

# Principles of Accounting

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## Course description

The course develops background for understanding and reading companies' financial reports and for assessing company's financial position and making managerial decisions. The course covers basic concepts of modern financial reporting, essentials in UK standard of financial and managerial accounting. It provides basic knowledge in preparing, processing and interpreting the data about business transactions for different types of external as well as internal investors, management and other accounting information users. The course requires the knowledge in micro and macroeconomics and banking. The course is based on lectures, seminars, case studies and self-study. "Principles of Accounting" is a two-semester course designed to prepare students for UL examination.

## Teaching objectives

The course is focused on developing skills in preparing and analyzing companies' financial statements and data for decision-making purposes. By the end of autumn semester students are expected to be able to apply a set of accounting concepts to read annual financial report of a corporation and financial ratios to assess its position. By the end of spring semester students are expected to apply managerial accounting analytical tools for internal control, pricing and developing different budgets for financial planning purposes as well as to get essential skills in capital budgeting techniques.

## Teaching methods

The following methods and forms of study are used in the course:

- lectures
- classes
- teacher's consultations
- self-study
- written home assignments
- essay writing

## Assessment

Current control includes: written home assignments, essays and their assessment, participation in classwork by solving exercises and case presentations.

Intermediate control is based on mid-term exam in each semester plus first-term exam in January in UOL format or MOCK exam in March/April.

Final exam is set by the University of London.

## Grade determination

The first term grade is calculated as weighted average with the following weights:

- 10% — for written home assignments
- 10% — for class participation
- 30% — for the mid-term exam
- 50% — for the first-term exam in January

The final grade is based on the final UOL exam (50%) and the remaining 50% is given for performance evaluation during the course including:

- 20% — for the first term grade
- 20% — for the spring MOCK exam grade
- 10% — for home assignments and class participation in the second term

## Main reading

1. M.W.E.Glautier and B.Underdown. *Accounting Theory and Practice*. 6th edition. Pitman Publishing. (GU)
2. J. Ireland. *Principles of Accounting*. Study guide. University of London. 2005 (SG)
3. *Accounting and Finance*. Reader for the 3rd year students. Prepared by V. Dobrynskaya. 2004
4. Dobrynskaya, V. *Financial Accounting: A Key to Your Success in the Exam*. SU–HSE Publishing House, 2007.

## Additional reading

1. J.Arnold, T.Hope, A.Southworth, L.Kirkham. Financial accounting. 2 edition. Prentice Hall. (ANSK)
2. Reader in Managerial Accounting. (R)
3. F.Wood, A. Sangster. Business Accounting. 8th edition. Financial Times. Pitman Publishing.1999.
4. A.H.McLaney. Accounting. ACCA. 3 edition. Longman.
5. D.Alexander, A.Britton. Financial Reporting. Chapman&Hil. 1999
6. C.Stickney.Financial Statement Analysis. A Strategic Perspective. 2 Edition. The Dryden Press.
7. Николаева О.Е., Шишкова Т.В.. Управленческий учет. Москва:УРСС.1997
8. Ч.Т.Хорнгрен, Дж. Фостер. Бухгалтерский учет: управленческий аспект.Москва: “Финансы и статистика”.1995
9. Т.Карлин,А.Макмин.Анализ финансовых отчетов. Москва:ИНФРА–М.1998
10. С.И.Пучкова, В.Д.Новодворский. Консолидированная отчетность. ФБК Пресс.1999.
11. Л.А.Бернстайн.Анализ финансовой отчетности. Москва: “Финансы и статистика”.1996
12. Д.Шим, Д.Сигел. Основы коммерческого бюджетирования. ЗАО “Бизнес Микро”.2001
13. Macmillan Dictionary of Accounting. 2 издание.

## Course outline

### Accounting Model of the Organization

#### 1. Introduction to the Course. The Scope of Accounting

Accounting as an information system. Functions of accounting. Users of accounting information and their requirements: investors and investment analysts, creditors and lenders, managers, customers, employees, government, competitors and public. Types of accounting. Major differences between accounting and financial accounting, financial accounting versus management accounting.. Accounting entities. Major types of organizations: the sole proprietorship, the

partnership, the limited companies (corporations). The type of organization and the scope of accounting information. Accounting leaders and institutions. The regulation of financial reporting: institutional framework and the role. The usefulness of accounting standards. Generally Accepted Accounting Principles and accounting policies. The need for harmonization of financial accounting standards: what has been done in IAS and under European Directives.

*(GU Ch.1–3; SG; AHSK Ch.1–3)*

## **2. Basic Accounting Elements and Accounting Equation**

Assets and their recognition criteria. Types of assets: current and non-current, liquid and illiquid, tangible and intangible. Claims on organization's assets. Liabilities and their recognition criteria. Types of liabilities. Owner's capital (equity) and its forms. Accounting equation: initial version. Revenues and expenses: the criteria and influence on owner's capital. Drawings (withdrawals) and owners investments. The expanded accounting equation. Types of accounts. Main T-accounts. Double entry bookkeeping techniques. Applying double-entry rule to expanded accounting equation. Accounting equation and basic statements. The balance sheet — the statement of financial position. Profit and loss statement — the statement of performance.

*(GU Ch.4; SG; AHSK Ch.4)*

## **3. The Framework for Conventional Accounting Model**

The role of accounting theory. The GAAP and fundamental accounting concepts. Entity concept and its requirements. Going-concern concept. Cost concept, money measurement concept and conventional accounting. Accrual concept versus cash accounting: advantages of accrual accounting, its limitations. Realization concept and revenue recognition criteria. Matching principle. Prudence concept and its constrains. The relevance and reliability of accounting information. Disclosure principle and the need for additional accounting information for limited company (corporation).

*(GU Ch.5–7; SG; AHSK Ch.3)*

## **4. Building Accounting Cycle**

Accounting cycle within the Organization. The accounting period. Accounting data processing. Balancing off the accounts. Closing entries. The trial balance and footing. The role of the trial balance. Accrual and matching concepts and the reasons for adjusting accounts and trial balance.

*(GU Ch.8–9; SG; AHSK Ch.5)*

## **5. Periodic measurement and identification of revenues and expenses**

Accounting concepts and the need to adjust revenues and expense accounts. Adjusting revenues accounts for amounts owing. at the end of the period. The use of debtors' accounts. The types of debtors and the types of debts. The reasons for bad debts and accounting for bad debts. Provisions for doubtful

debts. Adjusting accounts for prepayments. Adjusting accounts for accruals. The introduction to the concept of depreciation expense: the useful life, and the need for allocation of acquisition cost of fixed asset. The residual value of fixed asset and its depreciable value. Traditional method of depreciation — straight line. The accounting entries for depreciation.

*(GU Ch.10; SG; AHSK Ch.6 (pp.144–158), Ch.7)*

## **6. Preparing Balance Sheet and Profit and Loss Statement**

Preparing Trading and P&L statements. Adjusting revenues for returns inwards and for discounts allowed. Gross trading profit. Net profit. Different layouts for P&L: horizontal and vertical formats. Preparing balance sheet. The role of the trial balance. The types of adjustments to the trial balance. Accounting errors. The suspense account. Different layouts for the balance sheet: horizontal and vertical formats. Net working capital. Capital employed.

*(GU Ch.11; SG)*

## **7. Accounting and Reporting the Asset of Stock (Inventory)**

The asset of stock and the need for closing stock adjustments. Perpetual and periodic stock (inventory) measurement. The need for stock (inventory) valuation. The type of the business and the stock flows. Stock (inventory) costing: first-in, first-out (FIFO); last-in, first-out (LIFO); average cost (AVC). The choice of stock flow assumptions and accounting policies. The influence of inventory costing over the reported profits. Inventory (illusory) profits. Lower of costs or market rule. Net realizable value of stocks.

*(GU Ch.11; SG)*

## **8. Accounting and Reporting Noncurrent Assets: Fixed Assets**

Capital and revenue expenditures and their accounting treatment. Traditional method of depreciation for fixed assets: units of production (YOP). Accelerated depreciation: reducing (declining) balance (DB), sum of years digits (SYD). Factors affecting the choice of fixed assets depreciation methods. Fixed asset disposal. Disposal account. Recording changes in remaining useful life and residual value. Accounting for fixed assets and accounting policies. Fixed assets revaluation. Accounting treatment of leased assets. Operating leases and their influence on financial reports. Finance leases and their accounting problems. Principles of reporting financial investments in securities (bonds and shares).

*(GU Ch.12; SG; AHSK Ch.6, pp.160–173)*

## **9. Accounting and Reporting Intangible Assets**

Major types of intangibles (patents, licenses, trademarks and brands, software, goodwill) and their role in new economy. Internally created intangibles and acquired intangibles. The asset recognition criteria and accounting treatment of intangibles. The methods of writing off the intangibles. Amortization

of intangible assets and the accounting entries. Types of R&D expenditures. The asset recognition criteria and accounting treatment of R&D expenditures. Development cost. Goodwill and brands reporting. The choice of accounting policies for intangibles and the effect upon the Balance sheet and P&L statement.

*(GU Ch.12; SG; AHSK Ch.6, pp.160–173)*

## **10. Elements of Accounting and Financial Reporting in Limited Companies (Corporate Enterprises)**

The sources of financing in a limited company / corporation. The types of loan capital (debt finance). The issue of corporate bonds (debentures). Accounting treatment of debt finance. Preference shares and ordinary shares. The issue of shares. Authorized capital, issued capital, called up capital, calls in arrears. Accounting entries for dividend payments. Cash dividend, stock dividend, share repurchase. Bonus shares (scrip dividend). The types of reserves of limited company. Revenue reserves and their role. General reserve. Capital reserve.

*(GU Ch.13; SG; AHSK Ch.8)*

## **11. Basic Financial Statements of Limited Companies**

The final accounts of limited companies. The structure of Appropriation account and its role. Profit and Loss Statement of corporate firm. The relationship between Appropriation account and Profit and loss statement. The structure of the balance sheet of limited company. Conceptual framework for regulation of financial reporting for corporations. Published financial statements, directors reports and accompanying notes. The disclosure principle and published financial reports.

*(GU Ch.14; SG; AHSK Ch.8)*

## **Interpretation of Financial Reports**

### **12. The Cash Flow Statement**

The need for the Statement of cash flows. Accounting definition of cash and cash equivalents. Types of company's activities and cash flows: cash flow from operating, investing and financing activities. Net (gross) cash flow. Direct method of operating cash flow calculation. Indirect method of operating cash flow computation and working capital adjustments. Advantages of cash flow over net income for financial analysis. The reconciliation of cash flows from operating activities to the profit. The cash flow statement formats: UK standard as compared to international standard.

*(GU Ch.15; SG; AHSK Ch.11)*

### **13. Analysis of Financial Performance**

Horizontal and vertical analysis of financial statements. Ratio analysis. Types of financial ratios: liquidity, solvency, gearing, activity, profitability. Ratio analysis from lenders, owners and managers points of view. Du Pont earning power analysis. EPS computations. Advantages of ratio analysis. Limitations for ratio analysis: the type of industry, accounting policies. The sources of information for comparative ratio data.

*(GU Ch.16; SG; AHSK Ch.10)*

#### **14. Alternative Approaches to Valuation in Financial Accounting. Capital Maintenance**

The holes in conventional accounting model. Economic measures of income and capital and their role in accounting. Capital maintenance concept. Financial capital maintenance versus operational capital maintenance. Elements of accounting for changing prices. Current purchasing power (CPP) accounting: major principles, advantages and disadvantages. Current market values accounting: major principles, advantages and disadvantages. Replacement cost accounting. Main differences between historical cost and replacement cost accounting.

*(GU Ch.19–21; SG; AHSK Ch.12–14)*

### **Accounting and Managerial Decision-Making**

#### **15. Managerial Accounting: Costing Concepts and Costing Systems**

The organizations, their objectives and structure. The management need for information. A perspective for cost Analysis and classification. General cost classifications: manufacturing, nonmanufacturing, product and period costs. Costs for planning and control: direct and indirect, controllable and noncontrollable, differential costs. Types of costing systems. Job-order costing and the flow of costs. Measurement and application of manufacturing overheads. Process costing: the flow of costs, the problem of overheads. Advantages and disadvantages of traditional costing systems.

*(GU Ch.25–26; SG; R)*

#### **16. Advanced Costing Systems: ABC**

Design of activity-based costing (ABC). Assumptions of activity based costing. Tracing costs to activity centers. Application of overheads in ABC. Benefits and limitations of activity-based costing. Just-in-time inventories and its influence over costing systems.

*(GU Ch.27; SG)*

#### **17. Cost — Volume — Profit Relationship and Analysis**

Cost behavior analysis. Variable cost, fixed cost and mixed cost. Methods of mixed costs analysis. The contribution margin. The contribution format of P&L. Operating leverage, its use in risk assessment. Break-even analysis. The

margin of safety. The sales mix and break-even analysis. Target profit analysis. Limitations in CVP analysis.

*(GU Ch.28; R)*

## **18. Variable Costing**

Variable (marginal) costing compared to absorption (full) costing. Variable costing and stock valuation. Variable costing and activity-based costing. The benefits and limitations of variable costing. Variable costing controversy.

*(GU Ch.29; R)*

## **19. Accounting Data and Pricing**

Accounting treatment of pricing problems. “Cost plus” formula for pricing. Absorption pricing. Variable pricing. Mark-ups in different pricing methods. Target pricing and target costs.

*(GU Ch.30; R)*

## **20. Profit Planning and Budgeting**

Master budget and its structure. Steps in budgeting. Types of budgets. Cash budget and its role in planning and control. Cash budget and financing choices. The budgeted balance sheet and the budgeted P&L. Budgeting systems. The role of budgeting in planning and control. Using ratios in planning.

*(GU Ch.30; R)*

## **21. Standard Cost and Variance Analysis**

Standard costs and budgeted costs. Variance analysis for direct costs and overheads. Sales variance analysis. The influence of variances on income. Responsibility for variance analysis. Flexible budgets. Fixed cost and flexible budget. Activity based costing and flexible budgets.

*(GU Ch.35–36; R)*

## **22. Basics of Capital Budgeting**

Characteristics of investment project. The project physical life. Types of project’s cash flows: initial outlay, cash flows over the life, terminal (residual) cash flows.. The nature of relevant costs. Sunk costs. Differential costs. Traditional approaches to capital budgeting: accounting (simple) payback, accounting rate of return. Basics of discounted cash flow techniques. Net present value rule, its assumptions and limitations. IRR, its advantages and disadvantages. Discounted payback. Profitability index. Terminal value. Adding and dropping product lines. Make or buy decisions. Economic life of the project.

*(GU Ch.31–32; R)*

## **23. Using Accounting Data in Performance Evaluation**

Leadership style and the problem of control. Budget information and performance evaluation. Performance measurers. Segment reporting. Assigning costs to segments. Segment margin. The use of accounting data in strategic

planning. Customer profitability analysis. Elements of responsibility accounting.

*(GU Ch.37–38; SG; R)*

## Distribution of hours

#	Topic	Total hours	Contact hours		Self study
			Lectures	Seminars	
1.	Introduction to the Course. The Scope of Accounting	10	2	2	6
2.	Basic Accounting Elements and Accounting Equation	14	4	2	8
3.	The Framework for Conventional Accounting Model	12	2	2	8
4.	Building Accounting Cycle	18	4	4	10
5.	Periodic measurement and identification of revenues and expenses	12	2	2	8
6.	Preparing Balance Sheet and Profit and Loss Statement	18	4	4	10
7.	Accounting and Reporting the Asset of Stock (Inventory)	12	2	2	8
8.	Accounting and Reporting Non-current Assets: Fixed Assets	16	4	4	8
9.	Accounting and Reporting Intangible Assets	12	2	2	8
10.	Elements of Accounting and Financial Reporting in Limited Companies (Corporate Enterprises)	16	4	4	8
11.	The Cash Flow Statement	18	4	4	10
12.	Analysis of Financial Performance	16	4	4	8
13.	Alternative Approaches to Valuation in Financial Accounting. Capital Maintenance	18	4	4	10
14.	Analysis of Financial Reports (essay)	8			8
15.	Managerial Accounting: Costing Concepts and Costing Systems	16	4	4	8

#	Topic	Total hours	Contact hours		Self study
			Lectures	Seminars	
16.	Advanced Costing Systems: ABC	16	4	2	10
17.	Cost — Volume — Profit Relationship and Analysis	14	2	4	8
18.	Variable Costing	10	2	2	6
19.	Accounting Data and Pricing	6		2	4
20.	Profit Planning and Budgeting	16	2	4	10
21.	Standard Cost and Variance Analysis	16	4	4	8
22.	Basics of Capital Budgeting	18	4	4	10
23.	Using Accounting Data in Performance Evaluation	10	2	2	6
Total:		324	68	68	188