PRINCIPLES OF ACCOUNTING

- HAWASSA UNIVERSITY
- COLLEGE OF AGRICULTURE
- DEPARTMENT OF AGRIBUSINESS AND VALUE CHAIN MANAGEMENT
- CREDIT HOUR: 3
- Academic year: 2016/17
- INSTRUCTOR ASFAW D.(MSC.)

SECTION ONE

- **Definition:**
- **Accounting** is a process of identifying, analyzing, recording, summarizing, reporting, and interpreting F/I to decision makers.
- **Accounting as Language of Business:**

- by which people in business and organization communicate.

A Business

- is an organization in which basic resources are assembled and processed to provide goods or services to customers.
- It starts from a local coffee house to a large co.
- The objective of most businesses is to earn a profit.
- Profit is the difference between revenue & cost.

Types of Businesses

- Based on their functions:

- service,

-merchandising, and

-manufacturing businesses.

etc

Based on their legal forms:

- Sole proprietorship,

-Partnership,

- Corporation, cooperatives,

- based in areas of operation:

- business dealing with agricultural activities (production, processing) are said to be ***Agribusiness***.

Users of Accounting Information

- **Internal users and External users;**
- **Internal users:** managers and employees
- are directly involved in managing and operating the business.
- area of accounting that provides an internal user with information is called managerial accounting
- managerial accounting is provide relevant and timely information for managers' and employees'
- Internal information is sensitive and is not distributed outside the business

Users of Accounting Information

- Examples of sensitive information might include
  - information about customers,
  -prices, and
  -plans to expand the business.

➢ **External users:** customers, creditors, suppliers and the government.

- are not directly involved in managing and operating the business.
- area of accounting that provides external users with information is called **financial accounting**.

Profession of Accountancy

- **Private Accounting** - Accountants employed by a particular business firm not-for-profit organization or by government entities as chief accountant, controller & etc.
- **Public Accounting**: - Accountants who render accounting services on a fee basis and staff accountants employed by them

GAAPs

- Financial accountants follow GAAP in preparing reports.
- These reports allow investors and other users to compare one company to another.
- Financial Accounting Standards Board (FASB). It is accepted acctng practices, pronouncements of professional & authoritative bodies that GAAP evolve to form the underlying basis for accounting practice.

Accounting principles and concepts

- Business Entity Concept:
- The Cost Concept
- Objectivity concept
- Unit of Measure Concept
- Matching concept
- Going concern concept
- Consistency Principle
- Materiality principle

Accounting principles and concepts

- Business Entity Concept :activities of a business are recorded separately from the activities of its owners, creditors, or other businesses.
- Cost Concept :amounts are initially recorded in the accounting records at their cost or purchase price.
- Objectivity concept: requires that the amounts recorded in the accounting records be based on objective evidence.

-If records revised based on offers, appraisals, & opinions, accounting reports could become unstable and unreliable.

Accounting principles and concepts

- Unit of Measurement Concept: requires that economic data be recorded in money/Dollars, Birr,
- Matching concept: supports reporting revenues and related expenses in the same period (I/S)
- Going concern concept: states that an enterprise is expected to operate for an indefinite period of time.
- Consistency Principle: Organizations must consistently apply the same accounting principles from period to period. Use to compare d/t yrs data

Accounting principles and concepts

- Materiality principle: States that ‘material’ items should be given more emphasis than immaterial ones.

-An item is material if its disclosure is likely to affect users’ decisions.

Business Transactions

- A ***business transaction*** is the occurrence of an event or a condition that must be recorded.

Eg. -Payment of telephone bill of 100 birr,

-Purchase of merchandise on credit for 1200birr,

-Acquisition of Land and Building for 210,000 birr,

-sales of goods & services on cash for 2000birretc.

A particular business transaction may lead to an event or a condition that result in another transaction.

Business Transactions cont…

- For example, the purchase of merchandise on credit will be followed by payment to the creditor, which is another transaction. Each time a portion of a merchandise sold, another transaction occurs.
- Business transaction could be internal transaction or external transaction
- *External transactions* are an exchange of

Business Transactions cont…

- *Internal transactions* are internal conditions, such as

  -the wearing-out of building,

  - consumption of office supplies, etc., that must be recorded.

The Basic Accounting Equation

- The resources owned by a business are its **assets**.

Eg. cash, land, buildings, and equipment.

- The rights or claims to the assets are divided into two types:

(1) the rights of creditors and

(2) the rights of owners.

The rights of creditors are the debts of the business and are called **liabilities**.

The rights of the owners are called **owner's equity**.

Assets = Liabilities + Owner's Equity

- It is customary, to place "liabilities" before" owner's Equity" in accounting equation b/c creditors have preferential rights to assets.
- Any ↑ or ↓ in assets results in ↑↓ corresponding ↑↓ or ↓ in liabilities or owner's Equity or both.
- The two sides of the equation must always be equal.

Assets = Liabilities + Owner's Equity

20,000=9,000+ 11,000

Transaction and the Accounting Equation

- All business transactions, can be stated in terms the resulting change in the three basic elements of the accounting equation(asset, liabilities & Owner's Equity)

Financial Statements

- After the effect of individual transaction has been determined, the essential information is communicated to users.
- The accounting statements that communicate this information are called *financial statements*.
- Financial statements are the result of financial accounting process.

Income statement

- Presents the results of operations of an entity for a particular period of time.
- It is a summary of the revenue and the expenses of a business entity for a specific period of time, such as a year or month.
- The excess of revenue over the expenses incurred in the earning the revenue is called **net income**.
- If the expenses of the enterprise exceed the revenue, the excess is a **net loss**.

Net solutions
Income statement
For the month ended November 30, 2009

Fees Earned		**7500**
Operating expenses		
Wage expense	2125	
Rent expense	800	
Supplies expense	800	
Miscellaneous expense	275	
Total operating expenses		(4000)
Net Income		3500

Statement of Owner's Equity-

- Presents information about how owner's equity has changed over a particular period of time.
- It is the summary of the changes in the owner's equity of a business entity that have occurred during a specific period time.

Statement of Owner's Equity-

- Generally we have said that three types of transactions affect owner's Equity during a period:
  - Investment by owner
  - Revenues and Expenses as a result of operation of a business, and
  - Withdrawal by owner.
- It is considered as a link between the balance sheet and the income statement.

Net Solutions
Statement of Owner's Equity
For the month ended, November 30, 2009

Balance before November 1	**0**
Add: Investments in November 1,2005	25000
Net income for November	3500
Sub-total	28500
Less: Withdrawals in January	(2000)
Chris Clark, capital, November 30, 2009	**26,500**

Balance sheet

- Presents information about the financial position of an entity at a particular date.
- It is a list of assets, liabilities and owner's equity of a business entity as of a specific date, usually at the close or the last day of a month or a year.

Balance sheet cont…

- Report format – Under the report format liabilities and owner's equity are listed below the asset section.
- Account format– Under this formats assets are listed on the left and liabilities and owner's equity are listed on the right. It resembles the accounting equation.
- Financial position format- It is a vertical format in which current liabilities are deducted from current assets to derive working capital. Other assets then are added and other liabilities are deducted leaving a residual amount as an owner's equity.

Net Solutions
Balance sheet
November 30, 2009

Assets		Liabilities:	
Cash	5,900	Accounts payable	400
Supplies	550	**Owner's Equity:**	
Land	20,000	Chris Clark, capital	26,050
Total Assets	26,450	Total Liabilities & Owner's	26,4

Statement of Cash flow

- A summary of cash receipts and cash payments of a business entity for a specific period of time such as a month or a year.
  - Operating activities
  - Investing activities
  - Financing activities

Operating activities

- *Cash inflows*: - Collection of Receivable, sale of merchandise on cash, collection of interest Revenue, collection of dividend from investment in other companies, etc.
- *Cash outflows*: - Payments for creditors for purchase of inventory or supplies; and other payment for business operating costs, payment for interest on debt.

Investing activities

- purchase or sale of productive assets like: Building, Land, Machinery, furniture and Fixtures, etc and Purchase or sale of other companies debt or equity or other long term securities.

Financing activities

- the cash flows from financing activities section reports cash transactions related to cash investments by the owner, borrowings and cash withdrawals of owner.
- For corporation form of business these include payment of dividend to stockholders; issuance of equity or debt securities; repayment of the loan principal.

Net Solutions
Statement of Cash Flows
For the month ended, November 30, 2009

Cash flows from operating activities:	
Cash Received from customers	7500
Deduct: Cash payments for expenses and To creditors	(4600)
(a) Net cash flow from operating activity	2,900
Cash flow from investing activity	
(b) Cash payments for acquisition of land	(20,000)
Cash flow from Financing activity	
Cash received as owner's investment	25,000
Deduct: Cash withdrawal by owner	(2000)
(c) Net cash flow from financing activities	23,000
Net cash flow on November 30, 2009 cash balance [(a) +	**5,900**

END

END OF CHAPTER ONE

THANK YOU