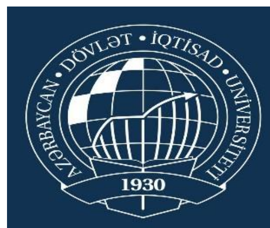
THE MINISTRY OF EDUCATION OF AZERBAIJAN REPUBLIC

THE ROLE OF FINANCIAL ACCOUNTING IN BUSINESS

Guliyev Huseyin

UNEC SABAH

Azerbaijan State Economic University



2018

ACKNOWLEDGEMENTS

Initially, I would like to thank to my scientific supervisor, PhD candidate Polad Azizov for his advice, encouragement and patient guidance. I am extremely lucky to have a supervisor who cared so much about my work and responded my questions so promptly.

ABSTRACT

THE ROLE OF FINANCIAL ACCOUNTING IN BUSINESS

Huseyin Guliyev

SABAH 2 Economy 1

Supervisor: PhD candidate Polad Azizov

UNEC SABAH

Azerbaijan State Economic University

The purpose of accounting is to accumulate and report on financial information about the performance, financial position, and cash flows of a business. This information is then used to reach decisions about how to manage the business, or invest in it, or lend money to it. This information is accumulated in accounting records with accounting transactions, which are recorded either through such standardized business transactions as customer invoicing or supplier invoices, or through more specialized transactions, known as journal entries.

Once this financial information has been stored in the accounting records, it is usually compiled into financial statements, which include the following documents.

Financial statements are assembled under certain sets of rules, known as accounting frameworks, of which the best known are Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS). The results shown in financial statements can vary somewhat, depending on the framework used. The framework that a business uses depends upon which one the recipient of the financial statements wants. Thus, a European investor might want to see financial statements based on IFRS, while an American investor might want to see statements that comply with GAAP.

The accountant may generate additional reports for special purposes, such as determining the profit on sale of a product, or the revenues generated from a particular sales region. These are usually considered to be managerial reports, rather than the financial reports issued to outsiders.

Thus, the purpose of accounting centers on the collection and subsequent reporting of financial information.

Contents

Acknowledgements 2

Abstract 3

Contents 4

INTRODUCTION 5

CHAPTER I. Financial accounting: basic concepts and principles 9

1.1 Definition and introduction 9

1.2 Concepts and Principles of Financial Accounting 13

CHAPTER II. International Financial Reporting Standards 27

2.1 Financial Accounting Standards 27

2.2 International Financial Reporting Standards (IFRSs) 31

CHAPTER III. The Role of Financial Accounting in Business 36

3.1 The benefits of IFRS/IAS application 36

3.2 The Role of Accounting in Business 39

CONCLUSION 46

REFERENCES 48

INTRODUCTION

How an entity presents information in its financial statements is very important because financial statements are a central feature of financial reporting – a principal means of communicating financial information to those outside an entity.

Globalization and transnational business expansion has resulted in an increased need for uniform rules so that the financial statements in different countries are prepared on a similar basis, and there would be no opportunity for interpretation. Although at an international level different professional accounting organizations have made efforts to harmonize financial reporting rules, there has been a lot of criticism on the address of financial statements for many reasons. Firstly, there are too many alternative ways to report financial information in the financial statements (IASB, 2008). This makes it difficult to compare the financial statements of different entities, and provides opportunities to false conclusions about the success of the activities of the entity. Secondly, the entities in different countries have different demands on how to draft financial statements (European Commission, October 25, 2011). This situation complicates the interpretation of the entities' financial results and comparisons of financial reports at the international level. Thirdly, the financial reporting requirements set on companies often do not take into account the size of the company and this raises the question of the need for differential reporting (Cole et al., 2012;

Evans et al., 2005; Collis et al., 2001). Fourthly, what users review in the financial statements differs, and therefore, when drafting the financial statements, the company should bear in mind the interests of the most significant user groups (Cole et al., 2012; Sian and Roberts, 2009).

Bearing the above criticism in mind it is crucial to analyze the financial accounting framework in Azerbaijan and to investigate, whether the users of the financial statements in Azerbaijan are experiencing the same problems. Taking into account that 99.9% of Azerbaijan companies are small and medium-sized entities (SMEs) the author has focused the research on those particular companies.

In addition, this doctoral thesis provides a comprehensive overview of the changes in Azerbaijan accounting legislation from 1990 to 2012 using institutional theory. First of all, there are only few authors publishing about Azerbaijan accounting issues and there is practically no accounting-related academic literature available, even at the local level in the Azerbaijan language. Therefore, this doctoral thesis tries to fill in this gap and provides a thorough overview of the main changes. Secondly, this thesis uses institutional theory in analyzing the country-specific factors affecting the development of financial accounting and reporting in Azerbaijan, as an inter-play between practices, routines and institutions.

From international perspective this doctoral thesis provides a comprehensive overview about different equity theories and links them to the conceptual frameworks of the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB). Although few authors have investigated conceptual frameworks using equity theories (Van Mourik, 2010a; Van Mourik, 2010b; Troberg et al 1995), its application is generally underexplored, especially from the perspective what are the objectives of financial reporting and who are considered to be the users of the financial statements. In addition, the doctoral thesis aims to provide an overview of the evolution of equity theories by identifying the prevailing theory of the period and determining the main users from whose point of view the financial statements should be presented.

The aim of this doctoral thesis is at first to formulate an understanding how current and future accounting standards that govern the preparation of SMEs' financial statements expect to meet the needs of users. Secondly, how should a complete set of financial statements that satisfies the needs of Azerbaijan stakeholders look like.

Although the overall research question aims at identifying the needs of SME financial statement users an d preparers in Azerbaijan, one should take a wider approach to this matter. As Azerbaijan economy is not a closed system, one should analyze the international factors influencing the development and compilation of Azerbaijan accounting standards. This also means identifying the underlying concepts of current accounting standards and linking them to a comprehensive theory. The contribution of the thesis from international perspective is that the findings of this study have implications for regulators who are now considering the possibility of developing guidance for the SMEs. From the EU perspective, this research can provide valuable insights for member states, how to implement the new Accounting Directive 2013/34/EU. In Azerbaijan, the research is interest of organizations and individuals concerned with Azerbaijan financial accounting guidelines (for example Azerbaijan Ministry of Finance, Azerbaijan Accounting Standards Board), as the doctoral thesis contains observation son the Azerbaijan current system of financial accounting concepts and relevant suggestions for the future. So in general, this doctoral thesis potentially contributes to the accounting reforms evidence in emerging economies, its progresses and obstacles.

CHAPTER 1. FINANCIAL ACCOUNTING: BASIC CONCEPTS AND PRINCIPLES

1.1 Definition and introduction

As discussed in the previous chapter, accounting is concerned with the recording, classifying and summarizing of financial transactions and events and interpreting the results thereof. It aims at providing information about the financial performance of a firm to its various users such as owners, managers employees, investors, creditors, suppliers of goods and services and tax authorities and help them in taking important decisions. The investors, for example, may be interested in knowing the extent of profit or loss earned by the firm during a given period and compare it with the performance of other similar enterprises. The suppliers of credit, say a banker, may, in addition, be interested in liquidity position of the enterprise. All these people look forward to accounting for appropriate, useful and reliable information.

For making the accounting information meaningful to its internal and external users, it is important that such information is reliable as well as comparable. The comparability of information is required both to make inter - firm comparisons, i.e. to see how a firm has performed as compared to the other firms, as well as to make inter-period comparison, i.e. how it has performed as compared to the previous years. This becomes possible only if the information provided by the financial statements is based on consistent accounting policies, principles and practices. Such consistency is required throughout the process of identifying the events and transactions to be accounted for, measuring them, communicating them in the book of accounts, summarizing the results thereof and reporting them to the interested parties.

This calls for developing a proper theory base of accounting.

The importance of accounting theory need not be over-emphasized as no discipline can develop without a sound theoretical base. The theory base of accounting consists of principles, concepts, rules and guidelines developed over a period of time to bring uniformity and consistency to the process of accounting and enhance its utility to different users of accounting information. Apart from these, the Institute of Chartered Accountants of Azerbaijan, (IAS), which is the regulatory body for standardization of accounting policies in the country has issued Accounting Standards which are expected to be uniformly adhered to, in order to bring consistency in the accounting practices. These are discussed in the sections to follow.

Profit, it has been said often, is the sole objective of business. Therefore, for those running a business, information about the financial performance of the enterprise is a most important requirement.

This information is not available easily and can be obtained only by systematically recording, classifying, and summarizing all the business transactions. The branch of accounting that accomplishes these tasks under internationally standardized procedures is called financial accounting.

However, financial accounting is not limited to recording, classifying, and summarizing information about business transactions. It also deals with reporting this information to stakeholders outside the organization, such as investors and creditors, who are the important, primary recipients of the information.

There may be secondary recipients, too, such as competitors, customers, employees, and stock-market analysts, but the information generated by financial accounting is mainly aimed at external stakeholders who are not part of the business organization per se.

Therefore, to put together a formal definition of financial accounting, it is a specialized branch of accounting that records and reports information about the

financial position and performance of a company, mainly for use by the business entity's external stakeholders.

How does financial accounting achieve its tasks? Financial accounting mainly generates three financial statements to provide the information required- the balance sheet, income statement, and cash flow statement.

These documents provide the stakeholders a clear idea about the performance of the business during a particular period and its financial position at a specific time. The objective of the financial accountants is not to estimate the value of a company but to facilitate this valuation by others.

According to the International Financial Reporting Standards, financial accounting provides information about a business organization that is useful to existing and potential investors, lenders, and other creditors in making decisions about providing resources to the organization.

Objectives

The objectives of financial accounting can be put in four categories, as follows:

- Record financial transactions as and when they occur (bookkeeping), so that the data can be analyzed for preparing financial statements
- Calculate profit or loss, to enable management to take course-correction strategies if required
- Ascertain the financial strength of the company by determining its assets and liabilities
- Communicate the information to stakeholders through statements and reports, so that these stakeholders can take appropriate decisions on their investments in the business

Financial statements

For meeting these objectives, financial accountants mainly prepare three types of documents, as briefly mentioned in the introduction above-the balance sheet, which reflects the assets and liabilities; income statement, which shows the profit and loss; and, cash flow statement, which charts the cash inflow and outflow.

The external users of financial statements look at the balance sheet to find out how strong the business is, financially (assets vs. liabilities), and at the income statement to find out how well the business is doing (profit vs. loss).

Creditors and other lenders would be happy to see a positive balance sheet so that they know their investments are safe, and investors would like to see an income sheet with profit so that they know some money would be coming to them from the company in the form of dividend or interest.

Almost all stakeholders want to see the cash flow statement to know the cash availability with the company and whether it will be able to clear its liabilities.

Among the internal users of financial statements are managers, who can take decisions on the basis of the financial statements, and among the external users are government authorities, who can initiate tax measures.

Here are some additional notes on the three financial statements mentioned above.

Balance sheet: The balance sheet of a company shows its assets, liabilities, and stockholders' equity as on the last day of the accounts-reporting period. Assets include cash, stocks, buildings, and machinery, while liabilities include loans, interest, and wages. Stockholders' equity is the difference between the assets and the liabilities. Read more about balance sheets.

Income statement: The income statement (issued quarterly or annually) reports the company's profitability in a given period. It presents the revenues

(sales and service revenues), expenses (operating expenses, such as wages and rent, and non-operating expenses, such as loan interest), gains, and losses. Read more on Profit and Loss.

Cash flow statement: The cash statement shows the inflow and outflow of cash and its use for operating, financing, and investing activities. Here are some details on the cash flow statement.

1.2 Concepts and Principles of Financial Accounting

The basic accounting concepts are referred to as the fundamental ideas or basic assumptions underlying the theory and practice of financial accounting and are broad working rules for all accounting activities and developed by the accounting profession. The important concepts have been listed as below:

Business entity;	Revenue recognition (Realisation);
Money measurement;	Matching;
Going concern;	Full disclosure;
Accounting period;	Consistency;
Cost;	Conservatism (Prudence);
Dual aspect (or Duality);	Materiality;
	Objectivity.

Business Entity Concept

The concept of business entity assumes that *business* has a *distinct and separate* entity from its owners. It means that for the purposes of accounting, the business and its owners are to be treated as two separate entities. Keeping this in view, when a person brings in some money as capital into his business, in accounting records, it is treated as liability of the business to the owner. Here, one separate entity (owner) is assumed to be giving money to another distinct entity (business unit). Similarly, when the owner withdraws any money from the business for his personal expenses(drawings), it is treated as reduction of the owner's capital and consequently a reduction in the liabilities of the business.

The accounting records are made in the book of accounts from the point of view of the business unit and not that of the owner. The personal assets and liabilities of the owner are, therefore, not considered while recording and reporting the assets and liabilities of the business. Similarly, personal transactions of the owner are not recorded in the books of the business, unless it involves inflow or outflow of business funds.

Money Measurement Concept

The concept of money measurement states that only those transactions and happenings in an organization which can be expressed in terms of money such as sale of goods or payment of expenses or receipt of income, etc. are to be recorded in the book of accounts. All such transactions or happenings which can not be expressed in monetary terms, for example, the appointment of a manager, capabilities of its human resources or creativity of its research department or image of the organization among people in general do not find a place in the accounting records of a firm.

Another important aspect of the concept of money measurement is that the records of the transactions are to be kept not in the physical units but in the monetary unit. For example, an organization may, on a particular day, have a factory on a piece of land measuring 2 acres, office building containing 10 rooms, 30 personal computers, 30 office chairs and tables, a bank balance of Rs.5 lakh, raw material weighing 20-tons, and 100 cartons of finished goods. These assets are expressed in different units, so can not be added to give any meaningful information about the total worth of business. For accounting purposes, therefore, these are shown in money terms and recorded in rupees and paise. In this case, the cost of factory land may be say Rs. 2 crore; office building Rs. 1 crore; computers Rs.15 lakh; office chairs and tables Rs. 2 lakh; raw material Rs. 33 lakh and finished goods Rs. 4 lakh. Thus, the total assets of

the enterprise are valued at Rs. 3 crore and 59 lakh. Similarly, all transactions are recorded in rupees and paise as and when they take place.

The money measurement assumption is not free from limitations. Due to the changes in prices, the value of money does not remain the same over a period of time. The value of rupee today on account of rise in prices is much less than what it was, say ten years back. Therefore, in the balance sheet, when we add different assets bought at different points of time, say building purchased in 1995 for Rs. 2 crore, and plant purchased in 2005 for Rs. 1 crore, we are in fact adding heterogeneous values, which can not be clubbed together. As the change in the value of money is not reflected in the book of accounts, the accounting data does not reflect the true and fair view of the affairs of an enterprise.

Going Concern Concept

The concept of *going concern* assumes that a business firm would continue to carry out its operations indefinitely, i.e. for a fairly long period of time and would not be liquidated in the foreseeable future. This is an important assumption of accounting as it provides the very basis for showing the value of assets in the balance sheet.

An asset may be defined as a *bundle of services*. When we purchase an asset, for example, a personal computer, for a sum of Rs. 50,000, what we are buying really is the services of the computer that we shall be getting over its estimated life span, say 5 years. It will not be fair to charge the whole amount of Rs. 50,000, from the revenue of the year in which the asset is purchased. Instead, that part of the asset which has been consumed or used during a period should be charged from the revenue of that period. The assumption regarding continuity of business allows us to charge from the revenues of a period only that part of the asset which has been consumed or used to earn that revenue in that period and carry forward the remaining amount to the next years, over the

estimated life of the asset. Thus, we may charge Rs. 10,000 every year for 5 years from the profit and loss account. In case the continuity assumption is not there, the whole cost (Rs. 50,000 in the present example) will need to be charged from the revenue of the year in which the asset was purchased.

Accounting Period Concept

Accounting period refers to the span of time at the end of which the financial statements of an enterprise are prepared, to know whether it has earned profits or incurred losses during that period and what exactly is the position of its assets and liabilities at the end of that period. Such information is required by different users at regular interval for various purposes, as no firm can wait for long to know its financial results as various decisions are to be taken at regular intervals on the basis of such information. The financial statements are, therefore, prepared at regular interval, normally after a period of one year, so that timely information is made available to the users. This interval of time is called accounting period.

The Companies Act 1956 and the Income Tax Act require that the income statements should be prepared annually. However, in case of certain situations, preparation of interim financial statements become necessary. For example, at the time of retirement of a partner, the accounting period can be different from twelve months period. Apart from these companies whose shares are listed on the stock exchange, are required to publish quarterly results to ascertain the profitability and financial position at the end of every three months period.

3. A concept that a business enterprise will not be sold or liquidated in the near future is known as :

(a) Going concern

(b) Economic entity

(c) Monetary unit

(d) None of the above

4. The primary qualities that make accounting information useful for decision-making are :

(a) Relevance and freedom from bias

(b) Reliability and comparability

(c) Comparability and consistency

(d) None of the above

Cost Concept

The cost concept requires that all assets are recorded in the book of accounts at their purchase price, which includes cost of acquisition, transportation, installation and making the asset ready to use. To illustrate, on June 2005, an old plant was purchased for Rs. 50 lakh by Shiva Enterprise, which is into the business of manufacturing detergent powder. An amount of Rs. 10,000 was spent on transporting the plant to the factory site. In addition, Rs. 15,000 was spent on repairs for bringing the plant into running position and Rs. 25,000 on its installation. The total amount at which the plant will be recorded in the books of account would be the sum of all these, i.e. Rs. 50,50,000.

The concept of cost is historical in nature as it is something, which has been paid on the date of acquisition and does not change year after year. For example, if a building has been purchased by a firm for Rs. 2.5 crore, the purchase price will remain the same for all years to come, though its market value may change. Adoption of historical cost brings in objectivity in recording as the cost of acquisition is easily verifiable from the purchase documents. The market value basis, on the other hand, is not reliable as the value of an asset may change from time to time, making the comparisons between one period to another rather difficult.

However, an important limitation of the historical cost basis is that it does not show the true worth of the business and may lead to hidden profits. During the period of rising prices, the market value or the cost at (which the assets can be replaced are higher than the value at which these are shown in the book of accounts) leading to hidden profits.

Dual Aspect Concept

Dual aspect is the foundation or basic principle of accounting. It provides the very basis for recording business transactions into the book of accounts. This concept states that every transaction has a dual or two-fold effect and should therefore be recorded at two places. In other words, at least two accounts will be involved in recording a transaction. This can be explained with the help of an example. Ram started business by investing in a sum of Rs. 50,00,000 The amount of money brought in by Ram will result in an increase in the assets (cash) of business by Rs. 50,00,000. At the same time, the owner's equity or capital will also increase by an equal amount. It may be seen that the two items that got affected by this transaction are cash and capital account.

Let us take another example to understand this point further. Suppose the firm purchase goods worth Rs. 10,00,000 on cash. This will increase an asset (stock of goods) on the one hand and reduce another asset (cash) on the other. Similarly, if the firm purchases a machine worth Rs. 30,00,000 on credit from Reliable Industries. This will increase an asset (machinery) on the one hand and a liability (creditor) on the other. This type of dual effect takes place in case of all business transactions and is also known as duality principle.

The duality principle is commonly expressed in terms of fundamental Accounting Equation, which is as follows :

Assets = Liabilities + Capital

In other words, the equation states that the assets of a business are always equal to the claims of owners and the outsiders. The claims also called equity of owners is termed as *Capital(owners' equity)* and that of outsiders, as *Liabilities(creditors equity)*. The two-fold effect of each transaction affects in such a manner that the equality of both sides of equation is maintained.

The two-fold effect in respect of all transactions must be duly recorded in the book of accounts of the business. In fact, this concept forms the core of *Double Entry System* of accounting, which has been dealt in detail.

Revenue Recognition (Realization) Concept

The concept of *revenue recognition* requires that the revenue for a business transaction should be included in the accounting records only when it is realized. Here arises two questions in mind. First, is termed as *revenue* and the other, when the *revenue* is *realized*. Let us take the first one first. Revenue is the gross inflow of cash arising from (i) the sale of goods and services by an enterprise; and (ii) use by others of the enterprise's resources yielding interest, royalties and dividends. Secondly, revenue is assumed to be realized when a legal right to receive it arises, i.e. the point of time when goods have been sold or service has been rendered. Thus, credit sales are treated as revenue on the day sales are made and not when money is received from the buyer. As for the income such as rent, commission, interest, etc. these are recognized on a time basis. For example, rent for the month of March 2014, even if received in April 2014, will be taken into the profit and loss account of the financial year ending March 31, 2014 and not into financial year beginning with April 2014.

Similarly, if interest for April 2014 is received in advance in March 2014, it will be taken to the profit and loss account of the financial year ending March 2014.

There are some exceptions to this general rule of revenue recognition. In case of contracts like construction work, which take long time, say 2-3 years to complete, proportionate amount of revenue, based on the part of contract completed by the end of the period is treated as realized. Similarly, when goods are sold on hire purchase, the amount collected in installments is treated as realized.

Matching Concept

The process of ascertaining the amount of profit earned or the loss incurred during a particular period involves deduction of related expenses from the revenue earned during that period. The matching concept emphasizes exactly on this aspect. It states that expenses incurred in an accounting period should be matched with revenues during that period. It follows from this that the revenue and expenses incurred to earn these revenues must belong to the same accounting period.

As already stated, revenue is recognized when a sale is complete or service is rendered rather when cash is received. Similarly, an expense is recognized not when cash is paid but when an asset or service has been used to generate revenue. For example, expenses such as salaries, rent, insurance are recognized on the basis of period to which they relate and not when these are paid. Similarly, costs like depreciation of fixed asset is divided over the periods during which the asset is used.

Let us also understand how cost of goods are matched with their sales revenue. While ascertaining the profit or loss of an accounting year, we should not take the cost of all the goods produced or purchased during that period but consider only the cost of goods that have been sold during that year. For this purpose, the cost of unsold goods should be deducted from the cost of the goods

produced or purchased. You will learn about this aspect in detail in the chapter on financial statement.

The matching concept, thus, implies that all revenues earned during an accounting year, whether received during that year, or not and all costs incurred, whether paid during the year, or not should be taken into account while ascertaining profit or loss for that year.

Full Disclosure Concept

Information provided by financial statements are used by different groups of people such as investors, lenders, suppliers and others in taking various financial decisions. In the corporate form of organization, there is a distinction between those managing the affairs of the enterprise and those owning it. Financial statements, however, are the only or basic means of communicating financial information to all interested parties. It becomes all the more important, therefore, that the financial statements makes a full, fair and adequate disclosure of all information which is relevant for taking financial decisions.

The principle of full disclosure requires that all material and relevant facts concerning financial performance of an enterprise must be fully and completely disclosed in the financial statements and their accompanying footnotes. This is to enable the users to make correct assessment about the profitability and financial soundness of the enterprise and help them to take informed decisions.

To ensure proper disclosure of material accounting information, the Azerbaijan Companies Act 1956 has provided a format for the preparation of profit and loss account and balance sheet of a company, which needs to be compulsorily adhered to, for the preparation of these statements. The regulatory bodies like SEBI, also mandates complete disclosures to be made by the companies, to give a true and fair view of profitability and the state of affairs.

Consistency Concept

The accounting information provided by the financial statements would be useful in drawing conclusions regarding the working of an enterprise only when it allows comparisons over a period of time as well as with the working of other enterprises. Thus, both inter-firm and inter-period comparisons are required to be made. This can be possible only when accounting policies and practices followed by enterprises are uniform and are consistent over the period of time.

To illustrate, an investor wants to know the financial performance of an enterprise in the current year as compared to that in the previous year. He may compare this year's net profit with that in the last year. But, if the accounting policies adopted, say with respect to depreciation in the two years are different, the profit figures will not be comparable. Because the method adopted for the valuation of stock in the past two years is inconsistent. It is, therefore, important that the concept of consistency is followed in preparation of financial statements so that the results of two accounting periods are comparable. Consistency eliminates personal bias and helps in achieving results that are comparable.

Also the comparison between the financial results of two enterprises would be meaningful only if same kind of accounting methods and policies are adopted in the preparation of financial statements.

However, consistency does not prohibit change in accounting policies. Necessary required changes are fully disclosed by presenting them in the financial statements indicating their probable effects on the financial results of business.

Conservatism Concept

The concept of conservatism (also called 'prudence') provides guidance for recording transactions in the book of accounts and is based on the policy of playing safe. The concept states that a conscious approach should be adopted in

ascertaining income so that profits of the enterprise are not overstated. If the profits ascertained are more than the actual, it may lead to distribution of dividend out of capital, which is not fair as it will lead to reduction in the capital of the enterprise.

The concept of conservatism requires that profits should not to be recorded until realized but all losses, even those which may have a remote possibility, are to be provided for in the books of account. To illustrate, valuing closing stock at cost or market value whichever is lower; creating provision for doubtful debts, discount on debtors; writing of intangible assets like goodwill, patents, etc. from the book of accounts are some of the examples of the application of the principle of conservatism. Thus, if market value of the goods purchased has fallen down, the stock will be shown at cost price in the books but if the market value has gone up, the gain is not to be recorded until the stock is sold. This approach of providing for the losses but not recognizing the gains until realized is called conservatism approach. This may be reflecting a generally pessimist attitude adopted by the accountants but is an important way of dealing with uncertainty and protecting the interests of creditors against an unwanted distribution of firm's assets. However, deliberate attempt to underestimate the value of assets should be discouraged as it will lead to hidden profits, called *secret reserves*.

Materiality Concept

The concept of materiality requires that accounting should focus on material facts. Efforts should not be wasted in recording and presenting facts, which are immaterial in the determination of income. The question that arises here is what is a material fact. The materiality of a fact depends on its nature and the amount involved. Any fact would be considered as material if it is reasonably believed that its knowledge would influence the decision of informed user of financial statements. For example, money spent on creation of additional

capacity of a theatre would be a material fact as it is going to increase the future earning capacity of the enterprise. Similarly, information about any change in the method of depreciation adopted or any liability which is likely to arise in the near future would be significant information. All such information about material facts should be disclosed through the financial statements and the accompanying notes so that users can take informed decisions. In certain cases, when the amount involved is very small, strict adherence to accounting principles is not required. For example, stock of erasers, pencils, scales, etc. are not shown as assets, whatever amount of stationery is bought in an accounting period is treated as the expense of that period, whether consumed or not. The amount spent is treated as revenue expenditure and taken to the profit and loss account of the year in which the expenditure is incurred.

Objectivity Concept

The concept of objectivity requires that accounting transaction should be recorded in an objective manner, free from the bias of accountants and others. This can be possible when each of the transaction is supported by verifiable documents or vouchers. For example, the transaction for the purchase of materials may be supported by the cash receipt for the money paid, if the same is purchased on cash or copy of invoice and delivery challan, if the same is purchased on credit. Similarly, receipt for the amount paid for purchase of a machine becomes the documentary evidence for the cost of machine and provides an objective basis for verifying this transaction. One of the reasons for the adoption of ‘Historical Cost’ as the basis of recording accounting transaction is that adherence to the principle of objectivity is made possible by it. As stated above, the cost actually paid for an asset can be verified from the documents but it is very difficult to ascertain the market value of an asset until it is actually sold. Not only that, the market value may vary from person to person and from

place to place, and so ‘objectivity’ cannot be maintained if such value is adopted for accounting purposes.

At the core of financial accounting is the double-entry accounting method, by which each financial transaction is entered in at least two accounts (assets, liabilities, and expenses are examples of accounts)-as a debit in one account and as a credit in another account.

“Debit” simply means to enter a transaction on the left side of an account, and credit means to enter a transaction on the right side. A debit increases some accounts and decreases some others. Similarly, a credit increases some accounts and decreases some others.

Imagine that a company takes a bank loan. Under the double-entry system, this transaction has to be entered as a credit in one account and as a debit in another account. Bolstered by the loan, the company’s cash/assets increase, and this transaction, where the assets have increased, is a debit transaction. Therefore, it is entered as a debit transaction under the assets account.

However, with the loan, the company’s liabilities also increase, and this transaction, where the liabilities have increased, is a credit transaction. So, it is entered as a credit transaction under the liabilities account. This procedure is followed under the double-entry system of accounting.

Information about which accounts to credit or debit for each transaction is available from online resources on accounting. For example, an increase in expense and a decrease in income are always debit entries, and a decrease in assets and an increase in liabilities are always credit entries.

An important aspect to remember is that debiting an account does not always mean decreasing it, nor does crediting an account always mean increasing it.

Each credit should be balanced by a debit, and vice versa (it is *not* a question of balancing each *increase* in an account with a *decrease* in another account).

The advantage of double-entry accounting is that it helps keep the accounting equation (assets = liabilities + stockholders' equity) always balanced. If a company records its accounts accurately, the left side of the equation will match the right side.

Another cornerstone of financial accounting is the accrual accounting system, by which revenues and expenses are recorded in the financial statements when they are earned or incurred, not when the cash comes in or goes out, as is done under the cash accounting system.

The accrual system ensures that the statements reflect the financial position of the company accurately, and that there is no overestimation of revenue or profits.

Principles of Financial Accounting

As discussed in the post "Accounting basics," the rules of accounting, including financial accounting, have been standardized to achieve the following goals:

- **Objectivity:** Financial statements should be free from bias, and financial accountants should scrupulously follow the principle of objectivity.
- **Usability:** Users of financial documents should be able to depend on them-the documents should facilitate decision-making.
- **Materiality:** Omission of data from financial statements will mislead financial decision-makers; therefore, all important data should be recorded and misstatement of facts avoided.
- **Comparability:** Financial statements should enable users to compare the performances of companies, and the documents should follow the standards set internationally.

CHAPTER 2. INTERNATIONAL FINANCIAL REPORTING STANDARDS

2.1 Financial Accounting Standards

As discussed in the preceding section, the Generally Accepted Accounting Principles in the form of Basic Accounting Concept have been accepted by the accounting profession to achieve uniformity and comparability in the financial statement. This is aimed at increasing the utility of these statement to various users of the accounting information. But the difficulty is that GAAP permit a variety of alternative treatments for the same item. For example, various methods of calculation of cost of inventory are permissible which may be followed by different enterprises. This may cause problem to the external users of information, which becomes inconsistent and incomparable. This necessitates brining in uniformity and consistency in the reporting of accounting information.

Recognizing this need, the Institute of Charted Accountants of Azerbaijan (IAS) constituted an Accounting Standards Board (ASB) in April, 1977 for developing Accounting Standards. The main function of ASB is to identify areas in which uniformity in standards is required and develop draft standards after wide discussion with representative of the Government, public sector undertakings, industry and other organizations. ASB gives due consideration to the International Accounting Standards as Azerbaijan is a member of International Account Setting Body. ASB submits the draft of the standards to the Council of the IAS, which finalizes them and notifies them for use in the presentation of the financial statements. ASB also makes a periodic review of the accounting standards.

Accounting standards are written statements of uniform accounting rules and guidelines or practices for preparing the uniform and consistent financial

statements and for other disclosures affecting the user of accounting information. However, the accounting standards cannot override the provision of applicable laws, customs, usages and business environment in the country.

The Institute tries to persuade the accounting profession for adopting the accounting standards, so that uniformity can be achieved in the presentation of financial statements. In the initial years the standards are of recommendatory in nature. Once an awareness is created about the requirements of a standard, steps are taken to enforce its compliance by making them mandatory for all companies to comply with. In case of non-compliance, the companies are required to disclose the reasons for deviations and the financial effect, if any, arising due to such deviation.

As discussed in the preceding section, the Generally Accepted Accounting Principles in the form of Basic Accounting Concept have been accepted by the accounting profession to achieve uniformity and comparability in the financial statement. This is aimed at increasing the utility of these statement to various users of the accounting information. But the difficulty is that GAAP permit a variety of alternative treatments for the same item. For example, various methods of calculation of cost of inventory are permissible which may be followed by different enterprises. This may cause problem to the external users of information, which becomes inconsistent and incomparable. This necessitates brining in uniformity and consistency in the reporting of accounting information. Recognizing this need, the Institute of Charted Accountants of Azerbaijan (IAS) constituted an Accounting Standards Board (ASB) in April, 1977 for developing Accounting Standards. The main function of ASB is to identify areas in which uniformity in standards is required and develop draft standards after wide discussion with representative of the Government, public sector undertakings, industry and other organizations. ASB gives due consideration to the International Accounting Standards as Azerbaijan is a

member of International Account Setting Body. ASB submits the draft of the standards to the Council of the IAS, which finalizes them and notifies them for use in the presentation of the financial statements. ASB also makes a periodic review of the accounting standards. Accounting standards are written statements of uniform accounting rules and guidelines or practices for preparing the uniform and consistent financial statements and for other disclosures affecting the user of accounting information. However, the accounting standards cannot override the provision of applicable laws, customs, usages and business environment in the country. The Institute tries to persuade the accounting profession for adopting the accounting standards, so that uniformity can be achieved in the presentation of financial statements. In the initial years the standards are of recommendatory in nature. Once an awareness is created about the requirements of a standard, steps are taken to enforce its compliance by making them mandatory for all companies to comply with. In case of non-compliance, the companies are required to disclose the reasons for deviations and the financial effect, if any, arising due to such deviation.

Most or all of the general principles of accounting apply to financial accounting, too. These principles are kept in mind in the preparation of financial statements under the “Generally Accepted Accounting Principles,” or GAAP, followed internationally.

In Azerbaijan, financial accounting standards are notified by the Ministry of Finance in tune with the guidelines of the International Financial Reporting Standards.

A new set of standards known as “International Accounting Standards,” is about to be implemented in the country.

Comparison: Financial vs. Management vs. Cost Accounting

A final word on financial accounting: it differs from management accounting and cost accounting in that it mainly caters to external stakeholders, such as investors.

Management accounting, however, is intended for a company's internal use and provides managers with the information necessary for taking steps to improve the performance of their company.

The objective of cost accounting, which is also an internal tool, is to calculate the cost of production and help managers come up with cost-reduction ideas.

Differences Between Financial, Cost & Management Accounting

Basis	Financial Accounting	Cost Accounting	Management Accounting
Objects	Record transactions & determine financial position & profit or loss.	Ascertainment, allocation, accumulation and accounting for cost	To assist the management in decision-making & policy formulation.
Nature	Concerned with historical data.	Concerned with both past and present recorded(historical in nature).	Deals with projection of data for the future (futuristic in nature)
Principle Followed	Governed by GAAP	Certain principles followed for recording costs.	No set principles are followed in it.
Data used	Qualitative aspects are not recorded	Only quantitative aspect is recorded.	Uses both quantitative and qualitative concepts.

2.2 International Financial Reporting Standards (IFRSs)

International Financial reporting Standards (IFRSs) are globally accepted accounting standards developed by International Accounting Standard Board (LASB). IFRS is a set of accounting standards for reporting different types of business transactions and events in the financial statements. The objective is to facilitate international comparisons for true and fair valuation of a business enterprise. The qualitative characteristics associated with the preparation of financial statements are useful to the users of accounting information in making financial decisions.

In an effort to narrow down the gap in the presentation of corporate financial statements, the Ministry of Corporate Affairs, Government of Azerbaijan has opted for the convergence of Azerbaijan Accounting Standards with IFRSs for bringing uniformity, comparability, transparency, rationalization and adaptability in the field of accounting. This has resulted to the introduction of revised schedule VI to the Companies Act 1956.

Benefits to Convergence to IFRSs

1. Easy access to global or international capital markets.
2. Easy comparisons and transparency.
3. True and fair valuation.
4. Increased trust and reliance.
5. Eliminates multiple reporting.

As cited in LAS-1 relating to Presentation of Financial Statements ‘ Financial Statements shall not be described as complying with IFRSs unless they comply with the requirements of IFRSs’.

Time Schedule for IFRSs Implementation in Azerbaijan

1. For companies other than Insurance, Banking and NBFCs

Phase	***Applicable to***	***Applicable from***
I	Companies which are part of NSE-Nifty 50 Companies which are part of BSE-sensex 30 Companies whose shares or other securities are listed on the stock exchange outside Azerbaijan Companies, whether listed or not which have a net worth in excess of Rs. 1,000 crores.	April 01, 2011
II	• Companies, whether listed or not having a net woth exceeding Rs. 500 crores but not exceeding Rs. 1,000 crores.	April 01, 2013
III	• Listed companies which have a net worth of Rs. 500 crores or less	April 01, 2014
For Insurance Companies, Banking Companies & NBFCs		
Insurance Companies April 01, 2012		

Banking Companies	
• All scheduled commercial banks and those urban co-operative banks which have a net worth in excess of Rs. 300 crores.	April 01, 2013
• Urban co-operative banks which have a net worth in excess of Rs. 200 crores but not exceeding Rs. 300 crores.	April 01, 2014
Non Banking Financial Companies (NBFCs)	
• Companies which are part of NSE Nifty-50	April 01, 2013
• Companies which are part of BSE sensex 30	April 01, 2013
Companies, whether listed or not which have a net worth in excess of Rs. 1000 crores All listed NBFCs and those unlisted NBFCs which do not fall in the above categories and which have a net worth in excess of Rs. 500 crores.	April 01, 2014

IFRSs that are Currently Applicable

List of IAS/IFRS and corresponding

IAS NO.	*Title*	
IAS 1	Presentation of Financial Statements	IAS 1
IAS 2	Inventories	IAS 2
IAS 7	Cash Flow Statement	IAS 7
IAS 8	Accounting policies, change in accounting estimates and errors	IAS 8
IAS 10	Events after the Balance sheet date	IAS 10
IAS 11	Construction contracts	IAS 11
IAS 12	Income taxes	IAS 12
IAS 16	Property, Plant and Equipment	IAS 16
IAS 17	Leases	IAS 17
IAS 18	Revenue	IAS 18
IAS 19	Employee Benefits	IAS 19
IAS 20	Accounting for Government grants and disclosure of Government Assistance	IAS 20
IAS 21	The Effects of Changes in the Foreign Exchange Rates	IAS 21
IAS 23	Borrowing Costs	IAS 23
IAS 24	Related Party Disclosures	IAS 24
IAS 26	Accounting and Reporting by Retirement Benefits Plan	IAS 26
IAS 27	Consolidated and separate financial statements	IAS 27
IAS 28	Investments in associates	IAS 28
IAS 29	Financial Reporting in Hyper Inflationary Economics	IAS 29
IAS 31	Interest in Joint ventures	IAS 31
IAS 32	Financial Instruments Presentation	IAS 32
IAS 33	Earnings per share	IAS 33
IAS 34	Interim Financial Reporting	IAS 34
IAS 36	Impairment Assets	IAS 36
IAS 37	Provisions, Contingent liabilities and Contingent assets	IAS 37
IAS 38	Intangible Assets	IAS 38
IAS 39	Financial Instruments: Recognition an d \ measurement	IAS 39
IAS 40	Investment Property	IAS 40
IAS 41	Agriculture	IAS 41

Key Terms Introduced in the Chapter

- Cost
- Matching
- Materiality
- Objectivity
- Consistency
- Dual aspect
- Conservatism(Prudence)
- Going concern
- Comparibility
- Full discloser
- Generally accepted
- Revenue Relisation
- Operating guidelines
- Accounting period
- Money measurement
- Accounting concept
- Accounting Principles (GAAP)

Summary with Reference to Learning Objectives

1. *Generally Accepted Accounting Principles (GAAP)* : Generally Accepted Accounting principles refer to the rules or guidelines adopted for recording and reporting of business transactions in order to bring uniformity in the preparation and presentation of financial statements. These principles are also referred to as concepts and conventions. From the practicality view point, the various terms such as principles, postulates, conventions modifying principles, assumptions, etc. have been used interchangeably and are referred to as basic accounting concepts, in the present book.

2. *Basic Accounting Concepts* : The basic accounting concepts are referred to as the fundamental ideas or basic assumptions underlying the theory and practice of financial accounting and are broad working rules of accounting activities.

3. *Business Entity* : This concept assumes that business has distinct and separate entity from its owners. Thus, for the purpose of accounting, business and its owners are to be treated as two separate entities.

4. *Money Measurement*: The concept of money measurement states that only those transactions and happenings in an organization, which can be expressed in terms of money are to be recorded in the book of accounts. Also, the records of the transactions are to be kept not in the physical units but in the monetary units.

5. *Going Concern :* The concept of going concern assumes that a business firm would continue to carry out its operations indefinitely (for a fairly long

period of time) and would not be liquidated in the near future.

6. *Accounting Period:* Accounting period refers to the span of time at the end of which the financial statements of an enterprise are prepared to know whether it has earned profits or incurred losses during that period and what exactly is the position of its assets and liabilities, at the end of that period.

7. *Cost Concept*: The cost concept requires that all assets are recorded in the book of accounts at their cost price, which includes cost of acquisition, transportation, installation and making the asset ready for the use.

8. *Dual Aspect:* This concept states that every transaction has a dual or two-fold effect on various accounts and should therefore be recorded at two places. The duality principle is commonly expressed in terms of fundamental accounting equation, which is :

Assets = Liabilities + Capital

9. *Revenue Recognition*: Revenue is the gross in-flow of cash arising from the sale of goods and services by an enterprise and use by others of the enterprise resources yielding interest royalties and dividedness. The concept of revenue recognition requires that the revenue for a business transaction should be considered realized when a legal right to receive it arises.

10. *Matching*: The concept of matching emphasizes that expenses incurred in an accounting period should be matched with revenues during that period. It follows from this that the revenue and expenses incurred to earn these revenue must belong to the same accounting period.

11. *Full Disclosure*: This concept requires that all material and relevant facts concerning financial performance of an enterprise must be fully and completely disclosed in the financial statements and their accompanying footnotes.

12. *Consistency*: This concepts states that accounting policies and practices followed by enterprises should be uniform and consistent one the period of time so that results are compostable. Comparability results when the same accounting principles are consistently being applied by different

enterprises for the period under comparison, or the same firm for a number of periods.

13. *Conservatism:* This concept requires that business transactions should be recorded in such a manner that profits are not overstated. All anticipated losses should be accounted for but all unrealized gains should be ignored.

14. *Materiality*: This concept states that accounting should focus on material facts. If the item is likely to influence the decision of a reasonably prudent investor or creditor, it should be regarded as material, and shown in the financial statements.

15. *Objectivity*: According to this concept, accounting transactions should be recorded in the manner so that it is free from the bias of accountants and others.

16. *Systems of Accounting*: There are two systems of recording business transactions, viz. double entry system and single entry system. Under double entry system every transaction has two-fold effects where as single entry system is known as incomplete records.

17. *Basis of Accounting:* The two broad approach of accounting are cash basis and accrual basis. Under cash basis transactions are recorded only when cash are received or paid. Whereas under accrual basis, revenues or costs are recognizes when they occur rather than when they are paid.

18. *Accounting Standards*: Accounting standards are written statements of uniform accounting rules and guidelines in practice for preparing the uniform and consistent financial statements. These standards cannot over ride the provisions of applicable laws, customs, usages and business environment in the country.

CHAPTER 3. THE ROLE OF FINANCIAL ACCOUNTING IN BUSINESS

3.1 The benefits of IFRS/IAS application

Accounting and finance are integrally related for a business firm. Accounting is the study of how information is gathered and distributed in and out. Finance, broadly, is the study of how firms make the investment and financing decisions they have to make in order to operate their business. Finance needs accounting information in order to operate. Accounting must have financial experts in order to translate accounting information for general use.

There are three major areas of finance that business owners and managers usually have to be knowledgeable of. There are three major areas of accounting as well:

Financial accounting is the area of accounting concerned with external parties interested in the business firm. Financial statements, for example, are produced for the benefit of the external investors. Investors need to be able to review financial statements such as the income statement, the balance sheet, and the statement of cash flows in order to determine whether or not to invest in the business firm or remain invested in the company.

Financial statements are also of interest to another group of external individuals and those are the creditors of the firm. Those creditors are the bondholders of the firm or they could be the debt holders of the firm. Creditors are individuals who have loaned money to the firm and are interested in receiving a return on their investment and, eventually, a return of their principal.

Financial accounting, according to the Financial Accounting Standards Board (FASB), provides important financial collecting and reporting functions for business firms.

Managerial accounting is the area of accounting associated with gathering and preparing financial information for those inside business organizations such as managers and staff.

It can be compared to financial accounting which is concerned with information for external individuals. Managerial accounting is the field where the gathering and preparation of financial information are for the insiders of the firm. The Institute of Certified Management Accountants states that management accountants are the "value creators" among accountants, thereby taking their place between the finance people and the financial accountants in the business organization.

Managers use financial information to make better business decisions in their managerial and control roles. Much of this information is private since it is for insiders of the firm instead of public. Also, the information that managerial accounting deals with is "forward-looking" as opposed to historical information like financial accounting uses. They use a variety of forecasting techniques such as variance analysis, risk management, and cost-volume-profit analysis to predict the best forward-looking information as possible.

Some business professionals include cost accounting as a part of managerial accounting and some think that cost accounting is a different functional area of accounting. Whatever the case, cost accounting and managerial accounting surely overlap.

Cost accounting looks at the costs of production for a business firm by looking at the fixed costs of the products they sell and their input costs. Input costs are compared to output costs to measure the financial performance of the firm with regard to production costs. Cost elements often used are indirect costs or overhead, raw materials, and labor. Managers often use the information from cost accounting to set up cost control programs for the business firm.

Problems arising in the application of IFRS/IAS

The adjustment of bookkeeping framework is not a forthright procedure. Amid the change, substances may confront a few shades of malice. These issues are all the more plain in the bookkeeping frameworks that are more differing from the bookkeeping framework to be acknowledged. As past parts noted, Azerbaijan bookkeeping techniques and systems are different from IFRS/IAS,

and at times the appraisal of both directions is not material because of the non-attendance of comparable applications. Subsequently, a substance in the interpretation procedure is to confront the issues connected with the utilization of IFRS/IAS or NAS traditions. These issues can be gathered as takes after:

- Transition to IFRS is a pricey process. The costs associated with the transition to IFRS are preparation of personnel, software, consulting and other costs. Training of personnel is essential in the switch process. First time agreement of IFRS/IAS or NAS involves substantial training of accounting and finance man. This exercise also has to be constant since the standards are moving and improving endlessly. The establishment of a suitable IT scheme is also significant for an entity in transition. This computer system is compulsory in order to reduction the costs to gather financial information and to formulate financial statements.

- The application of IFRS might effect in the change of economic position and performance. The outline of fair value financial broadcasting approach will result in the explosiveness in the balance piece and salary statement. For example, recognition of weakening losses and redefinition increases or decreases might shrinkage or increase the justness of an entity. Financial station of an entity capacity change as a result of alterations in the amount and valuation bases for belongings, liabilities and justice items. This capriciousness might present further difficulties in the creation relevant judgments for the management and stakeholders who are not trained at IFRS.

- Compound nature of intercontinental financial reporting ideals. The complex nature of some IFRS/IAS might existing problems in proper presentation of them. Standards related to the hedge accounting, diminishing test, and accounting regulations for pecuniary instruments are some of those compound regulations. An being might lack necessary expertise in the application of these regulations. Another complexity in the application of IFRS transmits to the way accounting is accompanied at the entity. Accounting has been measured as a legislative system for a long time. Judgment was not

prerequisite from accountants, but the tender of IAS/IFRS requires some decree. This requirement also changes the gaze to the accounting structure. Accounting will not be deliberated merely a parliamentary system, but a judgment making system.

- Demand for change in the accounting philosophy of workforces. For many decades, accounting has been considered as bookkeeping and recording to the central administration. However, IFRS affords some options in the commercial reporting and an auditor has to employ his conclusion and thinking in the office process. Consideration of accounting as a earnings of providing important information for the judgment making tenacity must be conventional at the entity.

- Running equivalent accounting systems. Since accounting evolution does not mean switch in the tax accounting, this might educate problems in the employment of parallel accounting organisms. IFRS/IAS and tax law apply different policies and an entity has to conserve two accounting structures in order to fix financial statements and information to the tax authorities.

Entities are not used to this equivalent reporting structure. This might product in the further intensification in writing costs.

In summary, an being may face some complications in the IAS/IFRS adoption. Those harms are high costs of transition, the variation in the financial recording practices, change in the financial situation and performance, complication of IFRS.

3.2 The Role of Accounting in Business

Accounting and finance are integrally related for a business firm. Accounting is the study of how information is gathered and distributed in and out. Finance, broadly, is the study of how firms make the investment and financing decisions they have to make in order to operate their business. Finance needs accounting information in order to operate. Accounting must have financial experts in order to translate accounting information for general use.

There are three major areas of finance that business owners and managers usually have to be knowledgeable of. There are three major areas of accounting as well:

Financial accounting is the area of accounting concerned with external parties interested in the business firm. Financial statements, for example, are produced for the benefit of the external investors. Investors need to be able to review financial statements such as the income statement, the balance sheet, and the statement of cash flows in order to determine whether or not to invest in the business firm or remain invested in the company.

Financial statements are also of interest to another group of external individuals and those are the creditors of the firm. Those creditors are the bondholders of the firm or they could be the debt holders of the firm. Creditors are individuals who have loaned money to the firm and are interested in receiving a return on their investment and, eventually, a return of their principal.

Financial accounting, according to the Financial Accounting Standards Board (FASB), provides important financial collecting and reporting functions for business firms.

Managerial accounting is the area of accounting associated with gathering and preparing financial information for those inside business organizations such as managers and staff.

It can be compared to financial accounting which is concerned with information for external individuals. Managerial accounting is the field where the gathering and preparation of financial information are for the insiders of the firm. The Institute of Certified Management Accountants states that management accountants are the "value creators" among accountants, thereby taking their place between the finance people and the financial accountants in the business organization.

Managers use financial information to make better business decisions in their managerial and control roles. Much of this information is private since it is for insiders of the firm instead of public. Also, the information that managerial

accounting deals with is "forward-looking" as opposed to historical information like financial accounting uses. They use a variety of forecasting techniques such as variance analysis, risk management, and cost-volume-profit analysis to predict the best forward-looking information as possible.

Some business professionals include cost accounting as a part of managerial accounting and some think that cost accounting is a different functional area of accounting. Whatever the case, cost accounting and managerial accounting surely overlap.

Cost accounting looks at the costs of production for a business firm by looking at the fixed costs of the products they sell and their input costs. Input costs are compared to output costs to measure the financial performance of the firm with regard to production costs. Cost elements often used are indirect costs or overhead, raw materials, and labor. Managers often use the information from cost accounting to set up cost control programs for the business firm.

There are other areas of accounting involved in business firms. There is tax accounting. Business firms may have internal tax accountants or may outsource their tax accounting. The area of auditing is usually both internal and external and budgeting analysis is an internal function.

In addition, there is governmental accounting, outside the sphere of business, and forensic accounting, which uses accounting and finance information to support litigation involving fraud and embezzlement.

Good accounting is as vital to your business as good sales. The role of accounting is to provide you and any other stakeholders with financial information about the company, such as sales revenue, the cost of benefits and the amount you owe your suppliers. Without the information from your accountants, you can't make good financial decisions for your business.

Management

Management accounting gives you and other executives information about company performance. When you're selling lots of merchandise, you may feel you're doing great, but the accounting may show a different story. If the cost of

sales is high, that reduces your profits. If all of the sales are on credit, you may not have enough cash on hand to pay your suppliers or the power bill. Accounting provides details about your finances so you know when you have money to burn and when to be cautious in your spending.

Government

Taxes are a part of business life. You have to pay tax on your business's income, Social Security on employee paychecks, sales tax and possibly several other tax bills. If you get the amounts wrong, the Internal Revenue Service or the state tax board can hit you with fines and penalties. A good accountant tells you how much to pay and what forms you need to fill out to meet your obligations. If you have to provide financial information to government regulators, your accountant provides you with that data.

Controls

The more your company grows, the harder you may find it to keep track of the money. That makes it easier for an enterprising but unethical employee to cheat you, particularly if he has access to the company accounts. A good accountant can spot warning signs that something's gone wrong -- a suspicious pattern of withdrawals or paychecks to non-existent employees, for instance. Accountants can also help you establish policies that reduce the opportunity for fraud.

Investment

Nobody's going to put money into your company expecting to lose it. Investors want a profit. Banks want their loan money back, with interest. Your accountant can turn the basic facts and figures on the ledger into a cash flow statement and a balance sheet, which enables outsiders to sum up your finances at a glance. If your company is a good investment, hard numbers in accounting statements will do more to convince investors than any amount of honeyed words.

CONCLUSION

This thesis has provided an introduction to some of the basics of accounting. You have learned the basic terminology of bookkeeping and accounting, the general purposes and functions of accounting and the differences between the two sorts of accounting (financial accounting and management accounting). You should also now be able to describe the different elements of financial information, such as income/revenue, costs/expenses, assets and liabilities, as well as identify the main financial statements (income statement, balance sheet and cash flow statement) and their purposes.

Performance evaluation will help a company to understand different sides of their business operations on one hand where by analyzing performance in a certain period and help the company to forecast their future business performances. These information obtained on business performances can be used by number of parties, different stakeholders which include shareholders, creditors, employees, tax authorities, government, media, etc. All the mention expertise can use these information of performance evaluation with an aim to assess the business operations of the firm, future of the company and can contribute towards decision making process of the company as evaluation will bring a clear image on the organizations' financial health or status, the financial feasibility, profitability and resource management. Also with the right information investors and shareholders will be able to make the right decision in terms of their investments where proper opportunities can be identified regarding the potential of positive outcome of it. In Tesco with the recent changes in market and economy there has been lots of changes to the organization as well. This is due to recessionals well as changes in the retail industry which affected all the players in the market. In assessing finance options for a company like Tesco it is important to assess the industry and assess the company's performance using different ratios to understand the situation of the company. With that understanding company like Tesco can go ahead and consider about new investments to decide which options to select and how to

finance these options. Company's capital structure decides how the company is going to fund their activities in the long term to obtain more benefit and maximize their wealth. With that they can select the best options to finance their needs and wants to achieve mentioned objectives where in Tesco's case it needed to assess sources of long and short term, finance structure and finance disciplines before come to an conclusion.

REFERENCES

Accounting Law of Azerbaijan Republic. Augusts 10, 1995. "Azerbaijan" newspaper. Baku.

Accounting Law of Azerbaijan Republic. September 2, 2004. "Azerbaijan" newspaper. Baku

ADB.2002. *Accounting and Auditing Practices in Selected Developing Member Countries: A diagnostic Study of Azerbaijan, Fiji Islands, Marshall Islands, Philippines and Sri Lanka. Manila.*

*Azerbaijan Republic Tax Code***.** 2016. Baku-Azerbaijan.

Baku Stock Exchange. www.bfb.az (accessed April, 2017).

Barry J. Epstein, Eva K. Jermakowicz. 2008. *Interpretation and application of international accounting and financial reporting standards***.** Wiley IFRS.

Walton, Peter et al. 2003. *International Accounting*. Thomson Learning.

Primary source:

BD Sensors s.r.o (Czech Branch) 2005-2008 Annual Reports.

Books:

Brigham, Eugene F., and Joel F. Houstan, eds. 2004. *Fundamentals of Fiannacial Management.* Ohio: South-Western.

Brigham, Eugene F., and Micheal C. Ehrhardt, eds. 2005. *Financial Management: Theory and Practice.* Ohio: South-Western.

Brealy, Richard A., and Stewart C. Myers, eds. 2003. *Principles of Corporate Finance*. Boston: McGraw-Hill/Irwin.

Cannon, Joseph P., Perrault, William D., and McCarthy, E. Jerome. 2008. *Basic Marketing: A Global Managerial Approach*. New York: McGraw-Hill.

Edmonds, Thomas P., Cindy D. Edmonds, Bor-Yi Tsay, Philip R. Olds, and Nancy W. Schneider, eds. 2006. *Fundamental Managerial Accounting Concepts.* Boston: McGraw-Hill/Irwin.

Hermanson, Roger H., James Don Edwards, and R.F.Salmonson, eds. 1989. *Accounting Principles.* Boston: BPI/IRWIN.

McLaney, Eddie, and Peter Atrill, eds. 2005. *Accounting: An introduction*. New-Jersey: Prentice-Hall.

Ross, Stephen A., Randolph W. Westerfield, and Jeffrey Jaffe, eds. 2008. *Corporate Finance*. Boston: McGraw-Hill/Irwin press.

Spiller, Earl A. and Phillip T. May, eds. 1990. *Financial Accounting: Basic Concepts*. Boston: Irwin.

Weygandt, Jerry J., Donald E. Keiso, and Paul D. Kimmel, eds. 2002. *Managerial Accounting: Tools for decision making.* New York: John Wiley and Sons press.

Wild, John J. 2008. *Financial Accounting: Information for decisions*. New York: McGraw-Hill/Irwin.

Berry, A. (1999), Financial Accounting An Introduction, Second Edition, London: Thompson

Black, G. (2009), Introduction to accounting and finance, Second edition, Essex: Pearson Education

Braiotta, L., Gazzaway, R.T., Colson, R. and Ramamoorti, S. (2010), The Audit Committee Handbook, New Jersey: John Wiley & Sons

Brealy, R.A., Myers, S.C. and Allen, F. (2011), Principles of Corporate Finance, 10thEdition, New York: The McGraw-Hill

Dodge, R. (1997), Foundations of Business Accounting, Second Edition, Boston: Thomson business press

Dransfield, R. (2013), Business Economics, Oxon: Routledge

Flick, U. (2009), An introduction to qualitative research, 4th edition, London: SagePublications

Gowthorpe,C. (2005), Financial Accounting for non-specialists, London : Thompson Learning

Groppelli, A.A. and Nikbakhat, E. (2006), Finance, Fifth Edition, New York: Barron’s

Horngren, C.T, Harrison, W.T. and Oliver, M.S. (2012), Accounting, Eleventh Edition, New Jersy: Pearson Prentice Hall

Web Sites:

"*Financial Statement Analysis Limitations*", 24 Apr 2010.

http://www.cliffsnotes.com/study_guide/Financial-Statement-Analysis-Limitations.

topicArticleId-21248,articleId-21214.html (accessed April 22, 2010).