CONCEPTUAL FRAMEWORK OF ACCOUNTING

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Limitations of financial information

- *Money measurement* - *Accounting records only those transactions which can be measured in monetary terms. Important information such as efficiency of management or employee motivation is left out.*
- *Price level changes* - *Accounting transactions are normally recorded at cost. The effect of price level changes is not brought into books and this renders comparison between years difficult.*
- *Concepts and Conventions* - *The financial position reported depends on the concepts and conventions used. For example, the profit level is not necessarily representative of actual profits because this depends on the concepts used.*
- *Historical information* - *By the time data is collected and recorded in books of account it is in the past. The records fail to show what is happening or what will happen in future.*

Accounting Concepts

Qualitative characteristics of accounting information

- *Understandable*
- *relevance*
- *reliable*
- *objective*
- *comparable*
- *consistency*

Postulates of Accounting

- *Business entity*
- *Measurability*
- *Periodicity*
- *Dual aspect*

An income statement is a record of income generated and expenditure incurred over a given period.

- *The statement shows whether the business has had more revenue than expenditure (a profit) or vice versa (loss).*
- *Revenue is the income generated by the business for a period.*
- *Expenses are the costs of running the business for the same period.*
- *The statement of financial position and the income statement form the basis of the financial statements of most businesses*

- *amounts invested in a business by the owner are amounts that the business owes to the owner. This is a special kind of liability, called capital. In a limited liability company, capital usually takes form of share capital, or equity.*

Elements of Financial Statements

Class exercise

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Accounting Concepts

Qualitative characteristics of accounting information

Postulates of Accounting

These are the fundamental ideas upon which the whole accounting discipline rests:

- Business entity
- Measurability
- Periodicity
- Dual aspect

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Elements of Financial Statements

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Elements of Financial Statements

- The principal financial statements of a business are the statement of financial position and the income statement.
- The statement of financial position is simply a list of all the assets owned and all the liabilities owed by a business as at a particular date
- An asset is something valuable which a business owns or can use. Can you think of examples of assets?
- What is the difference between current and non-current assets?
- A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.
- Can you think of examples of liabilities?

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Postulates of Accounting

- *These are the fundamental ideas upon which the whole accounting discipline rests:*
- *Business entity*
- *Measurability*
- *Periodicity*
- *Dual aspect*

- *Business entity - a business entity is distinct and separate from its owners and managers. The entity consisits of assets and liabilities. The difference between the money values of assets and of liabilities is known as capital. Thus, the fundamental accounting equation can be summed up as follows:*
    - $A - L = C$
- *Measurability - accounting involves measurement of value. Accounts will only deal with those items to which a monetary value can be attributed and thus the items which cannot be measured in monetary terms may not form part of the accounts.*

- *Periodicity - it is assumed that the continuous lifetime of the entity can be broken down into specific time periods known as the financial year of the entity and usually 12 months.*
- *Dual aspect - For every change in one of the three elements (assets, liabilities or capital) there must be a numerically equal but opposite change in another element or the other two elements put together. This introduces the fundamental rule of bookkeeping that every* debit is followed by a corresponding credit entry.