpreting the financial transactions of the organization, and also communicating the results to interested parties.

The first stage of the accounting process is the recording of all transactions of the organization. This process is called "journalizing", because it consists of daily recording the transaction in the book of original entry called "Journal". All transactions are recorded in chronological order with the help of various vouchers such as cash memos, cash receipts, invoices, etc.

At this stage of accounting the accrual principle is important – every transaction should be recorded, best when it actually occurs. This is the first general rule of Generally Accepted Accounting Principles (G.A.A.P.). According to this rule, organizations that do not record transactions, or incorrectly record transactions, are committing fraud.

6) **What do you understand by Dual Aspect Concept? Explain the accounting implications**

According to the Study Manual (p. 41-42) this is a basic concept of accounting. According to this concept every business transaction has a two-fold effect (debit-credit). In commercial context it is a famous saying that "every receiver is also a giver and every giver is also a receiver", increase in one asset means decrease in another asset.

Debit is the portion of transaction that accounts for the increase in assets and expenses, and the decrease in liabilities, equity and income. Credit is the portion of transaction that accounts for the increase in income, liabilities and equity, and the decrease in assets and expenses.

Thus, every business transaction involves two aspects: the receiving aspect, and the giving aspect. This principle is the core of double entry book-keeping. An income in cash or kind, not only increases the assets of the organization, but also its liabilities/equities correspondingly. Thus, at any given point of time, the total assets and the total liabilities must be equal. This equality is called "balance sheet equation" or "accounting equation": Liabilities/Equities = Assets. The recording of transactions in the accounting books is based on this accounting equation.

7) **Explain the role of Management Accountant in a modern business organization.**

The term Management Accountant has been applied to anyone who performs accounting work within an organization performing activities which range from posting customers' receivable accounts, doing financial analysis for decision making, and making high-level decisions in an organization. Usually such a person heads the accounting department. He is also known as financial controller, financial advisor, chief account's officer etc.

The Management Accountant is responsible for installation, development and efficient functioning of the management accounting system. He plays an important role in collecting, compiling, reporting and interpreting internal accounting information, also evaluation of policies and programs, tax administration, protection of assets, participate in strategic management. He prepares the financial and cost control reports to satisfy the requirements of different levels of management. Thus, the management accountant occupies an important position in the organization. He performs a staff function and also has line authority over the accountants. If he participates in planning and execution of policies, he is equal to other functional managers. He supplies information and gives his views about the data and leaves the final decision making to functional heads. If management accountant provides the facts accurately and are presented in a manner which allows proper analysis and interpretation, then he cannot be held responsible for any wrong judgment by the management. On the other hand, if the information provided by the management accountant is biased, inaccurate and is not presented properly then he is responsible to the management for wrong decision making (Study Manual, Module two, p. 27-29).

8) **What are the accounting concepts to be observed at the reporting stage? Explain any two in detail.**

According to the Study Manual (p. 43-49) the following accounting concepts have to be kept in mind at the reporting stage, while preparing the final accounts:

1. Going concern concept
2. Accounting period concept
3. Matching concept
4. Conservatism concept
5. Consistency concept
6. Full disclosure concept

7. Materiality concept

Accounting Period Concept

This concept's goal is to prepare the financial statements periodically to find out the profit or loss and financial position of the organization at a specific time. It also helps the interested parties to make periodical assessment of its performance. Therefore, accountants choose some shorter period to measure the results and one year has been generally accepted as the accounting period. However, accounts can also be prepared even for a shorter period for internal management purposes. But one-year accounting period is recognized by law and taxation is assessed annually. Accounting period may be a calendar year i.e., January 1 to December 31 or any other period of twelve months, say April 1 to March 31. The final accounts are prepared at the end of each accounting period and the financial reports thus, prepared facilitate to make good decision, corrective measures, business expansion etc. and also enable the end users to make an assessment of the progress of the organization.

Consistency Concept

The principle of consistency means that the same accounting principles should be used for preparing financial statement for different periods. It means that there should not be a change in accounting methods from year to year. Comparisons are possible only when a consistent policy of accounting is followed. If there are frequent changes in the accounting methods, there is little scope for reliability. Consistency eliminates personal bias and helps in achieving comparable results. If this principle of consisting is not followed, the accounting information about an organization cannot be usefully compared with similar information about other organizations and so also within the same organization for some other period. Consistency principle enhances the utility of the financial statements. However, consistency does not prohibit change. When a change is desirable, the change and its affect should be clearly stated in financial accounts.

Full Disclosure Concept

This concept states that the financial statements are to be prepared honestly and all significant information should be incorporated there in because these statements are the basic means of communicating financial information to all interested parties. Therefore, these statements should be prepared in such a way that all material information is clearly disclosed to the persons interested in its affairs. The purpose of this concept is that anybody who wants to study the financial statements should not be prejudiced by concealing any facts. It is, therefore, necessary that the disclosure should be fair and adequate to make impartial judgment.

9) Discuss in brief the basic accounting concepts and fundamental accounting assumptions.

Accounting principles are built on a foundation of a few basic concepts. These concepts are so basic that most preparers of financial statements do not consciously think of them, they are regarded as self-evident. According to Label (2013, ch.2) the basic accounting concepts are as follows:

1. **Going-Concern Concept** – The organization is viewed as long time existing entity. The philosophy behind is to see everything in long run, for long period in the future. The individual financial statements are part of a continuous, inter-related series of statements. This implies that data communicated are tentative. One should look back into the history to understand the present.

2. **Entity Concept -** The entity concept assumes that the financial statements and other accounting information are for the specific organizations which is distinct from its owners. Consequently, the analysis of business transactions involving costs and revenue is expressed in terms of the changes in the organization's financial conditions. This concept, therefore, enables the accountant to distinguish between personal and business transactions. The concept applies to sole proprietorship, partnership, companies, and small and large enterprises.

3. **Money Measurement Concept -** The common denominator chosen in accounting is the monetary unit. Money is the common denominator in terms of which the exchangeability of goods and services, including labor, natural resources and capital, are measured. Money measurement concept holds that accounting is a measurement and communication process of the activities of the firm that are measurable in monetary terms. Obviously, financial statements should indicate the money used. Money measurement concept implies two limitations of accounting. First, accounting is limited to the production of information expressed in terms of a monetary unit: it does not record and communicate other relevant but non-monetary information. Secondly, the monetary measurement concept concerns the limitations of the monetary unit itself as a unit of measure.

4. **Accounting Period Concept -** Financial accounting provides information about the economic activities of an enterprise for specified time periods that are shorter than the life of the enterprise. Normally, the time periods are of equal length to facilitate comparison. The time period is

identified in the financial statements. The time periods are usually of twelve months. Sometimes quarterly or half-yearly statements are also issued.

5. **Cost Concept** - The cost concept requires that assets be recorded at the exchange price, i.e., acquisition cost or historical cost. Historical cost is recognized as the appropriate valuation basis for recognition of the acquisition of all goods and services, expenses, costs and equities. For accounting purposes, business transactions are normally measured in terms of the actual prices or costs at the time the transaction occurs, i.e., financial accounting measurements are primarily based on exchange prices at which economic resources and obligations are exchanged. Thus, the amounts at which assets are listed in the accounts of a firm do not indicate what the assets could be sold for.

6. **Dual-Aspect Concept** - This concept lies at the heart of the whole accounting process. The accountant records events affecting the wealth of a particular entity. The question is—which aspect of this wealth is important? Since an accounting entity is an artificial creation, it is essential to know to whom its resources belong to or what purpose they serve. It is also important to know what kind of resources it controls, e.g., cash, buildings or land. Accounts recording systems have therefore developed so as to show two main things: (a) the source of wealth, and (b) the form it takes. Any transaction or event affecting the wealth of entity must have two aspects recorded in order to maintain the equality of both sides of the accounting equation (debit – credit).

7. **Accrual Concept** - Accrual accounting attempts to record the financial effects on an organization of transactions and other events and circumstances that have cash consequences for the for the organization in the periods in which those transactions, events and circumstances occur rather than only in the periods in which cash is received or paid by the organization.

8. **Conservatism Concept** - This principle is often described as "anticipate no profit and provide for all possible losses." The concept of accounting conservatism suggests that when and where uncertainty and risk exposure so warrant, accounting takes a wary and watchful stance until the appearance of evidence to the contrary. For example, inventories are valued at the lower ends of cost or market value. In its application to the income statement, conservatism encourages the recognition of all losses that have occurred or are likely to occur but does not acknowledge gains until actually realized.

9. **Matching Concept** - The matching concept in financial accounting is the process of matching accomplishments or revenues with efforts or to a particular period for which the income is being determined. This concept emphasizes which items of cost are expenses in a given accounting period. That is, costs are reported as expenses in the accounting period in which the revenue associated with those costs is reported.

10. **Realization or Recognition Concept** - The realization or recognition concept indicates the amount of revenue that should be recognized from a given sale. Realization rules help the accountant in determining that a revenue or expense has occurred, so that it can be measured, recorded, and reported in financial reports.

11. **Consistency Concept** - This concept requires that once an organization has decided on one method, it should use the same method for all subsequent transactions and events of the same nature unless it has sound reasons to change methods. If accounting methods are frequently changed, comparison of financial statements for one period with those of another period would be difficult. Consistency is necessary to help external users in comparing financial statements of a given firm over time and in making sound economic decisions.

12. **Materiality Concept** - In law there is a doctrine called de minimis non curat lex, which means that the court will not consider trivial matters. Similarly, the accountant does not attempt to record events so insignificant that the work of recording them is not justified by the usefulness of the results. Materiality concept implies that the transactions and events that have immaterial or insignificant effects should not be recorded and reported in the financial statements.

13. **Full Disclosure Concept** - The full disclosure concept requires that a business enterprise should provide all relevant information to external users for the purpose of sound economic decisions. This concept implies that no information of substance or of interest to the average investors will be omitted or concealed from an entity's financial statements.

10) Why should accounting practices be standardized?

The Generally Accepted Accounting Principles (GAAP) are very important, because the make financial reporting all over the world standardized and transparent, using commonly accepted terms, practices, and procedures. The consistency of presentation of financial reports that results from GAAP makes it easy for interested partied to understand financial statements and compare them with ones of another organization. GAAP makes organizations more accountable by requiring them to clearly and honestly report their finances.

11) Is it possible to give a true and fair view of a company's position using accounting information? Explain.

Yes, and is the responsibility of the management to make sure that financial statements of the organization are true and fair. This means that the financial statements are free from material misstatements and faithfully represent the financial performance and position of the organization.

True suggests that the financial statements are factually correct and have been prepared according to GAAP and they do not contain any material misstatements that may mislead the users. Misstatements may result from material errors or omissions of transactions & balances in the financial statements.

Fair implies that the financial statements present the information faithfully without any element of bias and they reflect the economic substance of transactions rather than just their legal form.

12) Explain the following:

i) Accounting equation

According to the Study Manual (p. 33-34) the recording of transactions in the books of accounts is based on accounting equation. Accounting equation is a formula expressing equivalence of the two expressions of assets and liabilities. The relationship will remain the same on account of dual aspect of the transaction. Each transaction has double effect on the financial profit of a concern. Thus, the total claims will equal to the total assets of the organization. The accounting equation can thus be expressed as follows:

Cash (Asset) = Capital (Liabilities) or Total Assets = Total Liabilities (Capital + Liabilities)
Fixed Assets + Current Assets = Internal Liabilities + External Liabilities Capital = Assets – Liabilities or Liabilities = Assets – Capital

ii) Convention of materiality

According to this convention only those events should be recorded which have a significant bearing and insignificant things should be ignored. The avoidance of insignificant things will not materially affect the records of the business. It should be seen that the efforts involved in recording the events should be worth the labor involved in it. There is no formula in making a distinction between material and immaterial events. It is a matter of judgment and it is left to the accountant to take a decision. The application of materiality concept is justifiable in so far as it serves to reduce the cost of accounting.

iii) Accounting standards

Accounting Standards (AS) are basic policy documents. Their main aim is to ensure transparency, reliability, consistency, and comparability of the financial statements. They do so by standardizing accounting policies and principles, so the transactions of all companies will be recorded in a similar manner if they follow these accounting standards. These Accounting Standards (AS) are issued by an accounting body (GAAP) or a regulatory board or sometimes by the government directly.

iv) Accounting process

Accounting process - is a series of procedures in the collection, processing, and communication of financial information. Accounting involves recording, classifying, summarizing, and interpreting financial information.

v) Branches of accounting

To meet the requirements of different people interested in accounting information, accounting can be broadly classified into three branches/categories:

a) **Financial Accounting**, which provides information regarding the status of the organization and results of its operations to management as well as to external parties.
b) **Cost Accounting,** which is the process of accounting for costs. It includes the accounting procedures relating to recording of all income and expenditure and preparation of periodical statements and report with the object of ascertaining and controlling costs. Such cost accounting is a good technique for determining profitability and supply information for decision making.
c) **Management Accounting**, which is a systematic approach to planning and control functions of management. It generates information for establishing plans and controls. It provides for a system of setting standards, plans, or targets and reporting variances between planned and actual performances for corrective actions.

vi) Accounting a source of financial information

Accounting is considered as the language of a business. It is used as a means of communication between a business organization and its shareholders. The accounting process is a source of information, it uses business data and processes it to generate relevant information. Accounting is the management information system of any organization and is concerned with providing necessary information to the management, i.e it is a source of information.

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