

MODULE 03: FINANCIAL ANALYSIS

Lecture 01: Accounting Concepts

Lecturer: **Antoine p. Portelli**

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**Undergraduate Diploma in
Business Administration**

Module Outline

Introduction
to Accounting
Concepts

Financial
Systems

Accountancy
Techniques &
Ratios

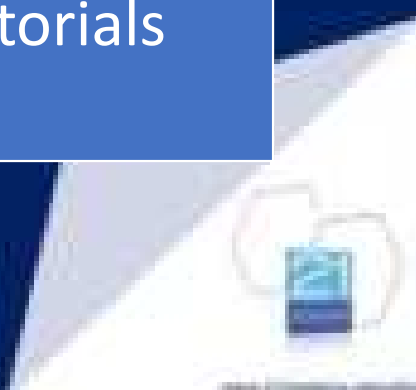
Short-Term vs
Long-Term
Decisions

Evaluation
Financial
Statements

Financial
Forecasts

Group
Presentations
& Assignment

Tutorials



Today's Agenda



Self- Assessment –
Part 1



Accounting
Principles &
Concepts



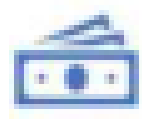
Accounting Theory



Business Set-Ups
and Formats

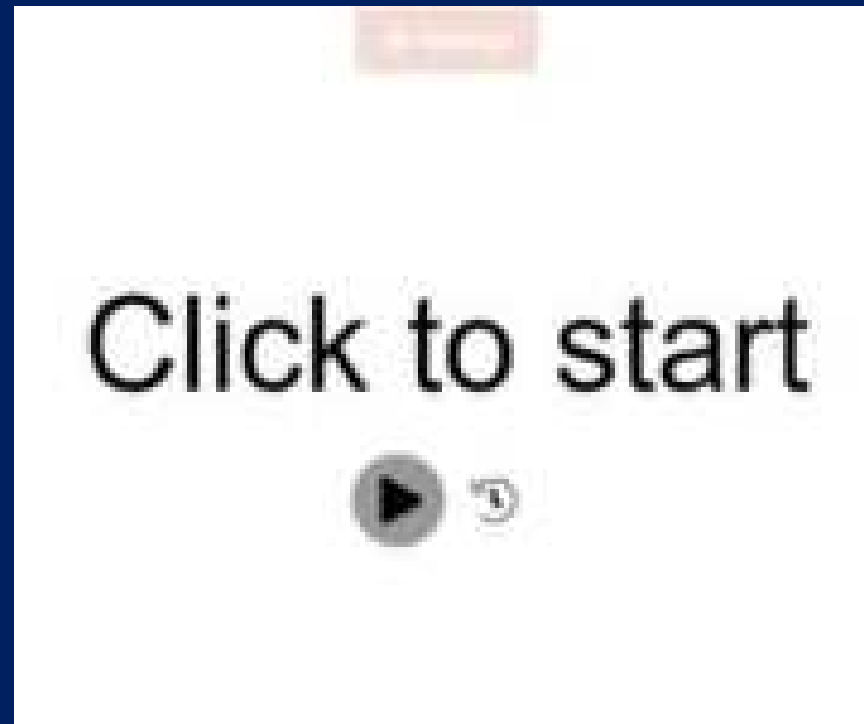


Books of Account



Financial
Statements

Self-Assessment



Accounting Environment



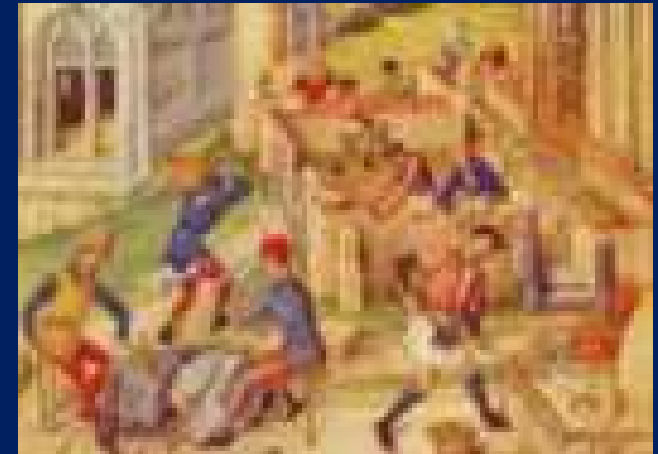
Accounting Environment

- Accounting has been defined as the language of business
- Accounting enables organizations to determine how much profits or losses have been made in a particular period (financial year)
- Accounting provides statistical benchmarks against which an organization's overall performance is measured
- Accounting provides a universal explanation of the financial strength of an organization



History

- Double-entry bookkeeping was developed in the **mercantile period** of Europe
- To help rationalize commercial transactions and make trade more efficient
- It also helped merchants and bankers understand their costs and profits
- Some thinkers have argued that double-entry accounting was a key calculative technology responsible for the birth of capitalism



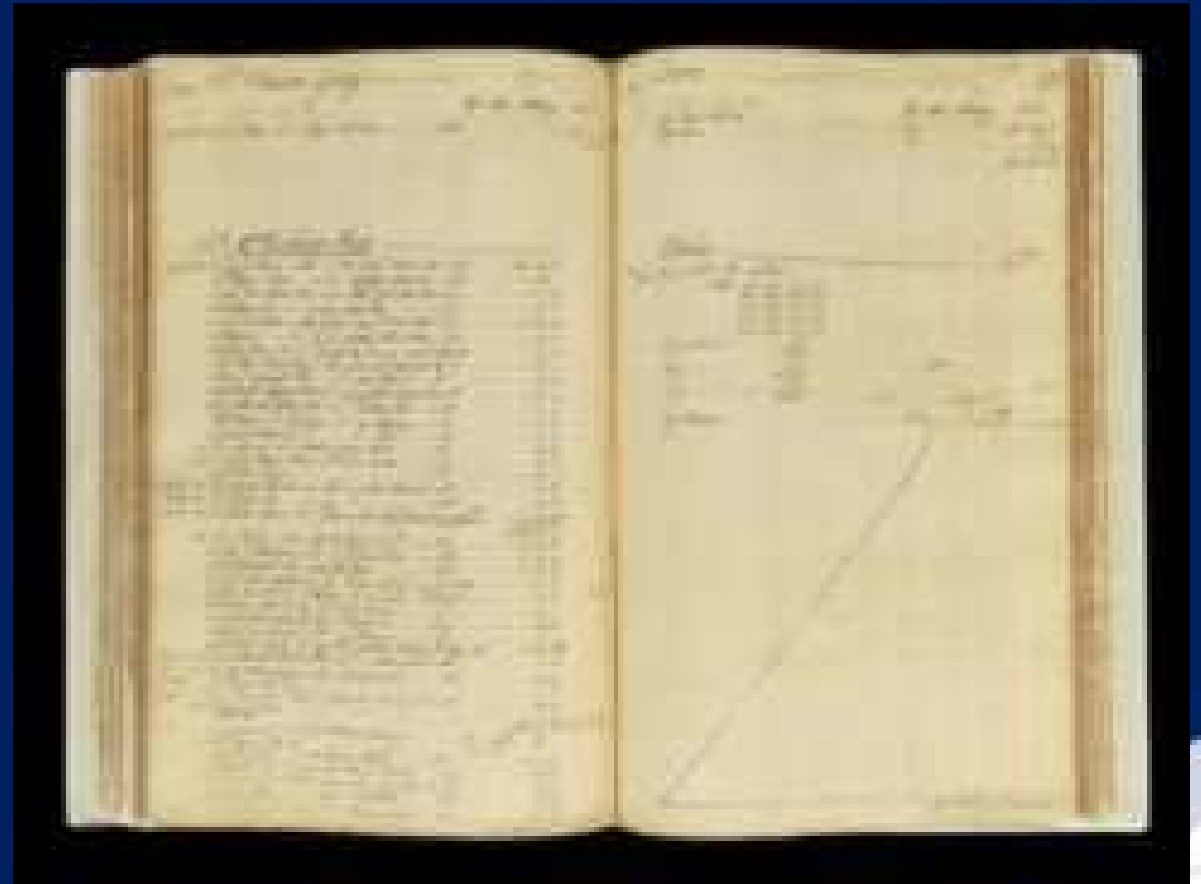
History

- The father of modern accounting is Italian Luca Pacioli, who in 1494 first described the system of double-entry bookkeeping used by Venetian merchants in his *Summa de Arithmetica, Geometria, Proportioni et Proportionalita*.



Book-Keeping...or Accounting ?

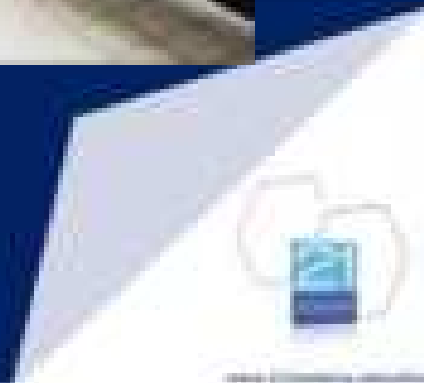
- Book-keeping focuses on recording and organizing financial data.
-
- Accounting is the interpretation and presentation of that data to business owners and investors.



Book-Keeping...or Accounting ?

Book-keeping typically consists of:

- invoicing
- receipts and bills
- recording business transactions
- payroll



Book-Keeping...or Accounting ?

Accounting typically consists of:

- financial statements and reports
- budgets
- tax returns
- analyzing business performance



Book-Keeping...or Accounting ?

The tasks that book-keepers and accountants do vary between businesses.

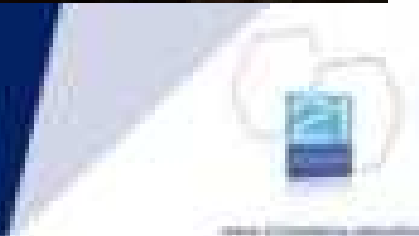
Book-keepers working for smaller businesses might do some basic accounting duties.

There's often overlap, and the duties may change a lot from one business to another.



Users of Accounting Information

- Owners / Shareholders / Partners
 - (Current Profitability, Capital Growth, Dividend Returns)
- Investors
 - (Future Profitability, Risks of Investment)
- Government
 - (Profitability, Taxation payments)



Users of Accounting Information

- Creditors/Suppliers
 - (Liquidity, Ability to repay debts, Time taken to pay debts)
- Employees
 - (Profitability, Organisation Growth, Organisational Stability, Security of Employment)
- Management
 - (Profitability, Return on Capital, Capital Growth, Owners' Satisfaction)
- General Public
 - (Profitability, Organisational Stability and Growth, Market Share)



Sources of Financial Information

- Financial Information is provided to different users from the annual published accounts
- These accounts are derived primarily from the accounting records and the annual financial statements
- Other sources of information include market surveys, company research information, share market prices, financial estimates and other relevant data that may be made available to users of accounting information



Accounting Principles



Accounting Principles

- All users will see the same financial statements
- Principles – to provide consistent usable financial statements
 - Relevance
 - Reliability
 - Comparability
 - Understandability



Accounting Principles

- **Relevance**

- Financial information is considered relevant if it affects the business decision

Any other decision outside of the business cycle is



Accounting Principles

• Reliability

- Information should be free from significant errors, bias and independently verified.

Auditors

Internal

External

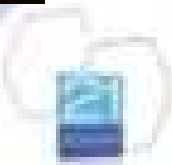
Opinions



Accounting Principles

- **Comparability**
 - Can be compared with other periods and similar businesses.

Like with Like



Accounting Principles

• Understandability

- The Financial Statements must be capable of being understood by the users of the report

Various users

Internal vs External

Name some



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Accounting Theory



The Accounting Theory



Business Set- Ups



Business Organisations

- Self-Employed – Sole Trader
- Self-Employed – With employees
- Partnership
- Limited Liability Company
- Public Company
- Government & Parastatal
- Group Structure
- VOs and Associations
- Trusts



Self-Employed

- A sole trader or practitioner
- Can work from home or mobile environment
- May have employees
- The **benefits** of being self-employed include:
 - being your own boss
 - creating your own schedule
 - flexibility
 - working towards your own dreams
 - taking enjoyment in the challenges of starting something from scratch
 - choosing the people you work with
 - creating your own work environment



Partnership

Advantages

- Two heads (or more) are better than one
- Your business is easy to establish
- Start-up costs are low
- More capital is available for the business
- Greater borrowing capacity
- High-calibre employees can be made partners
- Opportunity for income splitting, an advantage of particular importance due to resultant tax savings
- Partners' business affairs are private
- Limited external regulation
- Easy to change your legal structure later if circumstances change



Partnership

Disadvantages

- the liability of the partners for the debts of the business is unlimited
- each partner is 'jointly and severally' liable for the partnership's debts; that is, each partner is liable for their share of the partnership debts as well as being liable for all the debts
- there is a risk of disagreements and friction among partners and management
- each partner is an agent of the partnership and is liable for actions by other partners
- if partners join or leave, you will probably have to value all the partnership assets and this can be costly



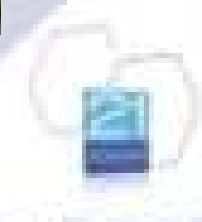
Limited Liability Company

- Formed by a group of persons
- Officially registered as a separate legal entity
- Shareholders own shares in Company
- Limited liability of Shareholders
- Perpetual existence
- Flexible Management structure
- Easy transferability of financial interests
- Taxation considerations
- Dividends distribution



Public Company

- Same structure of a Limited Liability Company
- Greater complexity and regulatory requirements
- Cost of setting Up
- Financial Reporting more detailed
- Investor Appetite
- Generation of greater funds
- Attracting top talent
- Reducing risk
- Image and brand



Government & Parastatal

Wholly owned by government

Advantages

- Control of strategic products
- Provides products at cheap prices
- Reduces duplication of resources
- Employs people
- Implement government policy
- Source of income to government, reducing tax burden
- Enjoys economies of large-scale operations



Government & Parastatal

Disadvantages

- Operates below full capacity
- Most times at a loss
- Provides poor quality products as they are mostly monopolies
- Political interference in operations
- Expensive to run and maintain
- Bureaucracy leads to inefficiencies
- No employee incentive to excel
- Loaded with cronies and government supporters
- Corruption



Accounting Concepts



Accounting Concepts

- Concepts represent the rules that are applied in recording transactions and preparing the Financial Statements
 - **Business Entity Concept**
 - **Money Measurement Concept**
 - **Historic Cost Concept**
 - **Realisation Concept**
 - **Dual Aspect Concept**
 - **Consistency Concept**
 - **Materiality Concept**
 - **Accruals Concept**
 - **Prudence Concept**
 - **Going Concern Concept**
 - **Substance over Form**

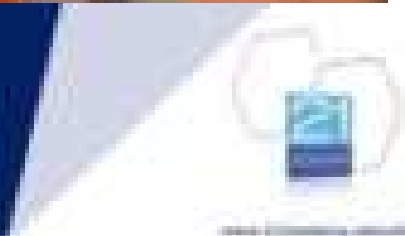


Business Entity Concept

- Only the transactions of the business should be recorded and **NOT** the owner's private transactions

E.g.

- Groceries bought for the Owner
- Necklace bought for Director's spouse
- Holiday Hampers bought for Clients



Money Measurement Concept

- Only Transactions that can be expressed in **monetary terms** are to be booked

E.g.

- Purchase of Transport Loader
- Acquiring a Bank Loan
- Employee Skills
- Brand value of Company



Historic Cost Concept

- All transactions are recorded at their **cost** to the business

E.g.

- Stocks bought at cost
- Office furniture bought at 50% discount
- Work of Art bought for Eur15,000; yet art valuers estimate it is worth Eur 100,000



Realisation Concept

- Profits are realized when cash or a receivable replaces the goods or services
- A transaction is **NOT** realized when an order is received or when a debtor pays their debt

E.g.

- Client receives the TV set bought
- Salesperson brings in an email asking for prices of goods



Dual Aspect Concept

- Every transaction will affect two items in the business
- Represented by both a **DEBIT** and a **CREDIT** entry in the Ledgers

E.g.

- Purchase of stock by cash
- What are the effects ?



Consistency Concept



- Transactions of a **similar nature** should always be recorded in the same consistent way

E.g.

- Depreciation percentage every year – should this be the same ?
- Definition of Sales Accounts
- Comparability



Materiality Concept

- Requires that transactions are to be recorded if they have a **material value**
- What is trivial ?
- What is of value ?

E.g.

- Electricity bulbs
- Ducking Tape
- Depreciation of Water cooler
- Paper reams by photocopier



Accruals Concept

- The Financial Statements should only include the income earned and the expenses incurred for that **particular** period / year

E.g.

- No Water & Electricity bill received at end of Year
- Rent payable for next year already paid
- Sales commissions due at Christmastime



Prudence Concept

- Profits must **NOT** be overstated and the value of Assets must **NOT** be shown to be too high, or higher than actual
- It is the Accountant's duty to ensure that the readers of the financial statements get a true and proper view of the financial state of the business

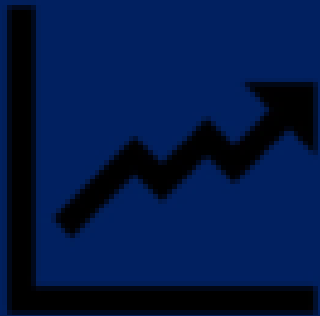
E.g.

- Write-off of Bad Debts
- Revaluation of Buildings



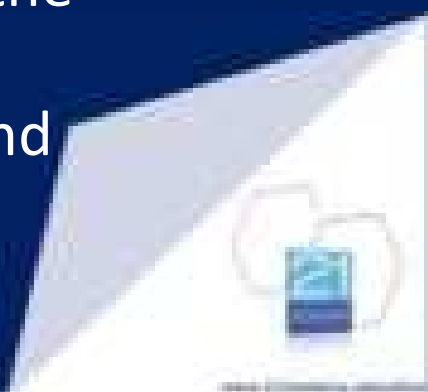
Going Concern Concept

- A basic assumption is that a business will continue to **exist** for a long period of time
- Allows users to presume that the business activity will carry on, and any investments made will render a positive return



E.g.

- Knowledge of a rival and better product to hit the markets
- Government intervention against business brand



Substance over form

- The **PRACTICAL** view vs the **LEGAL VIEW** in Accounting
- Practical – the substance
- Legal – the form

E.g.


- Equipment bought on hire purchase terms
 - Practical – owned by business and gives a return
 - Legal – still remains the possession of the seller until last payment is settled



Double Entry & Bookkeeping




Double Entry



Double Entry
[də-ˈbʌl ˈen-tri]

A fundamental concept underlying present-day bookkeeping and accounting which states that every financial transaction has equal and opposite effects in at least two different accounts.

 investopedia



Double Entry Bookkeeping

- Every financial transaction has equal and opposite effects in two different accounts
- Transactions are recorded in terms of debits and credits
- The sum of all debits must be exactly equal to the sum of all credits

The image displays six separate double-entry bookkeeping tables, each representing a different financial transaction. Each table is structured with columns for 'Date', 'Particulars', 'Debit', 'Date', 'Particulars', and 'Credit'. The transactions shown are:

- 1. **Bank** (Debit) and **Accounts Payable** (Credit).
- 2. **Accounts Payable** (Debit) and **Bank** (Credit).
- 3. **Accounts Payable** (Debit) and **Accounts Payable** (Credit).
- 4. **Accounts Payable** (Debit) and **Accounts Payable** (Credit).
- 5. **Accounts Payable** (Debit) and **Accounts Payable** (Credit).
- 6. **Accounts Payable** (Debit) and **Accounts Payable** (Credit).

Daily Process

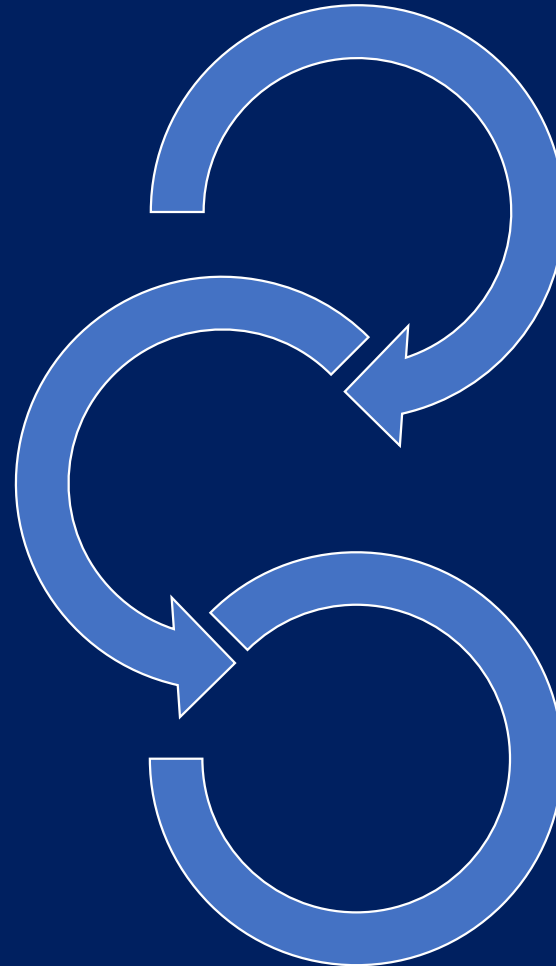
The transactions recorded in an entity must be initiated by:

- Documents
- Records
- Third party interaction
- Manual vs electronic



Process flow

- Orders
- Approvals
- Receipt of goods
- Confirmation
- Recording in Day Books
- Authorisation for Payment
- Payment
- Reconciliation



Daily Books

- Revenue Cycle
 - Cash Sales
 - Sales Invoices
 - Fiscal Invoices / Cash Register Chits / Z Readings
 - Receivables (or Debtors)



Samples of Sales Invoices



WY LIGHTHOUSE
1000 W. 10th St. | Suite 100 | Anchorage, AK 99501
Phone: (907) 552-1234 | Fax: (907) 552-5678
www.wylighthouse.com


Invoice # 10001 | **Invoice Date** 01/15/2020

Bill To: ABC COMPANY
123 Main St
Anchorage, AK 99501

DESCRIPTION	QUANTITY	UNIT PRICE	TOTAL
Item 1	100	10.00	1000.00
Item 2	50	20.00	1000.00
TOTAL			2000.00

TERMS: Net 30
Due Date: 02/14/2020

Payment Information: WY LIGHTHOUSE, 1000 W. 10th St, Suite 100, Anchorage, AK 99501



ABC COMPANY
123 Main St | Anchorage, AK 99501
Phone: (907) 552-1234

Invoice # 10001 | **Invoice Date** 01/15/2020

Bill To: WY LIGHTHOUSE
1000 W. 10th St
Anchorage, AK 99501

DESCRIPTION	QUANTITY	UNIT PRICE	TOTAL
Item 1	100	10.00	1000.00
Item 2	50	20.00	1000.00
TOTAL			2000.00

TERMS: Net 30
Due Date: 02/14/2020

Payment Information: ABC COMPANY, 123 Main St, Anchorage, AK 99501



Daily Books

- Purchasing Cycle
 - Purchase Orders
 - Purchase Invoices
 - Cash Expense
 - Payables (or Creditors)

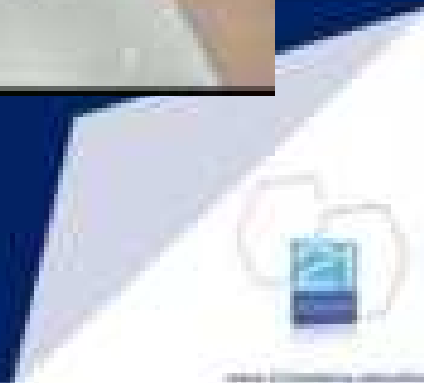


Daily Books

- Banking Cycle
 - Receipts
 - Payments
 - Bank Statements
 - Reconciliations
- Payroll
 - Time-keeping
 - Processing
 - Settlement
 - Documentation



Bank Statements



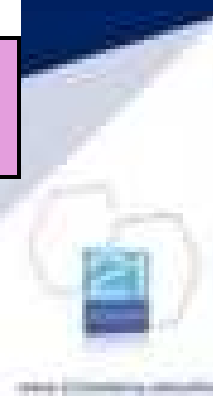
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Group Work



Groups

GROUP A	GROUP B	GROUP C	GROUP D
Rajneet Rohan Singh Jastoria Saloni Gupta Vishav Partap Singh Moiz Jalil Gagandeep Singh Juliet Nkiru Okele	Muhammad Yousaf Rana Shehroz Sabir Shrawan Das Hajra Haneef Usman Ali Manpreet Kaur Mahendra Dawadi	Abisek Shiwakoti Dipesh Kunwar Saroj Khadka Nisha Shetha Nisha Shetha Nischal Rimal Bijay Uchai	Nirmala Gajurel Mayank Dhiman Sajan Rijal Aashika Khatiwoda Ajaya Ghimire Bebina Dahal Malik Habib Sultan
SOLE TRADER	PARTNERSHIP	LIMITED LIABILITY COMPANY	PUBLIC COMPANY



Group Work

Get the 4 Groups together

Assigned Business Structure

Prepare an Organigram of the different Departments

Identify a product or Service

Explain which Accounts will be used

Where would these feature ?

Any issues





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