**Module 2 Assignment**

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Registration number is AIPMS/271/2019.

Africa Institute for Project Management Studies (AIPMS)

*Date 31st –July -2019*

**Course: Diploma in Financial Management for NGO’S.**

**Annotation**

Accounting‘s all about to deal with business and it numerous of transactions that may take place every day. It is humanly impossible to remember all of them. With the help of accounting records the businessman is able to ascertain the profit or loss and the financial position of the business at a given period and communicate such information to all interested parties. In this unit you will learn about an overview of accounting and the basic concepts which are to be observed at the recording and reporting stage. You will also learn different stages involved in accounting process and importance of accounting standards to maintain uniformity in the practice of accounting.

Module 2 Assignment

# Q1- What are operating and non-operating profits?

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. In fact, operating activities are the principal revenue-producing activities of the enterprise. Operating income measures the efficiency of a business enterprise, because these activities makeup the main business of the enterprise and are of recurring in nature.

**The operating activities may be:**

* Purchasing and selling of goods.
* Services and even securities by a Trading concern
* Exploration of natural resources by Extracting & Trading entity.
* Granting of loans and advances by a ‘Financial Institution’.
* Construction and development of colonies by construction enterprise.

Operating expenses are those expenses which are incurred in connection with main revenue producing activities. These operating expenses may be classified under various heads, such as office and administrative expenses and selling and distribution expenses.

These expenses are necessary to run the business enterprise but which are not directly related to trading or manufacturing activities. These directly related expenses are termed as direct

Expenses,

Which are charged to Manufacturing/Trading/Account.

However Operating Profit = Gross Profit – Operating Expenses (Office and Selling Distribution).

Equal = GP-OE.

Whereas Non-operating Incomes/profit.

Such incomes arise from other than major or principal revenue earning activities. These are in the form of, in case of:

* A manufacturing and trading concern,
* Rent received,
* Interest received,
* Dividend received,

Which are credited to Profit and Loss Account.

Profit on sale of fixed assets and the revenue arising from activities which are incidental to main business, are treated as non-operating profits.

Such types of incomes arise when unused portion of building used for business purposes is let-out or idle funds of business invested either in shares, debentures, government securities or deposited in a fixed deposit account.

Since such incomes have nothing to do with the business operation of the enterprise, these incomes are treated as non-operating profit.

**Q2- What do you understand by “Grouping” and “Marshalling” of assets and liabilities?**

The Grouping and Marshalling are the steps taken during the balance sheet preparation hence to arrange the asset and liability on their order and benchmark,

The two steps are as follows

1. Grouping
2. Marshalling

The first step refers to proper grouping of the various items, which are of similar nature. For example, amount due from persons who were sold goods on credit basis must be shown under the heading ‘Trade Debtors’ and must be distinguished from money owing other than due to credit sales of goods.

The second step involves ‘marshalling’ of assets and liabilities. It means orderly arrangement in which assets and liabilities are presented or shown in the Balance Sheet.

There are two methods of presentation:

1. In order of “Liquidity, and
2. In order of “permanence”. Under the “Liquidity Order”, assets are shown on the basis of liquidity or Reliability.

These are arranged in order of “most liquid”, more liquid”, “liquid”, “and least liquid” and “not liquid” (fixed) assets. Similarly, liabilities are arranged in the order in which these are to be paid or discharged.

The liquidity form is suitable for banking and other financial companies. Under the ‘‘Order of Permanence”, the assets are arranged on the basis of their useful life. The assets which are to serve business for the longest period of time are shown first, i.e. Fixed Assets, Semi Fixed, Current, Liquid and Most Liquid. Similarly, in case of liabilities, after Capital, the liabilities are arranged as long term, medium term, short term and current liabilities. The Companies Act has adapted permanency form preparing balance sheet. Some Important Items.

**Q3- Write short notes on the following:**

* **Outstanding of Expenses:** are the Income Received in Advance, Amount payable to Subsidiaries. Its therefore to be noted that short-term loans and interest outstanding thereon are to be shown Financial Statements under “Secured” or “Unsecured Loan” as the case may be and not under Current Liabilities.
* **Accrued Incomes:** are prepared expenses and unearned incomes, etc., while preparing the final accounts at the end of the accounting period. By application of this concept, the owner of the business easily knows about the operating results of his business and can make effort to increase earning capacity.
* **Intangible Assets:** Intangible assets are those capital assets which do not have any physical existence. Though cannot be touched or seen yet they have long life and help to generate income. Such assets have value by virtue of the rights conferred upon the owner by mere possession. Goodwill, trademarks, copyrights and patents are the examples of intangible assets.
* **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.
* **Cost of Conversion:** can be defined as a direct labor cost is a part of both Prime Cost and Conversion Cost because Conversion Cost is a cost that is needed to convert a raw material into finished goods and it includes all the cost to convert the raw material into finished goods except the cost of raw material.
* **Cost of Goods Sold:** The cost of goods sold is the cost of the products that a retailer, distributor, or manufacturer has sold. The cost of goods sold is reported on the income statement and should be viewed as an expense of the accounting period.
* **Direct vs. Indirect Expenses:** Direct expenses are those expenses that are paid only for the business part of your home, while Indirect Expenses are those expenses that are paid for keeping up and running your entire home. Examples of indirect expenses generally include **insurance, utilities, and general home repairs.**

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

The main objectives of accounting are as follows:

1. **To keep systematic records of the business:** Accounting keeps a systematic record of all financial transactions like purchase and sale of goods, cash receipts and cash payments etc. It is also used for recording all assets and liabilities of the business. In the absence of accounting it is impossible to a human being to keep in memory all business transactions.
2. **To ascertain profit or loss of the business :** By keeping a proper record of revenues and expenses of business for a particular period, accounting helps in ascertaining the profit or loss of the business through the preparation of profit and loss account. Profit and Loss account helps the interested parties in assessing the profit or loss made by the business during a particular period. It also helps the management to take remedial action in case the business has not proved remunerative or profitable. A proper record of all incomes and expenses helps in preparing a profit and loss account and in ascertaining net operating results of a business during a particular period.
3. **To ascertain the financial position of business :** The business man is also interested to know the financial position of his business apart from operating results of the business during a particular period. In other words, he wants to know how much he owns and how much owes to others. He would also like to know what happened to his capital, whether it has increased or decreased or remained constant. A systematic record of assets and liabilities facilitates the preparation of a position statement called Balance Sheet which provides necessary information to the above questions. Balance Sheet serves as barometer for ascertaining the financial solvency of the business.
4. **To provide accounting information to interested parties:** Apart from owners there are various parties who are interested in the accounting information. These are bankers, creditors, tax authorities, prospective investors etc. They need such information to assess the profitability and the financial soundness of the business. The accounting information is communicated to them in the form of an annual report. Parties Interested in Accounting Information Many people are interested in examining the financial information provided in the financial statements besides an owner or management of the concern.

These financial statements help them to know the following:

1. To study the present financial position of business,
2. To compare its present performance with that of past years, and
3. To compare its performance with similar enterprises.

***The following are the various parties interested in the financial statements:***

1. **Owners/Shareholders:** Shareholders are the real owners of the company because they contribute the required capital and take the risk of business. Obviously they are interested to know the result of operations and financial position of the company. The shareholders are also interested to use the accounting information to evaluate the performance of the managers because in company type of organization management of business is vested in the hands of paid managers. 9 Accounting: An overview
2. **Prospective Investors:** The persons who are interested in buying share of a company or who want to advance money to the company would like to know how safe and rewarding the investments already made or proposed investments would be.
3. **Lenders:** Initially the required funds of the business are provided by the owners. When business is going on, it requires more funds. These funds are usually provided by bank sand other money lenders. Before lending money they would like to know about the solvency of the enterprise so as to satisfy themselves that their money will be safe and repayments will be made on time.
4. **Creditors:** The creditors are those who supply goods and services on credit. These creditors like other money lenders are also interested to know the credit worthiness of the business. The accounting information greatly helps them in assessing the ability of the enterprise to what extent credit can be granted.
5. **Managers:** Accounting information is very much useful to managers. It helps them to plan, control and evaluate all business activities. They also need such information for making various decisions relating to the business.
6. **Government:** The Government may be interested in accounting information of a business on account of taxation, labor and corporate laws. The financial statements are of great importance for assessing the tax liability of the enterprise.
7. **Employees:** The employees of the enterprise are also interested in knowing the state of affairs of the organization in which they are working, so as to know how safe their interests are in the organization. The knowledge of accounting information helps them in conducting negotiations with the management.
8. **Researchers:** The accounting information is of immense value to the researchers undertaking research in accounting theory and practices.
9. **Citizen:** An ordinary citizen as a voter and tax payer may be interested to know the accounting information to measure the performance of Government Company or a public utility concern like banks, gas, transport, electricity companies etc

#### Q4- Briefly explain the accounting concepts which guide the accountant at the recording stage?

##### The below are the fundamental ideas or basic assumptions underlying the theory and practice of financial accounting and are broad working rules for all accounting activities developed and accepted by the accounting profession. It brings about uniformity in the practice of accounting. Concepts to be observed at the Recording Stage are briefly explain as follow,

##### Business Entity Concept

##### Money Measurement Concept

##### Objective Evidence Concept

##### Historical Record Concept

##### Cost Concept

##### Dual Aspect Concept

##### **Q5- What do you understand by Dual Aspect Concept? Explain the accounting implications?**

This is a basic concept of accounting. According to this concept every business transaction has a two-fold effect. In commercial context it is a famous dictum that “every receiver is also a giver and every giver is also a receiver”. For example, if you purchase a machine for SSP. 8,000, you receive machine on the one hand and give SSP. 8,000 on the other. Thus, this transaction has a two-fold effect i.e.

A -Increase in one asset, and

B - Decrease in another asset.

Similarly, if you buy goods worth SSP. 500 on credit, it will increase an asset (stock of goods) on the one hand and increase a liability (creditors) on the other.

Therefore, every business transaction involves two aspects

* + - The receiving aspect, and
    - The giving aspect.

In case of the first example you find that the receiving aspect is machinery and the giving aspect is cash. In the second example the receiving aspect is goods and the giving aspect is the creditor.

If complete record of transactions is to be made, it would be necessary to record both the aspects in books of account.

This principle is the core of double entry book-keeping and if this is strictly followed, it is called “Double Entry System of Book-keeping’.

**There is another accounting implication of the dual aspect concept.**

Hence, the initial funds (capital) required by the business are contributed by the owner. If necessary, additional funds are provided by the outsiders (creditors). As per the dual aspect concept all these receipts create corresponding obligations for their repayment, In other words, a contribution to the business, either in cash or kind, not only increases its resources (assets), but also its obligations (liabilities/equities) correspondingly.

Therefore 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’.

Here it’s under:

Liabilities (Equities) = Assets

Capital +Outside Liabilities = Assets

The term ‘assets’ denotes the resources (property) owned by the business while the term ‘equities’ denotes the claims of various parties against the business assets. Equities are of two types:

* + 1. Owners’ equity, and
    2. Outsiders’ equity.

Owners’ equity called capital is the claim of owners against the assets of the business outsiders’ equity called liabilities is the claim of outside parties like creditors, bank, etc. against the assets of the business.

Thus, all assets of the business are claimed either by the owners or by the outsiders. Hence, the total assets of a business will always be equal to its liabilities. When various business transactions take place, they affect the assets and liabilities in such a way that this equity is maintained.

**Q6- Explain the role of Management Accountant in a modern business organization?**

Accountant is responsible for installation, development and efficient functioning of the management accounting system. Some of his role in the modern business are explain as bellows.

1. **Planning and Control:**
   1. Management accountant establishes, coordinates and maintains an integrated plan for the control of operations. Such a plan would provide, to the extent required in the business cost standards, profit planning, programmes for capital investing and for financing, sales forecast and the expense budgets, together with necessary procedures to effectuate the plan.
   2. **Reporting and Interpreting***:*
2. Management accountant measures the performance against given plans and standards. The results of the operations are interpreted to all levels of management and to the owners of the business. This also includes installation of accounting and costing system and recording of actual performance to find out deviation, if any.
   1. **Evaluation of Policies and Programmes:**He is responsible to evaluate various policies and programmes. The effectiveness of policies programmes and organization structure to attain the objectives of the organization to a large extent depends upon the caliber of the management accountant.
   2. **Tax administration:** It is also the function of management accountant to report to the government as required under different laws in force and to establish and administer tax policies and procedures. He has also to supervise and coordinate preparation of reports to government agencies.
   3. **Protection of assets:** The management accountant has to assure fiscal protection for the assets of the business through *adequate internal control and proper insurance coverage.*
   4. **Appraisal of External Effects:** He has to assess continuously the effect of various economic and social forces and government policies and interpret their effect upon the business towards the attainment of common goals. The functions as stated above can also prove to be useful under the Indian context. Some of the above functions, in India are performed by Company Secretary, top level management, statistical department etc.

**Q7- What are the accounting concepts to be observed at the reporting stage? Explain any two in details.**

The following concepts have to be kept in mind 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

**1 Accounting Period Concept**

You know that the going concern concept assumes that life of the business is indefinite and the preparation of income and positional statements after a long period would not be helpful in taking appropriate steps at the right time. Therefore, it is necessary to prepare the financial statements periodically to find out the profit or loss and financial position of the business. 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 or Diwali to Diwali or Dasara to Dasara. 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 enterprise.

**2 Matching Concept**

Matching concept is based on the accounting period concept. The matching concept is also called Matching of costs against revenue concepts. To ascertain the profit made by the business during a particular period, the expenses incurred in an accounting year should be matched with the revenue earned during that year. The term ‘matching’ means appropriate association of related revenues and expenses. For this purpose, first we have to recognize the revenues during an accounting period and the costs incurred in securing those revenues. Then the sum of costs should be deducted from the sum of revenues to get the net result of that period. The question when the payment was received or made is irrelevant. In other words, all revenues earned during an accounting period, whether received or not and all costs incurred, whether paid or not have to be taken into account while preparing the final accounts. Similarly, any amount received or paid during the accounting period which actually relates to the previous accounting period or the following accounting period must be eliminated from the current accounting period’s revenues and costs. Therefore, adjustments are to be made for all outstanding expenses, accrued incomes, prepared expenses and unearned incomes, etc., while preparing the final accounts at the end of the accounting period. By application of this concept, the owner of the business easily knows about the operating results of his business and can make effort to increase earning capacity.

**Q8- Discuss in brief the basic accounting concepts and fundamental accounting assumptions?**

These are the fundamental ideas or basic assumptions underlying the theory and practice of financial accounting and are broad working rules for all accounting activities developed and accepted by the accounting profession. It brings about uniformity in the practice of accounting.

These concepts can be classified into two broad groups which are as follows:

1) Concepts to be observed at the recording stage i.e., while recording the transactions, and

2) Concepts to be observed at the reporting stage i.e., at the time of preparing final accounts. It must however be remembered that some of them are overlapping and even contradictory.

**Q9- Why do accounting practices be standardized? What progress has been made in India regarding standardization of accounting**?

GAAP is a **standardized** set of guidelines created by the Financial **Accounting** Standards Board (FASB) to ensure that all financial statements undergo the same processes so that the disclosed information is relevant, reliable, comparable, and consistent.

**Accounting** is often considered the language of business, as it communicates to others the financial position of the company. ... The main aim is to improve the reliability of financial statements. Now because the financial statements have to be made following the standards the users can rely on them.

The accounting policy selected must fit within the limits set by generally accepted accounting principles and also comply with the statutory requirements

The Accounting Standard Board (ASB) of India, has developed so far 27 standards to improve quality and parity with the preparation of financial statements.

**Q10- Is it possible to give a true and fair view of a company’s position using accounting information? Explain.**

This concept is subject to criticism that it is against the convention of full disclosure. It encourages creation of secret reserves and financial statements do not reflect a true and fair view of the affairs of the business.

**Explain the following:**

1. **Accounting Equation:**

Accounting equation is all about formula expressing equivalence of the two expressions of assets and liabilities. Thus, the total claims will equal to the total assets of the firm. The total claims may be to outsiders and the proprietor. In the beginning the owner of the firm provides funds to the business in the form of ‘capital’ which is also known as ‘owner’s equity’. In first place the capital contributed by the owner to the business will be in the form of cash and this cash is treated as an asset of the firm. At the same time a liability will be created in the form of owners’ equity according to business entity concept (i.e., business and the owner are two separate entities). Therefore, the asset is (cash) balanced against liability (capital).

The accounting equation can therefore be expressed as follows:

Cash (Asset) = Capital (Liabilities)

Total Assets = Total Liabilities (Capital + Liabilities)

**ii) Convention of materiality:** The materiality concept is an established accounting convention, recognized universally. Another such principle is the historical cost convention by which firms: Record transactions at the prevailing price at the time of acquisition.

**iii) Accounting standards i:** An accounting standard is a common set of principles, standards and procedures that define the basis of financial accounting policies and practices. Accounting standards improve the transparency of financial reporting in all countries.

* **iv) Accounting process:** is a series of activities that begins with a transaction and ends with the closing of the books. Because this process is repeated each reporting period, it is referred to as the accounting cycle and includes these major steps: Identify the transaction or other recognizable event. Analyzing and Classify Data about an Economic Event.
* Journalizing the transaction.
* Posting from the Journals to General Ledger.
* Preparing the Unadjusted Trial Balance.
* Recording Adjusting Entries.
* Preparing the Adjusted Trial Balance.
* Preparing Financial Statements. Etc.

**v) Branches of accounting v:** Some popular types or branches of accounting are briefly discussed below:

* Financial accounting.
* Management accounting.
* Cost accounting.
* Tax accounting.
* Project accounting.
* Not-for-profit accounting.
* International accounting.
* Government accounting.

**vi) Accounting a source of financial information.** Accounting is regarded 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.

(Mr. John Gatwich Kuol Year 2019)

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Last Name, John Gatwich. (2019).

*ACCOUNTING AND FINANCIAL STATEMENTS.* City Name Juba South sudan: Publisher Name. **F M**