BBS 1st Year Financial Account

NDGURU- Your Success Pathway

Unit I: Basic Understanding of Financial Accounting

1. Forms of Business Entities

Businesses can be structured in different legal forms, each with distinct characteristics:

(a) Sole Proprietorship

A business owned and managed by a single individual. A **sole proprietorship** is the simplest and most common form of business ownership where a single individual owns, manages, and controls the business. The owner is personally responsible for all business debts and obligations.

- **Features:**
  - Easy to establish with minimal legal formalities.
  - Owner has unlimited liability (personal assets can be used to pay business debts).
  - Owner enjoys all profits but bears all losses.
  - Limited access to capital.
  - Business dissolves upon the owner's death.

(b) Partnership

A business owned by two or more individuals (partners) who agree to share profits and losses. A **partnership** is a business structure where **two or more individuals** (called partners) agree to share the profits, losses, and responsibilities of a business. It is governed by a **Partnership Deed**, which outlines the terms of the partnership.

- **Features:**
  - Governed by a **Partnership Deed** (written or oral agreement).
  - Partners have **unlimited liability** (except in Limited Liability Partnerships).
  - More capital than sole proprietorship due to multiple owners.
  - Mutual agency (each partner can bind the firm in contracts).
  - Types: General Partnership, Limited Partnership, LLP.

(c) Corporate Entities (Companies)

A company (or corporate entity) is a legal business structure that is separate from its owners (shareholders). It is formed under the Companies Act of a country and has its own legal identity, rights, and liabilities.

Features:

- Incorporated under the Companies Act.
- Limited liability (shareholders' liability limited to their investment).
- Perpetual existence (not affected by shareholders' death).
- Can raise large capital through shares and debentures.
- Management by elected directors.
- Types: Private Limited, Public Limited, Government Companies.

Cyclical Nature of Business

(a) Financial Cycle

- Refers to the process of raising capital, investing, generating revenue, and distributing profits.
- Steps:
  1. **Capital Acquisition** (Equity/Debt).
  2. **Investment in Assets** (Land, Machinery, Inventory).
  3. **Revenue Generation** (Sales).
  4. **Profit Distribution** (Dividends, Retained Earnings).

(b) Operating Cycle

- The time taken to convert cash into inventory, inventory into sales, and sales back into cash.
- Steps:
  1. **Cash → Inventory** (Purchase raw materials).
  2. **Inventory → Receivables** (Sell goods on credit).
  3. **Receivables → Cash** (Collect payments from customers).

Financial Accounting: Concept, Features, Objectives, and Scope

Concept:

- Systematic recording, classifying, summarizing, and interpreting financial transactions. Financial accounting is the systematic process of **recording, classifying, summarizing, and reporting** a business's financial transactions to external users through financial statements.

Features:

- Records only monetary transactions.
- Follows **GAAP (Generally Accepted Accounting Principles).**
- Historical in nature (records past transactions).
- Provides financial statements (Income Statement, Balance Sheet, Cash Flow Statement).

Objectives:

1. To maintain systematic financial records.
2. To determine profit/loss (Income Statement).
3. To ascertain financial position (Balance Sheet).
4. To provide information to stakeholders (investors, creditors, government).

Scope:

- **Bookkeeping:** Daily transaction recording
- **Financial Statements:** Preparation of core reports
- **Auditing:** Verification of financial records
- **Tax Compliance:** Calculation of tax liabilities
- **Regulatory Filings:** Submission to government agencies

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5. **Book-keeping, Accounting, and Accountancy**

   1. **Book-keeping**

   Book-keeping is the **systematic recording** of financial transactions (sales, purchases, payments, receipts) in chronological order.

Key Features:

✓ **Daily recording** of transactions (journal entries)

✓ **Classification** into ledger accounts

✓ Preparation of **trial balance** (to check arithmetic accuracy)

✓ **Does not involve analysis**—only data collection

Processes Involved:

1. **Identifying transactions** (invoices, receipts, bills)
2. **Recording in journals** (sales book, purchase book, cash book)
3. **Posting to ledgers** (grouping transactions by account)
4. **Balancing accounts** (debit vs. credit)
5. **Preparing trial balance** (summary of all ledger balances)

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2. Accounting

Accounting is the **analysis, interpretation, and reporting** of financial data recorded by book-keeping.

Key Features:

✓ **Summarizes** book-keeping data into financial statements

✓ **Interprets** financial health (profitability, liquidity, solvency)

✓ Follows **GAAP/IFRS** standards

✓ Helps in **decision-making**

Processes Involved:

1. **Adjusting entries** (accruals, prepayments, depreciation)
2. **Preparing financial statements** (Income Statement, Balance Sheet, Cash Flow)
3. **Analyzing ratios** (profit margin, current ratio, debt-equity)
4. **Auditing & compliance** (ensuring accuracy and legal adherence)

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3. Accountancy

Accountancy is the **profession and body of knowledge** related to accounting principles, standards, and ethics.

Key Features:

✓ **Theoretical framework** behind accounting rules
✓ Includes **auditing, taxation, and financial advisory**
✓ Governed by **professional bodies** (CPA, ACCA, ICAI)
✓ Ensures **ethical compliance** (anti-fraud, transparency)

Processes Involved:

1. **Setting accounting standards** (GAAP, IFRS)
2. **Auditing financial statements** (ensuring fairness)
3. **Tax planning & consultancy** (legal compliance)
4. **Forensic accounting** (fraud detection)

Comparison Table

Aspect	Book-keeping	Accounting	Accountancy
Purpose	Records transactions	Analyzes & reports data	Profession & principles
Scope	Narrow (data entry)	Wider (analysis)	Broadest (theory + practice)
Skills Needed	Basic math, attention to detail	Analytical, financial knowledge	Advanced expertise, ethics
Output	Ledgers, trial balance	Financial statements	Audits, tax reports, standards
Example Role	Book-keeper	Accountant	Chartered Accountant (CA)

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Nature of Accounting

- **Art & Science:** Requires skill (art) and follows principles (science).
- **Information System:** Collects, processes, and communicates financial data.
- **Service Activity:** Helps stakeholders make decisions.

Qualitative Features of Accounting Information

1. **Relevance:** Information should influence decisions.
2. **Reliability:** Free from bias and errors.
3. **Comparability:** Consistent across periods.
4. **Understandability:** Clear to users.
5. **Timeliness:** Available when needed.

Users of Accounting Information

Accounting information is used by various stakeholders to make financial decisions. These users can be broadly classified into **Internal Users** (within the organization) and **External Users** (outside the organization).

Here are users of Accounting:

Internal Users	External Users
- Management (decision-making)	- Investors (profitability)
- Employees (job security)	- Creditors (creditworthiness)
- Owners (performance)	- Government (taxation)
	- Researchers (economic analysis)

Limitations of Financial Accounting

- Historical data (not future predictions).
- Ignores non-monetary factors (employee morale).
- Subject to manipulation (window dressing).
- No uniform accounting policies globally.

Bases of Accounting

Cash Basis	**Accrual Basis**
Records transactions when cash is received/paid.	Records when revenue is earned/expense incurred.
Simple, used by small businesses.	Follows **matching principle**, used by companies.

Accounting and Other Disciplines

- **Economics:** Helps in cost analysis and pricing.
- **Law:** Compliance with tax and company laws.
- **Mathematics:** Calculations, ratios.
- **Management:** Decision-making, budgeting.

Unit 2: Conceptual Framework of Accounting

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1. GAAP [Generally Accepted Accounting Principles]

Meaning:

GAAP refers to a set of rules, standards, and procedures used in financial accounting and reporting. These principles ensure **uniformity**, **transparency**, and **comparability** in the preparation of financial statements.

Features of GAAP:

1. **Standardized** – Ensures consistency across firms.
2. **Widely Accepted** – Used internationally or nationally depending on region.
3. **Authoritative** – Issued by professional bodies like ICAN (Nepal), IASB (global).
4. **Reliable and Transparent** – Enhances users' confidence.
5. **Basis for Auditing** – Auditors rely on GAAP compliance.

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2. Basic Accounting Concepts

Business Entity Concept

- The business is treated as a separate entity from its owner(s).
- Transactions of the business are recorded separately from personal transactions of the proprietor.

Monetary Unit Concept

- Only transactions that can be measured in monetary terms are recorded.
- Non-monetary elements like employee skills or reputation are not recorded.

Going Concern Concept

- The business is assumed to operate indefinitely unless there is evidence to the contrary.
- Assets are recorded at cost, not liquidation value.

Cost Concept (Historical Cost)

- Assets are recorded at their original purchase price (cost), not market value. **Dual Aspect Concept**

- Every transaction has two aspects: **Debit = Credit**.
- Example: Buying goods for cash affects both inventory and cash.

Accounting Period Concept

- Financial reports are prepared for a specific period (e.g., yearly, quarterly).
- Helps in comparing results over different periods.

Realization Concept

- Revenue is recognized when it is earned, not when payment is received.
- Example: Revenue from sales is recorded at the time of sale, not when cash is received.

Accrual Concept

- Revenues and expenses are recorded when they occur, not when money is exchanged.
- Ensures matching of income and related expenses in the same period.

Matching Concept

- Expenses should be recognized in the same period as the revenue they help to generate.
- Example: If goods are sold in March, the cost of goods sold is also recorded in March.

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3. Accounting Concepts vs. Accounting Conventions

Basis	Accounting Concepts	Accounting Conventions
Nature	Theoretical ideas or assumptions	Practical customs or traditions
Basis	Fundamental assumptions	General practices accepted by accountants
Examples	Going Concern, Accrual, Matching	Consistency, Conservatism, Materiality
Purpose	Lays the foundation for accounting principles	Brings uniformity and reliability
Flexibility	More rigid and compulsory	More flexible, subject to change over time

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4. Basic Accounting Conventions

Consistency

- The same accounting methods and policies should be applied every year.
- Helps in making comparisons over time.

Conservatism (Prudence)

- Recognize expenses and liabilities **as soon as possible**, but revenues only when **sure**.
- "Anticipate no profit, provide for all losses."

Materiality

- Only significant items (material information) should be disclosed.
- Insignificant items can be ignored or grouped.

Full Disclosure

- All relevant and necessary information must be disclosed in the financial statements.
- Notes and explanations are included to give a full picture.

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5. Accounting Standards

Meaning:

Accounting standards are **authoritative guidelines** that govern how financial transactions should be recorded, presented, and disclosed in the financial statements.

Nature:

- Uniform in application
- Established by accounting regulatory bodies
- Technical and systematic

Need for Accounting Standards:

1. To ensure **transparency**
2. To promote **comparability** between entities
3. To protect **investors and creditors**
4. To minimize **misinterpretation**
5. To ensure **compliance and auditability**

Significance:

- Builds public confidence
- Facilitates uniform reporting
- Improves global comparability
- Reduces fraud and manipulation

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6. Types of Accounting Standards

NAS (Nepal Accounting Standards)

- Issued by **ICAN (Institute of Chartered Accountants of Nepal)**
- Applicable to Nepali companies and government entities

IAS (International Accounting Standards)

- Issued by the **International Accounting Standards Committee (IASC)**
- Replaced gradually by IFRS

IFRS (International Financial Reporting Standards)

- Issued by **IASB (International Accounting Standards Board)**
- Used globally by many countries
- More flexible and principle-based than older IAS

NP **NFRS (Nepal Financial Reporting Standards)**

- Nepal's version of IFRS adopted by ICAN
- Applied by public interest and listed entities in Nepal

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7. Classification of Accounting Standards

Basis	Types
By Function	Measurement standards, disclosure standards, presentation standards
By Issuer	NAS, IAS, IFRS, NFRS

Basis	Types
By Area	Inventory, revenue recognition, leases, fixed assets, financial instruments

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8. Ethics in Accounting

Meaning:

Ethics in accounting refers to the moral principles and professional conduct that govern how accountants act in practice.

Importance:

- Builds **trust** and **credibility**
- Prevents **fraudulent activities**
- Promotes **transparency and accountability**

Key Principles:

1. **Integrity** – Be honest and straightforward.
2. **Objectivity** – Avoid bias or conflict of interest.
3. **Professional Competence** – Maintain and update skills.
4. **Confidentiality** – Protect client and business information.
5. **Professional Behavior** – Follow laws and avoid discrediting the profession.