

# Importance of Accounting, Principles and Concepts

## MAIN BODY

### Part A

#### Question 1.

*(A) If you were a banker, why would you need information from PepsiCo's financial statements?*

Bankers need the financial statements for multiple purpose. Basically, bankers ask for financial statements for companies at the end of a financial year. Generally, banks want to check balance sheets, profit & loss account statement etc. Herein, below reason for which bankers can see the financial statement:

- **Balance sheet-** The Balance Sheet shows the assets, debt and net value (equity) of business at a particular time period (Ahadiat and Martin, 2015). Taking the time to analyse the balance sheet of business enable bankers to get a clear understanding of company's plan. The Bank must aim for good net worth and the liabilities-to-equity ratio. Analysing the balanced sheet lets the bank decide whether its existing and/or potential debt obligations can be met by the company.
- **Income statement-** The Income Statement or Profit and Loss Statement shows how much money the corporation received over a number of years and how much was left after payment of costs (net income). Analysing this argument will enable companies as an owner to assess whether there are possible areas for controlling costs or areas that seem out of line. By help of it, bankers can become able to analyse whether they should make credit transaction with company or not.

So these are the reasons for which bankers will be interested to assess financial information of PepsiCO's company.

*(B) If you were a potential investor in PepsiCo stock, what information would you want from their financial statements?*

Investors are those who make investment in company's practices and securities. They need to analyse financial position of companies so that they can take decisions whether they should make investment or not. Herein, below list information is mentioned which is needed by investors:

- **Net profit- Financial reports** will show the net income of a corporation, net profit is the cash left over by a corporation after all costs have been paid. "Does company make money?" is often the first question asked, but it's just a point of departure (Ragland and Ramachandran 2014). By analyse the information about net profitability, investors take decision about making investment.

- **Sales-** It is also a key information which is assessed by investors in order to take suitable actions for investment. This is so because if PepsiCo's company's sales revenue is higher then it may leads to higher payment of dividend to shareholders. Hence, investors evaluate information about sales.
- **Cash flow Statement-** For business entities, cash is the king. Investors interpret the bank's cash as a symbol of being able to deal with unexpected issues and focus on new possibilities. Free cash flow is a sign of successful operations and in accordance of the information of cash flow, investors analyse efficiency of companies.

***(C) If you were a labor negotiator for a union that represents a group of PepsiCo's employees, which financial statement would provide you with the most useful information?***

For labour union, income statement will be suitable. This is so because under it, detailed information regards to companies operations, revenues, cost of sales etc. is provided (Stone and Lightbody, 2012). Such as in the aspect of above company, there are income statement for two years 2013 and 2014. The labour union can analyse key information about how much salary and wages expenditures is done by company during these years.

## Question 2

***\*Melissa is the owner of Missy's Tea Shop, a sole proprietorship. She purchases a new computer for her personal use at home. Melissa records the computer as an asset of Missy's Tea Shop.***

- Overview- In accordance of given case, this is being stated that Melissa who is a sole proprietor of a tea shop buys a computer for personal use but records it as an assets of tea shop. The concept which she is applying is wrong. Under this case, below mentioned accounting principle is needed to be applied:

***Economic entity assumption principle-*** The accountant holds all a sole proprietorship's business transactions apart from the private transactions of the company owner (Daly, Hoy, Islam and Mak, 2015). A sole proprietorship and its holder are deemed to be one party for legal purposes, but they are treated as two different entities for billing purposes. Thus, in the context of above case, owner of tea shop should keep its personal financial transactions separate from business transactions.

***\*Houston Electronics purchased an office building several years ago for \$500,000. The office building could be sold today for \$850,000. The accountant will now show the building as an asset on the books for \$850,000.***

- Overview of case- As per the given information, this can be find out that Houston electronic company made purchasing of building some years ago whose value was of \$500000. In current time period, the value of assets is of \$850000. The accountant is presenting the value of assets as \$850000 in books of accounting. In this context, they should apply an appropriate accounting principle which is as follows:

***Historical cost accounting principle-*** In accounting, the historical expense of a financial item is that item's initial estimated economic value. Historical cost accounting includes recording assets and liabilities at their historical values that are not adjusted for adjustments in the prices of the products (Pan and Perera, 2012). In the aspect of above case, this is important for their accountants to record their financial transactions in accordance of historical cost accounting principle.

***\*Henry is a new accountant for Acme Foods. He is extremely busy and has decided that he can prepare the financial statements every two years.***

- Overview of case – In accordance of given data, this can be find out that Henry is a new accountant and busy. That is why he is planning to prepare financial statements in each two years. This policy is wrong, he should make financial statements at the end of each year. For this purpose, there is an accounting principle which is needed to be applied:

***Time period principle-*** The concept of time period is a financial accounting principle which implies that all companies and organizations should divide operations into periods of time. Such intervals are often referred to as time periods for accounting and reporting and may be weekly, quarterly, semi-annual, annual, or any other time span. Such as in the above case, it is essential for accountant to prepare income statements at the end of each year in accordance of this accounting principle.

***\*The Candle Store is having financial problems. It has no plans to liquidate, but decides to use market value to report their assets since they plan on moving to a smaller store.***

- Overview of case- The given company is facing monetary issue and recording assets as per the market value though they are planning to move to a smaller store. It shows that they are using wrong concept to record their assets. In this aspect, it is important to them to follow below mentioned accounting principle which is as follows:

***Going concern principle-*** This accounting theory implies that a business will continue to remain long enough to meet its goals and obligations and in the future will not be liquidated. If the financial position of the business is such that the accountant concludes that the business will not be able to continue, this determination must be reported to the accountant (McLeod and Harun, 2014). In the above company, they should apply this accounting concept so that financial statements can be prepared in an effective manner.

## Question 4

***Dividends, you have learned, are a distribution of income, not an expense. What is the difference? Why can't the corporation list them as an expense, since dividends are just another amount of money paid out to somebody?***

**Dividend-** The term dividend can be defined as a reward which company pays to their shareholders. This can be paid to companies in different forms such as cash payment, stock or any other way. Basically, the corporation's dividend is determined by board of directors and this needs approval from shareholders. Though, this is not a liability for companies to pay the dividend. It is a part of profit which is being shared by business entities with its shareholders. This dividend is not recorded as an expense. There is difference as the dividend is not an expenses. It is so because dividends of a business are not an expenditure and therefore will not show on its statement of profits. Cash dividends are a payment of part of the earnings of a company paid to its shareholders. When a company has preferred shares, the dividends on preferred shares are excluded from the net income of a company in order to arrive at common stock earnings. As well as money or stock dividends paid to stakeholders are not reported in the income statement of a corporation as an expenditure. This is because securities and even money dividends do not impact the net income of a business.

***Why it is not recorded as an expenses:***

Dividends are not an expenditure. Therefore, dividends never show as an expenditure on the financial statements of an issuing company (Siriwardane, Low and Blietz, 2015). Alternatively, dividends are viewed as a transfer of a company's equity. As such, dividends are deducted from the balance sheet equity portion and are also deducted from the balance sheet cash line item, resulting in an overall decrease in the balance sheet size. When dividends are reported but not yet paid, they will be listed on the balance sheet as current liability. Dividends paid during the fiscal quarter are also classified as capital outflows in the funding portion of the cash flow statement.

Apart from it, the dividend is shared with the shareholders of companies not to other parties so it can not be considered as an expense (Osmani, Al-Esmail and Weerakkody, 2017). As well as this is distributed from the net income of companies. For this no addition cost is paid by companies. So these above mentioned reasons show that dividend is not an expenses. It is just a sharing of profits among shareholders of companies who make investment in company with an expectation of gaining higher amount of return. By comparison to costs, dividends are not component of a business profit measurement: they are not a cost of business. They are essentially a process through which businesses allocate to their investors the profits they have made.

So in accordance of above mentioned discussion, this can be stated that payment of dividend is not an expenses. The main reason of it is that payment of dividend does not impact to balance sheet and profit & loss account of companies (Mitrić, Stanković and Lakićević, 2012).

**Question 5.**

***(a) Purpose of auditors' report.***

**Auditors' report-** Basically, an auditor's report is designed to provide assurance that the financial reports of an entity do not contain material errors (Liu, 2012). It is assumed that the auditor will provide the organization and its financial statements with a complete picture. They also have to state their relation to the financial statements in the report, and whether they operate externally or directly for the business. Herein, below purpose of auditors' report are mentioned which are as follows:

- The report allows financial statement clients to ensure the financial information is accurate or not.
- The most crucial thing is that the government wants the company to comply with the rules and

regulations, so the audit report says it follows the rules and laws (Jones, 2014).

- Audit report benefits the investor as the investor can think the business is booming and there is no concern.

***(b) What is going concern concept?***

Going concern- The current accounting principle means that the corporation will continue its activities in the potential and will not be forced to sell or suspend operations for any reason whatsoever (Elijido-Ten and Kloot, 2015). A business is an ongoing concern if there is no evidence to say that in the near future it will or will have to interrupt its activities. In other words, the going concern is a basic accounting concept. This assumes that a corporation can execute its current plans, use its existing assets and continue to meet its obligations during and after the next fiscal year. Basically, it is an expectation that the company will remain profitable and also that the value of its assets will last. The fundamental theory is also referred to as the idea of continuing concern.

***(c) Are losses, restructuring, and the disposal of segments necessarily precursors to the demise of the company?***

No, the losses, restructuring, and the disposal of segments are necessarily precursors to the demise of the company (Anis, 2017). This is so because in business, loss can be occurred in any time which does not mean that business will close. Companies can make effective policies and plans to overcome from losses. As well as restructuring of business is also a necessary process of companies in order to grow in competitive market. Thus, above mentioned statement is not accurate.

***(d) What is auditors saying about above company?***

The auditors are stating that company has limited amount of cash and working capital to fund its upcoming operations. As well as in accordance of consolidated financial statement of company, this can be find out that they had net loss which resulted as accumulated deficit of \$49.7 million. Along with this financial statement does not consists any modifications which may result from outcome of the uncertainties.

## **Question 7 .**

***Is Unique factory considered a business or non business company?***

In accordance of given data, this can be find out there are two financial statements which are balance sheet and income statement. The information included in both of statements states that above company is to be considered as a business entity. It is so because of following reasons:

- Net sales- In the income statement , it is stated that there is sale of \$174206 and \$209203 for year 2014 and 2015. This is indicating that they are making sales transaction with customers and it is being done in a business entity. A non business entity does not make any sales transactions or if they make transaction then does not record in their accounting books.
- Selling, general and administrative expenses- Under the financial statement of company, this is being stated that they are making expense on selling and administration in both of years. The company which is involved in process of business makes these expenses and records in their accounting books. This shows that company is considered as business entity.

- **Income tax expenses-** This can be defined as a type of expenditure which is paid by companies to government on the occurred amount of income during a particular time period (Pernsteiner, 2015). It is essential to business entities who conduct specific operations and activities. Such as in the income statement of above company, this can be find out that they are making payment of income tax expenses which are \$2388 and \$3534 for year 2014 & 2015. It shows that company is considered to be a business entity.
- **Stock holder equity-** In the above company, there are different number of stockholders who are making investment. Basically, the stakeholders make investment in business entities not in the non business entities. Such as the total value of stakeholder equity is of \$86919 and \$90908 for year 2014 and 2015. This is indicating that above company is a business entity.
- **Long term debts-** The company is taking huge amount of debts from different sources and recording it in their balance sheet. As well as they are recording this amount, in their balance sheet. The amount is of \$25676 and \$20491 for year 2014- 2015. This huge amount of debts shows that company is operating their business activities in large number.
- **Investment-** In the aspect of current liabilities of this company, it can be find out that there is investment amount in both of years 2014 and 2015. It is showing that company is involved in the context of business operations. Such as in year 2014, the amount of investment was of \$1061 which reduced in next year 2015 and became of \$303.

So in accordance of above discussion, this can be find out that company is considered to be a business entity because they are conducting all those activities which are performed by businesses.

## Part B

### Exercise 1.

**Total liabilities-** Total liabilities are the net debt and financial commitments accrued at any particular time by a business to people and organizations. Total liabilities are listed on the financial statements of a company and are part of the overall accounting equation:  $\text{assets} = \text{liabilities} + \text{equity}$ . There are mainly two types of liabilities which current and non current (Abayadeera and Watty, 2016). In the below mentioned statement, this can be find out that there is non current liabilities are of \$41000 and current liabilities are of \$24000. Eventually, it is essential for companies to keep their overall liabilities lower as much as possible. If companies liabilities are lower then the assets then it is considered as a suitable condition. Such as in the below mentioned company, their total liabilities are of \$65000 and total assets are of \$173000. This shows that their financial position is in an effective manner.

Balance sheet of Brock Corporation's for year ending:

|                         |        |
|-------------------------|--------|
| <b>EQUITY:</b>          | 108000 |
| Capital stock – 100000  |        |
| Retained earnings- 8000 |        |

|                          |       |
|--------------------------|-------|
| <b>LIABILITIES:</b>      |       |
| Non current liabilities- | 41000 |
| Long term debt- 41000    |       |

|                                       |               |
|---------------------------------------|---------------|
| Current liabilities-                  | 24000         |
| Accounts payable- 24000               |               |
| <b>TOTAL LIABILITIES AND EQUITIES</b> | <b>173000</b> |
| <b>ASSETS:</b>                        |               |
| Current assets-                       | 104000        |
| Cash- 25000                           |               |
| Accounts receivable- 46000            |               |
| Inventory - 33000                     |               |
| Non current assets-                   | 69000         |
| Property, plant & equipment- 69000    |               |
| <b>TOTAL ASSETS</b>                   | <b>173000</b> |

Analysis- The total liabilities of above company are of \$65000. As well as the value of equities is of \$108000.

### **Exercise 2.**

Income statement- The statement of profits and loss shows a business ' financial results for a set period of time. The statement quantifies the amount of revenue earned and costs incurred during a fiscal quarter by a company as well as any net profit or loss arising from it. The income statement is an essential component of an institution's financial statements (Yap, Ryan and Yong, 2014). The other aspects of the accounts are the balance sheet and cash flow statement.

Net income- Net income equals for a company is the amount left after all costs and expenditures have been subtracted from sales. Net income is used by listed companies to help measure their earnings per share (EPS). As well as shareholders assess the information about net income of companies before taking decision regards to investment in companies. This is so because if net income is higher then there will be more change that return on investment will be higher.

Income statement for year ending 31 December, 2018:

| <b>Particulars</b>                                | <b>Amount (IN \$)</b> |
|---------------------------------------------------|-----------------------|
| Sales                                             | 560000                |
| Less: cost of goods sold                          | 400000                |
| Gross profit                                      | 160000                |
| Less: Salary expenses                             | 40000                 |
| Operating profit (Profit before interest and tax) | 120000                |
| Less- Interest expenses                           | 30000                 |

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|                               |       |
|-------------------------------|-------|
| Less- Income tax expenses     | 25000 |
| Profit after interest and tax | 65000 |

|                |       |
|----------------|-------|
| Less- Dividend | 20000 |
| Net income     | 45000 |

Analysis- On the basis of above presented income statement of this company, it can be find out that net income is of \$45000. As well as sales revenue is of \$560000 and gross profit is of \$160000. The operating profit is of \$120000 for company. The value of interest and tax expenses is of \$55000. This is showing that company's financial position is in an effective manner.

### **Exercise 3.**

#### **(A) Calculation the net income or loss for 2014.**

| <i>Particulars</i>                                | <i>Amount (IN \$)</i> |
|---------------------------------------------------|-----------------------|
| Sales                                             | 190000                |
| Less: cost of goods sold                          | 80000                 |
| Gross profit                                      | 110000                |
| Less: Operating expenses                          | 45000                 |
| Operating profit (Profit before interest and tax) | 65000                 |
| Less- Income expenses                             | 30000                 |
| Profit after income tax                           | 35000                 |
| Less- Dividend                                    | 12000                 |
| Net income                                        | 23000                 |

Analysis- On the basis of above presented income statement of company, this can be find out that there is net profit of amount \$23000 at the end of year. The company is able to generate this higher amount of net income because there are less number of expenses in compare to revenues. Such as the sales revenue of company is of \$190000.

#### **(B) Explanation of how the amount from part “A” will affect the financial position of Micco’s Gift Store.**

In accordance of above measured net profit of this company, it can be find out that there is net profit of \$23000. This is showing that company is in good condition and their financial position will be effected in a positive manner. Along with the company's expenses are also lower in compare to overall amount of profitability.

#### **(C) Is the company profitable? Explain your answer.**

As per the calculated amount of net profit of this company, it can be find out that their financial position is in profitable manner. This is so because their amount of expense is lower and generated revenues are higher. It shows that company's financial position is better and profitable at which they can attract more number of stakeholders to make investment in their company.

**Exercise 4.**

| <b>Name of item</b>   | <b>Appears on Which Statement?</b> | <b>Type of Account</b> |
|-----------------------|------------------------------------|------------------------|
| Retained earnings     | Balance sheet                      | Equities               |
| Buildings             | Balance sheet                      | Fixed assets           |
| Common stock          | Balance sheet                      | Equities               |
| Accounts payable      | Balance sheet                      | Current liability      |
| Football ticket sales | Income statement                   | Revenue                |
| Salaries expenses     | Income statement                   | Operating expense      |
| Accounts receivable   | Balance sheet                      | Current assets         |

Analysis- On the basis of above presented table this can be find out that there are different types of items which are categorised into various statement and types of accounts. Such as the retained earnings are appeared in the balance sheet as the account of equities. While building is also entered in the balance sheet in the account of fixed assets.

The common stock is appeared in the balance sheet in the account of equities. In addition, accounts payable and receivables also entered in the statement of balance in account of current liabilities and assets. There are only two items which are included in the income statements which are football ticket sales and salaries expenses. The ticket sales is considered in the revenue account and salary expenses in the operating expenses.

**Exercise 5.****(a) Total assets at the end of 2016:**

Total assets- Total assets means a person or entity's total amount of assets. Assets are items of added value that are invested over time to provide the owner with a profit (Nicholls, Wegener, Bay and Cook, 2012). If the owner is a company, the company records actually record these assets and show in the company balance sheet. There are mainly two types of assets which are current and non current assets.

Current assets- It can be defined as a type of assets which can be converted into cash in less then one year (Goh and Scerri, 2016). This type of assets is being used for making payment of day to day activities. Such as in the below mentioned company's balance sheet it can be find out that there is current assets of \$68000.

Non current assets- It can be defined as a type of assets which can not be converted into cash in less then one year. This type of assets is being used for completing large business operations and activities in an effective manner. Such as in the below mentioned company's balance sheet it can be find out that there is non current assets of \$42000.

Income statement of Galaxy Corporation for the year ended December 31, 2016:

| <b>Particulars</b> | <b>Amount (IN \$)</b> |
|--------------------|-----------------------|
| Sales              | 165000                |

|                                 |        |
|---------------------------------|--------|
| Less: cost of goods sold        | 51000  |
| Gross profit                    | 114000 |
| Less: Salary and wages expenses | 40000  |
| Less- Selling expenses          | 44000  |
| Less- Income tax expenses       | 18000  |
| Add- Interest income            | 3000   |
| Net income                      | 15000  |

Balance sheet of Galaxy Corporation for the year ended December 31, 2016:

|                                       |               |
|---------------------------------------|---------------|
| <b>EQUITY:</b>                        | 73000         |
| Capital stock (41000+15000) = 56000   |               |
| Retained earnings- 17000              |               |
| <b>LIABILITIES:</b>                   |               |
| Non current liabilities-              |               |
| Current liabilities-                  | 37000         |
| Accounts payable- 12000               |               |
| Notes payable- 20000                  |               |
| Income tax payable- 5000              |               |
| <b>TOTAL LIABILITIES AND EQUITIES</b> | <b>110000</b> |
| <b>ASSETS:</b>                        |               |
| Current assets-                       | 68000         |
| Cash- 30000                           |               |
| Accounts receivable- 14000            |               |
| Inventory – 22000                     |               |
| Prepaid expenses- 2000                |               |
| Non current assets-                   | 42000         |
| Equipment- 42000                      |               |
| <b>TOTAL ASSETS</b>                   | <b>110000</b> |

Analysis- The above presented balance sheet shows that they have total assets of \$110000 at the end of year 2016

**(b) Total liabilities at the end of year 2016**

As per the prepared balance sheet of company, this can be find out that there is total liabilities is of \$37000. This is a current liability. There is no any specific information about non current liabilities.

**(c) What parties have a claim on Galaxy Corporation' assets? Explain you answer in the terms of the accounting equation.**

Accounting equation- The double-entry accounting system is likely to be based on the accounting equation. The accounting equation indicates on the balance sheet of a business in which the average of all the company's assets is the amount of the liabilities of the company and the equity of the investors. The parties have to claim on company's current assets because its value is too higher in compare to current liabilities.

## CONCLUSION

On the basis of above project report, it has been concluded that accounting skills are essential for companies in order to manager entire business transactions. The report concludes about role of financial information for bankers and investors as well as in next part of report some accounting concepts are concluded such as going concern principle, time period principle etc. In addition further part of report concludes about, role of auditors report and about dividends. In the end part of report some practical questions are solved in accordance of given data in brief.