**Pakistan School, Kingdom of Bahrain**

**E- Support and Learning Material / Session 2020-2021**

**Subject: Accounting Grade: 11**

**Book: Principles of Accounting FIRST TERM**

 **Unit 1 & 2**

**Chapter 1: Introduction**

**Definition of Accounting**

**Accounting** is the process of systematically recording, measuring and communicating information about financial transactions. The **three major** financial statements produced by **accounting** are the profit and loss statement, the balance sheet and the cash flow statement.

**Book Keeping**

The activity or occupation of keeping records of the financial affairs of a business.

**Branches of Accounting**

There are three main branches of accounting which include **financial accounting**, **cost accounting** and **management accounting**.

**Important Accounting Terms**

1. **Accounts receivable (AR)**

**Accounts receivable (AR) definition:** The amount of money owed by customers or clients to a business after goods or services have been delivered and/or used.

1. **Accounting (ACCG)**

**Accounting (ACCG) definition:** A systematic way of recording and reporting financial transactions for a business or organization.

1. **Accounts payable (AP)**

**Accounts payable (AP) definition:** The amount of money a company owes creditors (suppliers, etc.) in return for goods and/or services they have delivered.

1. **Assets (fixed and current) (FA, CA)**

**Assets (fixed and current) definition: Current assets (CA)** are those that will be converted to cash within one year. Typically, this could be cash, inventory or accounts receivable. **Fixed assets (FA)** are long-term and will likely provide benefits to a company for more than one year, such as a real estate, land or major machinery.

1. **Capital (CAP)**

**Capital (CAP) definition:** A financial asset or the value of a financial asset, such as cash or goods. Working capital is calculated by taking your current assets subtracted from current liabilities—basically the money or assets an organization can put to work.

1. **Cost of goods sold (COGS)**

**Cost of goods sold (COGS) definition:** The direct expenses related to producing the goods sold by a business. The formula for calculating this will depend on what is being produced, but as an example this may include the cost of the raw materials (parts) and the amount of employee labor used in production.

1. **Credit (CR)**

**Credit (CR) definition:** An accounting entry that may either *decrease* assets or *increase* liabilities and equity on the company's balance sheet, depending on the transaction. When using the [double-entry accounting method](https://www.accountingcoach.com/blog/what-is-the-double-entry-system) there will be two recorded entries for every transaction: A credit and a debit.

1. Debit (DR)

**Debit (DR) definition:** An accounting entry where there is either an *increase* in assets or a *decrease* in liabilities on a company's balance sheet.

1. **Expenses (fixed, variable, accrued, operation) (FE, VE, AE, OE)**

**Expenses (FE, VE, AE, OE) definition:** The fixed, variable, accrued or day-to-day costs that a business may incur through its operations.

**Fixed expenses (FE)**: payments like rent that will happen in a regularly scheduled cadence.

**Variable expenses (VE):**expenses, like labor costs, that may change in a given time period.

**Accrued expense (AE):** an incurred expense that hasn’t been paid yet.

**Operation expenses (OE)**: business expenditures not directly associated with the production of goods or services—for example, advertising costs, property taxes or insurance expenditures.

1. **Equity and owner's equity (OE)**

**Equity and owner's equity (OE) definition:** In the most general sense, equity is assets minus liabilities. An owner’s equity is typically explained in terms of the percentage of stock a person has ownership interest in the company. The owners of the stock are known as shareholders.

1. **Trial balance**

**Trial balance definition:** A business document in which all ledgers are compiled into debit and credit columns in order to ensure a company’s bookkeeping system is mathematically correct.

1. **Liabilities (current and long-term) (CL, LTL)**

**Liabilities (current and long-term) definition:** A company's debts or financial obligations incurred during business operations. Current liabilities (CL) are those debts that are payable within a year, such as a debt to suppliers. Long-term liabilities (LTL) are typically payable over a period of time greater than one year. An example of a long-term liability would be a multi-year mortgage for office space.

**Trade discount vs Cash discount**

A **trade discount** is the amount by which a manufacturer reduces the retail price of a product when it sells to a reseller, rather than to the end customer. ... For **example**, ABC International offers its resellers a **trade discount**. The retail price for a green widget is $2.

A **cash discount** is a deduction allowed by some sellers of goods or by some providers of services in order to motivate customers to pay within a specified time. ... The sellers and providers offering a **cash discount** will refer to it as a sales **discount**, while the buyer will refer to the same **discount** as a purchase **discount**.

**Accounting Principles**

Accounting principles are the [foundation of accounting according to GAAP](https://www.iedunote.com/accounting-gaap). These principles are used in every step of the accounting process for the proper representation of the financial position of the business.

**Five principles of accounting are;**

1. Revenue Recognition Principle,
2. Historical Cost Principle,
3. Matching Principle,
4. Full Disclosure Principle, and
5. Objectivity Principle.

**These are explained below;**

## **Revenue Recognition Principle**

Revenue Recognition Principle is mainly concerned with the [revenue being recognized in the income statement of an enterprise](https://www.iedunote.com/income-statements).

Revenue is the gross inflow of cash, receivables or other considerations arising in the course of ordinary activities of an enterprise from the sale of goods, rendering of services and use of enterprise resources by others yielding interests, royalties, and dividends.

## **Historical Cost Principle**

According to Historical Cost principle, an asset is ordinarily recorded in the accounting records at the price paid to acquire it at the time of its acquisition and the cost becomes the basis for the accounts during the period of acquisition and subsequent accounting periods.

## **Matching Principle**

According to Matching Principle, the expenses incurred in an accounting period should be matched with the revenues recognized in that period, e.g., if revenue is recognized on all goods sold during a period, the cost of those goods sold should also be charged to that period.

## **Full Disclosure Principle**

According to this principle, the financial statements should act as a means of conveying and not concealing.

The [financial statements must disclose all the relevant and reliable information](https://www.iedunote.com/financial-statements-definition-component-importance) which they purport to represent so that the information may be useful for the users.

## Objectivity Principle

According to the Objectivity Principle, the accounting data should be definite, verifiable and free from the personal bias of the accountant.

In other words, the [Objectivity Principle requires that each recorded transaction/event in the books of accounts](https://www.iedunote.com/transactions-events-difference) should have adequate evidence to support it.

**Chapter 2**

**Monitory Events**

If the financial position of a business is change due to the happening of event that Event is called Monetary Event.

**Non**-**monetary event**

The **events** which are not related to money or money's worth i.e. occurrence of which does not bring any financial change are called **non**-**monetary events**. For example, writing of a book, passing examination, winning the game, deliberation of speech, placing an order for goods, etc.

**Types of Transactions**

**Cash Transaction**

A **cash transaction** is a **transaction** where there is an immediate payment of **cash** for the purchase of an asset.

**Credit Transaction**

A **cash transaction** is a **transaction** where there is an immediate payment of **cash** for the purchase of an asset.

**Internal vs External Transactions**

The difference between an **external** and **internal transaction** is the people involved. In **external transaction**, people of a different region or outside the company are involved. In **internal transaction**, people of the same country or company transact.

**Accounting Equation:**

### ****Equation Definition****

The basis of accounting balances and reports on profits and losses (financial statements) of almost all foreign organizations is based on a basic accounting equation. The accounting equation is considered to be the foundation of the [double-entry](https://www.investopedia.com/terms/d/double-entry.asp) accounting system. This equation has the following formula:
Assets = Liabilities + Owner’s equity
Let’s take a close look at accounting equation components:

