CAPACITARTE

Curso de inglés económico, de finanzas y tributos
Module 10

Accounting

What does accounting mean?

The activity of accounting consists in recording and summarizing of an organization's transactions (purchases and sales), then reporting them in the form of Financial Statements. This profession is called **Accounting** or **Accountancy**.

Accounting mainly involves:

- **Bookkeeping:** day-to-day recording of transactions.
- **Financial Accounting:** bookkeeping and preparation of financial statements for shareholders and creditors.
- **Management Accounting:** the use of accounting data by managers for making plans and decisions.

What do accountants do?

An Accountant is a professional who is skilled in keeping accounts and books of accounts correctly and properly. They design and control the systems of accounts required for records of various transactions of business, trade, and finance.

In the USA, a public accountant is a general accountant who either works for an accounting firm or has his or her own private practice.

Certified Public Accountant (CPA) is the statutory credential provided for qualified accountants in the U.S. for persons who have passed the Uniform Certified Public Accountant Examination.

In the U.K., a **Chartered Accountant** is defined as a British accountant who is a member of a professional body that has a royal charter, e.g. The Institute of Chartered Accountants in England and Wales.

Different **types of accountants** include:

- **Auditors:** they specialize in the study of the records and reports of an enterprise.
- **Forensic accountants:** they use their accounting, auditing, and investigative skills to assist the court in legal matters.
- **Tax professionals:** they are specifically trained in the field of taxation to represent taxpayers for audits, collections, and appeals.
- **Financial advisors:** they provide investment advice and financial planning services to individuals, organizations, and governments.
- **Consultants:** they have a high subject matter expertise in preparing financial reports, pro-forma financial statements and reports. They also analyze, interpret and evaluate financial statements and reports for various regulatory and statutory authorities and internal management of organizations.

There are **professional organizations** which operate training and examination systems for accountants, and make technical and ethical rules related to accepted ways of doing things.

Accounting Rules & Standards

Companies have to publish the value of their assets and liabilities regularly. In order to calculate their profits and losses, companies can choose their accounting policies.

There is a range of methods of valuation and measurement accepted by law or by official accounting standards.

In the USA, there are **Generally Accepted Principles** (known as GAAPs). There, companies whose stocks are traded on public stock exchanges have to follow rules set by the Securities Exchange Commission.

In most of the rest of the world, there are **International Financial Reporting Standards** (IFRS), set by the International Accounting Standards Board. These are a combination of authoritative standards (set by policy boards) and the commonly accepted ways used by companies to compile their financial statements.

Accounting Assumptions

When writing accounts and financial statements, accountants have to follow a number of assumptions, principles and conventions. An **assumption** is something generally accepted as being true.

The main assumptions used by accountants are as follows:

- **The separate entity** or **business entity assumption** implies that a business is an accounting unit separate from its owners, creditors, managers and their assets. These people can all change, but the business continues as before.
- **The time period assumption** states that the economic life of the business can be divided into time periods such as the financial year (BrE) fiscal year (AmE), or a quarter of it (which is three months).
- **The unit of measure assumption** is that all financial transactions are in a single monetary unit or currency. That's why companies with subsidiaries in different countries have to convert their results into one currency in consolidated financial statements for the whole group of companies.
- **The continuity** or **going concern assumption** says that a business will continue into the future, so the current market value of its assets is not important.

Accounting Principles

Accounting principles are the rules and guidelines that companies must follow when reporting financial data. As we have seen before, the common set of U.S. accounting principles is the generally accepted accounting principles (GAAP).

These include the followings:

- **The full-disclosure principle** states that financial reporting must include all significant information: anything that makes a difference to the users of financial statements.
- **The principle of materiality**, however, says that very small and unimportant amounts do not need to be shown.
- **The principle of conservatism** means that where different accounting methods are possible, you choose the one that is least probable to overstate or over-estimate assets or income.
- **The objectivity principle** says that accounts should be verifiable (auditors should be able to show that they are true). However, items such as depreciation and provisions for bad debts are necessarily subjective, based on opinions.

- **The revenue recognition principle** states that revenue is recognized in the accounting period in which it is earned. This means the revenue is recorded when a service is provided or goods delivered, not when they're paid for. In relation to this principle, the matching principle states that each cost or expense related to revenue earned must be recorded in the same accounting period as the revenue it helped to earn.
- **The consistency principle** means that businesses have to use the same methods every year, unless there is a good reason to change a policy.
- **The historical cost principle** states that companies record the original purchase price of assets, and not their (estimated) current selling price or replacement cost.

Bookkeeping vs Accounting/Accountancy

The terms bookkeeping and accounting or accountancy are generally confused.

Accountancy is the British term used to describe the activities and theories comprising accounting. It refers to accounting as a science. It includes practice, research and teaching of the guidelines, principles, and procedures.

Accounting is the umbrella term encompassing the multitude of disciplines including auditing, taxation, financial statement analysis, and managerial accounting. It is primarily concerned with the design of the system of records, the preparation of reports based on the recorded data, and the interpretation of the reports.

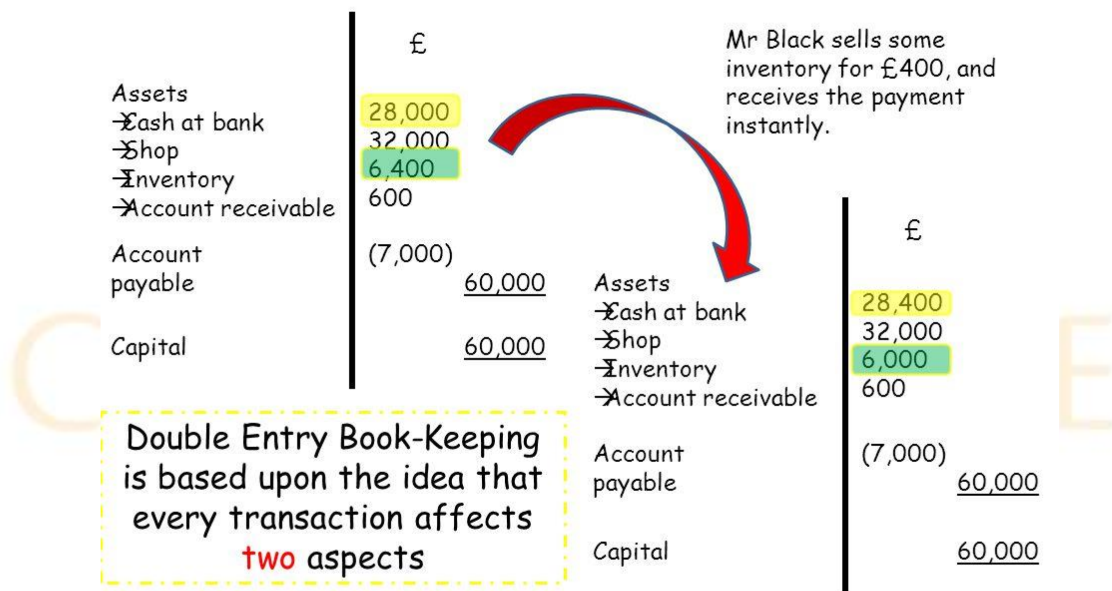
Bookkeeping refers to the recording of business data in a prescribed manner. Bookkeepers are responsible for keeping the records of a business or of only a small segment. Accountants often direct and review the work of bookkeepers.

Bookkeeping: Double-entry system

Double-entry bookkeeping is a system that records two aspects of every transaction: a debit – a deduction- in one account and a corresponding credit – an addition – in another. It is based on a

simple concept: each party in a business transaction will receive something and give something in return.

For example, if a company buys some raw materials for $100 that it will pay for a month later, it **debits** its purchases account and **credits** the supplier's account. If the Company sells an item on credit, it credits the sales account and debits the customer's account. Each account records debits on the left and credits on the right. If the bookkeepers do their work correctly, the total debits always equal the total credits.



The Process of Bookkeeping

Below you can find the process of bookkeeping:

For accounts with a large number of transactions, companies often record them in **day books** or **journals**, and then put a daily or weekly summary in the main double-entry records, known as **General Ledger**. This book is a complete **record of financial transactions** over the life of a company. It used by businesses that employ the **double-entry bookkeeping** method, and where each account has two columns. Because a debit in one account is **offset** (compensated) by a credit in a different account, the sum of all debits will be equal to the sum of all credits.
In Britain, they call the main books of account **nominal ledgers**. They still use these names, even though these days all the information is on the computer.

At the end of an accounting period, bookkeepers prepare a **trial balance**, a listing of the account balances from the general ledger, prepared at the end of the accounting period. All accounts are listed in the order in which they appear in the ledger. This transfers the debit and credit balances of different accounts onto one page. As always, the total debits should equal the total credits. When all the accounts in the Ledger have been **ruled** and balanced, only one step remains in the accounting cycle: all of the debit balances must be added, all of the credit balances must be added, and the two totals must be compared to test their equality. This procedure is known as taking a **Post-Closing Trial Balance**.

The accountants can then use these balances to prepare the organization's **financial statements.** For this purpose, accountants use a **Chart of Accounts**, a list of ledger account names and numbers arranged in the order in which they customarily appear in the financial statements.