

Chapter 17 Generally accepted accounting principles (公認會計原則)

17.2 Key assumptions in financial statements (編製財務報表的主要假設)

There are two key assumptions underlying the preparation of financial statements: accrual and going concern. (編製財務報表有兩個主要的假設(應計概念和繼續經營概念))

17.2.1 Accrual concept (應計概念)

- Under accrual basis of accounting, revenues and expenses are recognized when they are earned or incurred, regardless of when the actual cash is received or paid. (按應計制會計，收益和費用是在賺取或招致時確認，而不是在收款或付款時確認)
- This is very different from the cash basis of accounting, where revenues and expenses are recognized when the actual cash is received or paid. (按現金基礎，企業在收取款項時確認收益及在支付款項時確認費用)
- Financial statements prepared on the accrual basis provide more information for users. (按應計制會計編製的財務報表可提供更多信息給報表使用者)
- Without the use of accrual accounting, only cash transactions are reflected in financial statements. (如果企業不採用應計制會計，財務報表便只能反映現金交易項目)
- But cash transactions do not give information about other important business activities such as goods purchased and sold on credit, future rights and obligations. (但是現金收付制不能反映其他重要的商業活動，例如賒購、賒銷、企業將來的權利和責任等等)
- By using the accrual concept, a business can measure what it has to pay and what it expects to receive in future. (企業採用應計概念可計算將來須支付或預期收取的金額)
- Therefore, the accrual basis of accounting is more commonly used in business than cash-basis accounting. (因此，應計制會計比現金基礎會計較為常用)

Classwork 1

- 1 Define the accrual concept and give an example of the application.

According to the accrual concept, revenues and expenses are recognized when they are earned or incurred, regardless of when the actual cash is received or paid. For example, an adjustment is made in preparing the profit and loss account for salaries accrued but not yet paid.

- 2 A retail store sold goods for \$200,000 on credit on 20 March 2010. The amount was not paid until 20 April 2010. Assume the financial year ended on 31 March 2010.

(a) Discuss how the \$200,000 should be recorded under accrual-basis accounting and cash-basis accounting.

Under accrual-basis accounting, the credit sales should be recognised as revenue on 20 March 2010. This would then be included in the income statement for the year ended 31 March 2010.

Under cash-basis accounting, the credit sales should be recognised as revenue on 20 April 2010. This then be included in the income statement for the year ended 31 March 2011.

(b) If the store adopts the cash basis, how the net profit of the store would be affected for the year ended 31 March 2010?

The retail store would show a lower net profit for the year.

17.2.2 Going concern concept (繼續經營)

- The going concern concept states that a business will continue to operate for the foreseeable future. (繼續經營概念假設企業在可見的未來會繼續經營)
- This assumption does not hold if management intends or needs to liquidate the entity or significantly reduce its scale of operations. (如果管理層有意或需要結業或企業顯著縮減其經營規模這，歷史成本原則不再適用)

When the going concern assumption is appropriate (當繼續經營假設適用時)

- If a business is a going concern, assets that are acquired, for use within the business should be valued on the basis of historical cost (如果企業將繼續經營，其自用而非作轉售用途的資產應按歷史成本計價)。
- Under the going concern concept, it is assumed that the entity will continue in business long enough to use its assets for their intended purposes and recover the cost of those assets. (根據繼續經營概念的假設，企業是會一直經營下去的，並有充分的時間按預期目的使用資產並收回資產的成本)
- Therefore, the current market value of an asset may not be relevant for decision-making. (因此，資產的現行市場價值未必是企業作決策時需要考慮的相關因素)

When the going concern assumption is not appropriate (當繼續經營假設不適用時)

- When an entity is going to be liquidated, its assets will be disposed of in the near future to pay off its liabilities. (當企業面臨清盤，它便會在短期內出售資產以償還債務)
- Then current fair value (market value) should be used to value the assets. (在這種情況下，企業便應按現行公允價值計算資產的價值)

Classwork 2

- 1 Explain the importance of the going concern assumption in the preparation of financial statements.

If a business is a going concern, assets that are acquired for use within the business rather than for resale should be valued on the basis of historical cost. Under the going concern concept, it is assumed that the entity will continue in business long enough to use its assets for their intended purposes and recover the cost of those assets. Therefore, the current market value of an asset may not be relevant for decision-making.

- 2 Define the going concern concepts and give an example of the application.

The enterprise is expected to continue in operational existence for the foreseeable future. Businesses are assumed to continue for a long period of time.

For example, if a company decides to close its business soon, the value of the assets should be recorded at their market prices.

17.3 Qualitative characteristics of financial statements (財務報表的質量特徵)

For financial statements to be useful to users, the information provided must possess four principal qualitative characteristics: **understandability**, **relevance**, **reliability** and **comparability**. (對用戶有用的財務報表，所提供的信息必須具備四個主要質量特徵：可理解性，相關性，可靠性和可比性)

1 Understandability (可理解性)

- The information provided in financial statements should be readily understandable by users. (財務報表所提供的信息應讓使用者容易明白)
- The business should ensure that financial statements are prepared in accordance with generally accepted principles and generate important information that can be easily understood by users. (企業應確保財務報表的內容是根據公認會計原則編製的，並能提供讓使用者容易理解的重要信息)

2 Relevance (相關性)

- Accounting information must be relevant to the decision-making needs of users. (有用的會計信息必定是與財務報表使用者的決策需要有關的)
- To be relevant, information should be able to help users evaluate past, present or future events, or confirm or correct their past evaluations. It must also be timely. (相關的信息應可幫助使用者評估過去、現在和將來發生的事情(有預測作用)，或確定、糾正過去的評估(有確認作用))

3 Reliability (可靠性)

- Accounting information must be reliable and users can depend on it with confidence. (有用的會計信息也必須是可靠的。使用者可放心信賴這些信息)
- Information must faithfully represent what it is meant to represent. (信息必須能如實反映事實)

4 Comparability (可比性)

- Accounting information can be compared with similar facts about the same entity over several periods or about another entity for the same period. (會計信息可以比較同一企業在不同時期的相類會計信息或跟另一企業的相類信息在同一時期作比較)
- Consistent use of accounting policies is important in achieving comparability. (同一會計政策在比較時是十分重要)

17.4 Generally accepted accounting concepts and principles (公認的會計概念和原則)

17.4.1 Business entity concept (企業個體概念)

Meaning (意義)

- The business entity concept states that a business is treated as an entity separate from other entities, including its owner(s). (企業個體概念指出企業應被視為一個獨立個體，獨立於其他個體（包括其東主）)
- Only transactions affecting the business should be recorded in the books of the business. (只有那些影響企業的交易才會被入帳)
- The incomes and expenses of the owner(s) should not be treated as those of the business. (不應把東主的私人交易記錄在企業的帳目內)

Applications (應用)

- The entity concept is applicable to any form of business ownership: a sole proprietorship, a partnership, a small limited company or a large corporation. (個體概念適用於所有企業擁有權類型，包括獨資企業、合夥、小型有限公司以至大集團)

Importance (重要性)

- The entity concept sets the boundary for what should be recorded in the books of an entity. (個體概念限制了應被記入企業帳目的項目)
- It allows us to measure the financial performance and position of each entity independently. (讓我們能量度每個個體的財務表現和狀況)

Classwork 3

- 1 Define the business entity concepts and give an example of the application.

The business entity concept states that a business is treated as an entity separate from other entities, including its owner(s). Only transactions affecting the business should be recorded in the books of the business. The incomes and expenses of the owner(s) should not be treated as those of the business.

For example, The personal transactions, assets and liabilities of the owner of a business should not be included in the business books, unless they are concerned with the owner's capital contributions or drawings of business assets.

2. The owner has gained a profit of \$6,000 from his private investments. He intends to report the profit in the income statement of his business. Explain which accounting concept or principle is violated.

The business entity concept is violated. The profit from the owner's private investments should not be recorded in the income statement of the business. However, if the \$6,000 is put into the business, it should be recorded as additional capital contribution by the owner.

17.4.2 Historical cost principle (歷史成本原則)

Meaning (意義)

- The historical cost principle states that the assets of a business should be valued at their original cost of purchases or production rather than market value. (歷史成本原則指出企業的資產應按其購買或生產成本計價，並在往後繼續以成本(而非現行市值)為計價基礎)

Applications (應用)

- The business entity concept states that a business is treated as an entity separate from other entities, including its owner(s). (企業個體概念指出企業應被視為一個獨立個體，獨立於其他個體(包括其東主))

Importance (重要性)

- The historical cost principle provides an objective basis for measuring the value of assets. (歷史成本原則提供了一個量度資產價值的客觀基礎)

Shortcomings (缺點)

- The principle may not be useful in some moment (inflation or deflation) for evaluating the present and future financial performance and position of a business. (當企業把資產按歷史成本入帳，資產的價值便很可能會在通脹時期被少計，而企業的盈利則會被多計；在通縮時期，則會出現相反的情況)

Classwork 4

1. Your company wanted to buy a piece of land for business use. At first, the seller asked for \$150 million. He said that this was a bargain because the land was purchased for \$152 million two year ago. But the surveyor you employed appraised the land at \$148.5 million. So you offered \$147 million for the land. The seller then made a counter offer of \$149 million, and you both finally agreed on a price of \$148 million.

According to the historical cost principle, which value should be reported for the land in your financial statements?

A value of \$148 million should be reported in the company's financial statements, as this was the price that your company paid for that piece of land.

- 2 Define the historical cost concept and give an example of the application.

The assets of the business are normally recorded at cost price, which is the basis for valuation of the assets. For example, a fixed asset is recorded at its original purchase price on the balance sheet even though there is a great increase in its market value.

- 3 Explain why in periods of inflation the value of assets will likely be understated while profits will be overstated if assets are recorded at historical cost.

In periods of inflation, the general price levels of goods and assets rise. The value of assets shown at historical cost, which is lower than the current price, will be understated. Depreciation charged on assets that are undervalued will also be understated. As a result, profits will be overstated

- 4 Explain why in periods of deflation the value of assets will likely be overstated while profits will be understated if assets are recorded at historical cost.

In periods of deflation, the general price levels of goods and assets fall. The value of assets shown at historical cost, which is higher than the current price, will be overstated. Depreciation charged on assets that are overvalued will also be overstated. As a result, profits will be understated

5. The closing inventory had a cost of \$12,340 and a market value \$20,000. The bookkeeper stated the closing inventory at market value in the balance sheet. State the accounting principle or concept that has been applied or violated.

The historical cost principle has been violated. The historical cost principle states the assets of an entity should be recorded at their original cost of purchase or production. Historical cost is considered the most objective measure of the value of an asset. In the present case, the closing inventory should be stated at its cost of \$12,340.

17.4.3 Prudence concept (穩健保守概念)

Meaning (意義)

- The prudence concept requires that caution be used in the exercise of judgements needed when making estimates under uncertain conditions. (穩健保守概念要求企業在不確定的情況下進行預測時，須謹慎判斷)
- This is to ensure that assets or revenues are not overstated and that liabilities or expenses are not understated. (以避免多計企業的資產值或收益，以及少計負債或費用)

Applications (應用)

- One of most common applications of the prudence concept is the use of the lower-of-cost-or-market (LCM) method for inventory valuation. (應用穩健保守概念的其中一個常見例子是運用成本與市價孰低法為存貨計價)
- Under this method, inventory is valued at cost or market value (i.e., net realizable value), whichever is lower. (根據這個方法，存貨是按成本與市價(即變現淨值)的較低者計價)
- The other applications included: (其他應用包括)
 - To make an allowance for doubtful debts (呆賬撥備)
 - To make an allowance for discounts allowed (折扣允許準備)
 - To make a provision for pensions (退休金準備)

Importance (重要性)

- The prudence concept acts as a safeguard against over-optimism on the part of management. (穩健保守概念可以防止管理層有過份樂觀的看法)

Shortcomings (缺點)

- The prudence concept sometimes conflicts with the historical cost principle. (穩健保守概念有時會與歷史成本原則產生矛盾)
- Sometimes, the exercise of prudence may be abused, leading to the deliberate understatement of assets or revenue, or the deliberate overstatement of liabilities or expenses. (穩健保守的做法有時也會讓企業有機會刻意少報資產值或收益，或多報負債或費用)

Classwork 5

1. Define the prudence concept and give an example of the application.

The prudence concept requires that caution be used in the exercise of judgements needed when making estimates under uncertain conditions.

For example, the firm should make an allowance for accounts receivable that are likely to become uncollectible, even though they are not yet confirmed as bad debts.

2. Some goods were purchased for \$6,000 in October 2010. At the year end, these goods remained unsold and could only be sold for \$4,000. According to the prudence concept, which value of the goods should be recorded and what is the accounting entries.

The goods should be valued at the market value of \$4,000, which was lower than the cost. The closing inventory should be written down by \$2,000 as follows:

| | | | |
|----|-------------------------------------|-------------------|---------|
| Dr | Profit and loss – Closing inventory | \$2,000 | |
| | Cr | Inventory account | \$2,000 |

3. A long-outstanding debt of \$2,000 owed by Kong has been written off as a bad debt, even though his father is expected to die soon and may leave him a fortune. Which accounting concept has been applied.

The prudence concept has been applied. The debt is long-outstanding and it is not yet certain whether Kong's father will leave him enough money to pay off the debt. For the sake of prudence, the debt should be written off as an expense. It is better to overstate rather than understate expenses. Alternatively, an allowance can be made for the doubtful debt

4. K Chan says that if he sells the inventory now, he could get \$20,000 for it. Yet his accountant has shown it as an asset at its historical cost of \$18,000.

The prudence concept has been applied. The cost of the inventory is lower than its current resale value. For the sake of prudence, it should be stated at a lower value, i.e., its cost.

17.4.4 Consistency principle (一貫原則)

Meaning (意義)

- The consistency principle states that a firm should keep using the same accounting policy or method for similar items from period to period. (一貫原則要求企業在採用某種會計做法(即會計政策或方法)後,便應一直沿用下去)
- A change is allowed only if the existing accounting practice is no longer appropriate. (如果現行的會計做法不再合用,企業便可作出改變)
- Any material changes in the accounting policies adopted by a company have to be disclosed in the notes to the financial statements. (企業必須在其財務報表的附註部分披露有關的改變和影響,讓使用者得知)

Applications (應用)

- Various methods can be used to calculate depreciation on non-current assets, including the straight-line method and the reducing-balance method. (可以使用各種不同的方法計算非流動資產折舊,包括直線法和餘額遞減法)
- Once a firm has adopted a depreciation method for a certain type of non-current asset, it should keep using the same method for that type of noncurrent asset year after year. (一旦公司採用某種非流動資產折舊方法,今後它應該繼續用同樣的方法)

Importance (重要性)

- Consistent application of accounting policies and methods helps achieve comparability in the financial statements and companies would be more difficult to manipulate their financial results by switching to a more favourable accounting method. (一貫的會計政策和方法有助增加財務報表的可比性,並使到公司更加困難使用更有利的會計方法去操縱財務業績)

Classwork 6

1. How can the public know if there have been material changes in the accounting policies adopted by a company?

Any material changes in the accounting policies adopted by a company have to be disclosed in the notes to the financial statements.

2. Explain the consistency principle and illustrate with an example:

The consistency principle states that a firm should keep using the same accounting policy or method for similar items from period to period. A change is allowed only if the existing accounting practice is no longer appropriate. Any material changes in the accounting policies adopted by a company have to be disclosed in the notes to the financial statements.

For example, if the straight-line method has chosen in calculating the depreciation expenses, the same method should be adopted consistently. Otherwise, the fluctuations in the depreciation expenses may lead to over-statement or under-statement of the profits.

3. Companies in the same industry use different accounting methods for similar items. Does the consistency principle violate?

This does not violate the consistency principle. Companies have the option of choosing appropriate accounting methods for themselves.

4. A Company changes its depreciation method from straight-line to reducing-balance in order to lower the reported profit for the year. Does the consistency principle violate?

This violates the consistency principle. Changing the depreciation method in order to lower the reported profit is not justified and will lead to a misleading profit figure

17.4.5 Materiality principle (重要性)

Meaning (意義)

- Materiality refers to the relative importance of an item. (信息的重要性是指某項目的相對重要性)
- An item of information is material if its omission or misstatement could influence decisions made by users on the basis of the financial statements. (如果某項目的信息的遺漏或錯誤陳述能夠影響財務報表使用者的決定，這個信息便算是重要的)
- The decision as to what is material and what is not depends on judgement. The size and the nature of the business will also affect the decision. (決定什麼是重要或不重要取決於公司判斷，公司規模和業務性質也會影響信息重要性的決定)
- For example, unused stationery at the balance sheet date is generally not included in the balance sheet as an asset because the amount involved is normally too immaterial. (例如，未使用的文具一般不包括在資產負債表中作為資產，因為涉及的金額通常是太無關重要)

Applications (應用)

- The materiality of an item is usually determined by relating its dollar value to a key figure in the financial statements, such as sales or total assets. (要判斷某項目的信息的重要性，通常要將該項目的貨幣價值與財務報表上其中一項主要數字作比較，例如銷售或總資產)

Importance (重要性)

- The materiality principle frees accountants from having to compute and report every item in strict accordance with generally accepted accounting principles. (有了重要性原則，會計師便無須在計算和匯報所有項目時，都一成不變地嚴守公認的會計原則)
- Thus it reduces administrative cost. It also reduces the time users spend on reading financial statements. (這有助降低行政費用，節省使用者花在閱讀財務報表上的時間)

Shortcomings (缺點)

- There is no standard for materiality. (重要性沒有固定的標準)
- The materiality limit is set by the business itself. Businesses of different sizes and nature will have different standards as to what is material. (企業可自行制定重要性的標準。但不同的公司規模和業務性質會有不同的重要性標準)
- This may create problems in comparing the financial statements of different businesses whose materiality limits are quite different. (這可能會產生問題在比較不同企業當它們的重要性標準有很大的不同)

Classwork 7

1. Define the materiality principle and give an example of the application.

Materiality refers to the relative importance of an item. An item of information is material if its omission or misstatement could influence decisions made by users on the basis of the financial statements.

For example, A firm has bought some stationery that cost \$200. As this amount is immaterial, the stationery can be written off as a sundry expense instead of being capitalised as a non-current asset.

2. Discuss the advantages of applying the materiality principle.

The materiality principle frees accountants from having to compute and report every item in strict accordance with generally accepted accounting principles. Thus it reduces administrative cost. It also reduces the time users spend on reading financial statements.

3. W set the materiality limit at \$1,000 for her company. Discuss whether the following accounting treatments are correct:

- (a) W bought 30 wastebaskets. As each wastebasket cost only \$50, she recorded them as general expenses.

Incorrect. The \$1,500 ($30 \times \50) spent on the wastebaskets was a material cost to the business as it exceeded the materiality limit of \$1,000. Therefore, it should be capitalised and treated as a non-current asset.

- (b) W bought plastic bags for the wastebaskets. As the bags cost only \$200, she did not bother to record them in the books.

Incorrect. All business transactions must be recorded in the books, no matter how small the amount. In this case, the cost of \$200 should be written off as a sundry expense in the current period because this amount would be considered immaterial.

17.4.6 Realisation principle (實現原則)

Meaning (意義)

- The realization principle states that revenue should be recognized in the period when goods are sold or when services are rendered. (實現原則指出，收入應在售出商品或提供服務時確認)
- One of the necessary conditions for recognising revenue is that collectibility has to be reasonably assured. (款項的可收回程度得到合理的保證)

Applications (應用)

- Under the realization principle, three conditions must be met before revenue is recorded: (根據實現原則，記錄收入前必須滿足三個條件)
 - 1 The seller completed a sale or performed a service. (賣方已售出貨品或提供服務)
 - 2 The amount of revenue can be objectively determined. (企業能客觀地確定收益金額)
 - 3 **Collectibility** is reasonably assured. (款項的可收回程度得到合理的保證)

Importance (重要性)

- The realization principle governs the recording of revenues. It affects the determination of profit for a period. (實現原則規定了何時記錄收益，這會影響企業在某期間所錄得的利潤)

Shortcomings (缺點)

- The timing and amount of revenue recognition cannot be easily determined. (有時，企業要決定何時確認收益並不容易)

Classwork 8

1. Explain the realisation principle and illustrate the principle with an example.

Revenue for a period is determined by applying the realisation principle, which required that revenue be recognized in the period when goods are sold or when services are rendered.

For example, Rental income received in advance for January 2006 on 25 December 2005 is not recognized as revenue for the year 2005. The rental receipt should only be recognized as revenue in 2006.

2. A magazine publisher receives subscriptions in advance. Each subscription is entitled to 12 monthly issues. Discuss how the subscription revenue should be recorded in the books of the publisher.

According to the realisation principle, subscriptions should be recognised as revenue when the magazines are delivered to customers. Any subscriptions received in advance should not be recognised as revenue but be treated as a current liability in unearned revenue (subscription is for one year).

3. A law firm does not record its fee income until that cash is received. This is because the firm often finds it difficult to collect payments from clients. Discuss whether this way of recognizing revenue is appropriate.

One of the necessary conditions for recognising revenue is that collectibility has to be reasonably assured. If the law firm often finds it difficult to collect payments from clients, it is appropriate to recognise fee income upon the receipt of cash.

4. A Chu made a sale as follows:

- (i) Received a purchase order on 10 November 2010.
- (ii) Took the ordered goods out of the warehouse on 15 November 2010.
- (iii) The customers received the goods on 17 November 2010 together with the sales invoice. He was given 30 day's credit.
- (iv) Received a cheque from the customer on 14 December 2010.
- (v) Presented the cheque at the bank on 22 December 2010.

According to the realization principle, when should the sales revenue be recorded?

According to the realization principle, the sales revenue should be recognized on 17 November 2010. This was the date when the goods were delivered and accepted by the customer, the sales amount was ascertained on the sales invoice and payment would be made within the credit period.

17.4.7 Matching concept (配比概念)

Meaning (意義)

- The matching concept states that a business should identify and record all the expenses incurred in earning the revenues for a period. This concept goes hand in hand with the realization principle that governs the recognition of revenues. (配比概念指出，一個企業應該識別和記錄所有為了賺取期內收益而招致的開支。這個概念與實現原則一起使用來確認收益)
- For a given period, a business would first measure its revenues by the realization principle. The matching concept then requires the business to identify and record all the expenses incurred in earning those revenues over that period. (企業會先根據實現原則計算期內的收益，然後根據配比概念找出並記錄為了賺取期內收益而招致的費用)

Applications (應用)

- Some expenses can easily be matched with specific revenues. Examples are the cost of goods sold and sales commissions. (某些費用很容易與相關的收益進行配比，例如銷貨成本和銷售佣金)
- When there is no direct way to link revenues with specific expenses, accountants usually match these expenses with revenues on a time basis, for example, depreciation expenses. (但某些費用沒有直接的相關收益，會計師便須按時間性來進行配比，舉例說，折舊費用)

Importance (重要性)

- The matching concept governs the recording of expenses. It affects the determination of profit for a period. (配比概念規定了何時記錄費用。與實現原則一樣，它會影響企業在某期間所錄得的利潤)

Shortcomings (缺點)

- It is not easy to match certain expenses with specific revenues. They are often charged on an arbitrary basis determined by accountants, which may be considered subjective. (有些費用並不容易與相關的收益進行配比。會計師通常要自行決定配比的方法，但這些方法往往會被視為帶有主觀成分)

Classwork 9

1. Explain why the cost of goods sold and sales commissions are easily be matched with specific revenues.

Sales commissions are calculated based on the sales volume or revenue. The cost of goods sold is also directly related to the sales volume or revenue. Thus, both can easily be matched with sales.

2. Discuss whether it is easy to match advertising expenses with specific revenues.

It is not easy to match advertising expenses with specific revenues because there is no direct link between advertising expenses and sales or other revenues. It is difficult to measure the actual benefit gained from an advertising campaign.

3. Opening inventory has to be added while the closing inventory has to be deducted in arriving at the cost of goods sold for the current year. Explain the accounting concept or principle behind this accounting treatment.

The matching concept is behind this accounting treatment. Refer to the text for the definition. Under the matching concept, the cost of goods is expensed during the period when the goods are sold. Opening inventory is added to the cost of goods sold as these goods are assumed to be sold in the current year. Closing inventory has to be deducted as these goods have not been sold by the year end. These goods are assumed to be sold in the following year and hence it will be added to the cost of goods sold in that year.

4. The value of some goods purchased for \$7,850 in the year-end inventory decreased. But the firm's accountant decided to ignore the current saleable value and maintained the book value of the goods at \$7,850 in the inventory account. List the accounting concept or principle that has been violated and give your explanation:

Matching

The matching concept states that a business should identify and record all the expenses incurred in earning the revenues for a period.

For example, the cost of a non-current asset will not be wholly charged as an expense in the year of acquisition. It will be written off as depreciation in the profit and loss account over the years it is in use.

17.4.8 Objectivity principle (客觀性原則)

Meaning (意義)

- The objectivity principle required that accounting information be based on facts and be verifiable. (客觀性原則要求會計信息要建基於事實，以及可被核實)
- When situations arise that required the exercise of personal judgement, accountants should follow generally accepted accounting practice without bias. (當會計師遇上一些須運用個人判斷的情況，應遵守公認會計慣例，不可帶有偏見)

Applications (應用)

The sole owner wanted to put one of his buildings into the company. He believed the building was worth \$200 million. To confirm his valuation, the owner hired two professional surveys who appraised the building at \$220 million. Which value is more objective measure?

The surveyors' appraised value of \$220 million is a more objective measure. This is because the surveyor's valuation is supported by verifiable facts and is not biased towards a particular group. The company should therefore record the building at a cost of \$220 million.

Importance (重要性)

- Without the objectivity principle, accounting information would be biased and cannot be relied upon by users. (如果沒有客觀性原則，會計信息便會有偏差，而使用者也無法依賴這些信息作決策)

Shortcomings (缺點)

- The objectivity principle sometimes conflicts with relevance. (有時，客觀性原則會與相關性產生矛盾)
- For example, historical cost is regarded as an objective measure of the value of assets. However, it is not as relevant as current market value in evaluating the current and future financial results of a business. (舉例說，歷史成本被公認為量度資產值的一種客觀標準，但是它在評估企業現時和未來的財務業績時的作用卻比不上現行市值)

17.4.9 Timeliness (及時性)

Meaning (意義)

- Timeliness means that accounting information should be provided soon after the occurrence of an event. (有價值的會計信息必須是及時的，即企業應在事件發生後的一段短時間內提供信息)

Applications (應用)

- According to the SEHK, for annual accounting periods ending on 31 December 2010, the reporting deadline will be shortened to three months. For half-yearly accounting periods ending on or after 30 June 2010, the reporting deadline will be shortened to two months. (根據香港交易所的上市規則，在主板上市的公司必須在會計年度終結後的四個月內刊發年度業績公告，亦要在半年度終結後的三個月內刊發半年度業績公告)

Importance (重要性)

- Financial statements prepared on timely basis provided relevant and useful information for users. (及時編製的財務報表可為使用者提供相關和有用的信息)

Shortcomings (缺點)

- Management needs to strike a balance between timely reporting and the provision of reliable information. (管理層須在及時匯報與提供可靠的信息之間取得平衡)
- To provide information on timely basis, it is often necessary to report before all aspects of transaction or an event are known. This affects the reliability of the information. (為了提供及時的信息，企業有時要在確定所有交易或事件的詳情前進行匯報，而這種做法會影響信息的可靠性)

Classwork 10

1. Give one example showing the conflict between timeliness and reliability.

For example, a firm is involved in a legal case that has not been resolved. If it loses the case, it will have to pay a very large but uncertain amount of compensation. To provide information on a timely basis, the firm should report the above information before the case is resolved. However, the probability, timing and amount of payment are uncertain, thus affecting the reliability of the information. If the firm reports the information once all the facts are known, reporting will be delayed and the information may be of little use to users.

2. Explain the Timeliness and illustrate each with an example:

Meaning: To be relevant, accounting information must be timely, that is, it should be provided soon after the occurrence of an event.

Example: According to the listing rules of the SEHK, companies listed on the main board are required to publish their annual financial results within four months after the end of the financial year. Half-yearly results need to be published within three months after the end of the period.

17.4.10 Money measurement (quantifiability) (貨幣量度單位概念)

Meaning (意義)

- The money measurement concept states that transactions and events are recorded in monetary terms. (企業所進行的交易和發生的事件都是以貨幣單位記錄的)
- Under this concept, only facts which are measurable in monetary term would be included in accounting. A transaction has to be quantifiable before it can be recorded. (根據這個概念，唯一可用貨幣量度的事實才會被納入會計。所以記錄一個交易前，一定要把它量化)
- This concept is in fact closely related to the objectivity concept, which states that only those facts which are objective should be considered during the whole accounting process. (這個概念和客觀性原則是密切相關的，它指出只有那些屬於客觀事實才會考慮處理)
- Qualitative factors such as the loyalty, skills and experience of staff may be valued by the owner as the assets of a firm. However, since such items cannot be objectively measured, they should be excluded from the financial statement. (不能量化的事實，如員工的忠誠度，技能和經驗，可作為一間公司的重要資產。但是因為這些事實，不能客觀量度，他們應從財務報表中排除)
- Items that cannot be objectively measured in monetary terms should not be recorded. (企業不應把無法以貨幣單位客觀地量度的項目入帳)

Applications (應用)

- The cost of goods sold can be objectively measured in monetary terms but their quality cannot. The latter information should not be shown in the accounting books. (貨品的生產或銷售成本能以貨幣單位客觀地量度，但貨品的品質不能。因此，貨品的品質不應列示在企業的會計帳冊內)

Importance (重要性)

- Money is the only factor that is common to all business transactions. Thus, it is the only practical unit of measure that can produce comparable accounting information. (貨幣是所有商業交易項目唯一共通的量度單位。因此，它是唯一可以提供具有可比性的會計信息的量度單位)

Shortcomings (缺點)

- A great deal of important information about a business, such as the quality of its management, staff morale and relationships with customers and suppliers is not provided in its financial statements. This is because such information cannot be objectively measured in monetary terms. (很多關於企業的重要信息，例如管理層的質素、員工的士氣、企業與客戶和供應商的關係，都不會展示在企業的財務報表中，因為我們無法用貨幣單位客觀地量度這類信息)

Classwork 11

1. Define the money measurement concept and give an example of the application.

The money measurement concept provides that accounting is only concerned with those facts that can be measured in monetary terms with a fair degree of objectivity.

For example, the morale and loyalty of company staff may be one of the significant factors for a company's success, but it is almost impossible to put a value on them and they therefore do not appear in the balance sheet.

2. Give one more example showing the conflict between the money measurement concept and relevance.

Qualities that are important to the success of a business but cannot be objectively measured in monetary terms, such as corporate governance, leadership, corporate culture, etc

3. Mr Chiu is the sole owner of a trading company that specialises in selling clocks. When he looks at the final accounts prepared by his accountant, he asks the following questions:

- (i) "Why isn't something charged for my services against the profit. If I had to pay someone to do the duties I perform, I would pay him at least \$20,000 a year. Should that amount be charged as wages in the profit and loss account?"
- (ii) "I have kept our van in perfect condition. Why should we charge something for depreciation?"
- (iii) "You have charged me for taking a clock for my personal use. If I did not have it, I might not be able to go to work on time each day. Surely it should be treated as an expense of the business, right?"

Required:

Explain to Mr Chiu why the final accounts should not be prepared in this way. (10 marks)

(i) Money measurement concept

It is accounting custom NOT to charge anything in a sole trader's profit and loss account for services rendered by him/her to his/her business. This is due to the fact that the value of his/her services cannot be objectively measured in units of money.

(ii) Matching concept

Depreciation is provided to write off the cost of a non-current asset consumed over the period of its life.

(iii) Business entity concept

A business is treated as a separate entity from its owner. The business resources taken out by the owner for his personal use should thus be treated as drawings.

17.4.11 Substance over form (實質重於形式原則)

Meaning (意義)

- The substance over form principle states that transactions and events should be accounted for and presented in accordance with their substance and economic reality. (實質重於形式原則指出企業應按交易及事件的實質和經濟現實決定會計的處理和展示方法，而不是單看其法定形式)

Applications (應用)

- According to the substance over form principle, the leased asset should be recorded as a non-current asset in the lessee's accounting books when entering the finance lease. (根據實質重於形式原則，以融資租賃形式租用的資產應在合約生效時，記錄為承租人的非流動資產)
- The reason is, although the leased asset is still owned by the lessor from a legal perspective, all the risks and benefits associated with the ownership of the leased asset have been transferred to the lessee. (因為雖然該資產的擁有權在法律上仍屬於出租人，但與該資產的擁有權相關的所有風險和利益已轉移到承租人身上)
- In this case, depreciation has to be charged and the outstanding lease obligations have to be shown by the lessee as a liability in its balance sheet. (在這種情況下，承租人要為資產計算折舊，並在資產負債表上把尚欠的租賃債務列作企業的負債)

Importance (重要性)

- The substance over form principle helps ensure that financial statements reflect the economic reality of an entity and not the legal form of transactions and events. (實質重於形式原則有助確保財務報表所反映的是企業的經濟現實，而不是交易或事件的法定形式)

Shortcomings (缺點)

- Some business transactions are quite complex. (某些商業交易是十分複雜的)
- To be able to differentiate substance from form, the accountants of an entity and also its auditor need to be vigilant and have very good inside knowledge of the company's operations. (要分辨交易的形式和實質，企業會計師和核數師必須提高警覺，並深入了解企業的營運實況)
- These conditions are not easily met in reality. This is why so many cases of accounting fraud have occurred as a result of the failure to apply the principle of substance over form. (但在現實中，這些要求並不容易達到。結果是實質重於形式原則在一些情況下難以應用)

Classwork 12

1. Define the substance over form principle and give an example of the application.

The substance over form concept provides that a transaction is accounted for in accordance with the economic substance of the transaction rather than its strict legal form.

For example, a motor vehicle acquired under a hire purchase agreement is included as a fixed asset even though the company does not own the motor vehicle according to the strict legal form.

2. What is a finance lease? According to the substance over form principle, how should it be accounted for in the lessee's books?

A finance lease is a contract that gives the lessee the right to use an asset for a certain period. During the lease period, the lessee has to make lease payments and bear all the costs involved in the use of the asset. The legal ownership of the asset is usually transferred to the lessee at the end of the lease term, with or without any additional payment.

According to the substance over form principle, the leased asset should be recorded as a non-current asset in the lessee's accounting books when entering the finance lease. The reason is, although the leased asset is still owned by the lessor from a legal perspective, all the risks and benefits associated with the ownership of the leased asset have been transferred to the lessee. In this case, depreciation has to be charged and the outstanding lease obligations have to be shown by the lessee as a liability in its balance sheet.

3. Company A sold goods costing \$100,000 to Company B for \$180,000 just prior to its year end date. At the same time, Company A signed an agreement to repurchase the goods from Company B within one year for \$200,000. As a result, Company A increased its profit for the year by \$80,000. In addition, its current assets rose by \$80,000. Both the profitability and liquidity of the company seem to have improved as a result. According to the substance over form principle, how should it be accounted for in the Company A's books?

In substance, this was a loan from Company B to Company A. The recording of the above transaction as a sale is not allowed under accounting standards. If Company A recorded the sum of \$180,000 as a sale in its books, no one would know this was actually a loan and the company's gearing ratio would not be adversely affected.

The transaction should be recorded in the books of Company A as:

Dr Bank \$180,000

Cr Company B / Short-term loans \$180,000

The difference between the sale value of \$180,000 and the repurchase value of \$200,000 represents the interest charge on the loan (i.e., finance cost).

Classwork 13

1. Explain what accounting concept or principle has been applied to each of the following accounting treatments in the books of K Chan, whose accounting year ends on 31 December:
- (a) A smoke alarm costing \$250 has been charged as a sundry expense, even though it is expected to be in use for five years.
 - (b) A long-outstanding debt of \$2,000 owed by Kong has been written off as a bad debt, even though his father is expected to die soon and may leave him a fortune.
 - (c) K Chan says that if he sells the inventory now, he could get \$20,000 for it. Yet his accountant has shown it as an asset at its historical cost of \$18,000.
 - (d) K Chan wants to abolish the allowance for doubtful debts account so as to increase the net profit for the year. But his accountant disagrees.
 - (e) K Chan had sent some goods to an agent on a sale or return basis. As the goods were not sold by the year end, they were counted in the closing inventory of K Chan.
 - (f) M Fong operates a shop in Mongkok and her sister, D Fong, also operates a shop selling similar things in Wanchai. The sisters requested their accountant to combine the accounts of both shops and prepare only one set of financial statements.

(a) Materiality

The cost of the smoke alarm appears to be insignificant and therefore it should be expensed in the period incurred instead of being capitalised as a non-current asset.

(b) Prudence

The debt is long-outstanding and it is not yet certain whether Kong's father will leave him enough money to pay off the debt.

For the sake of prudence, the debt should be written off as an expense. It is better to overstate rather than understate expenses. Alternatively, an allowance can be made for the doubtful debt.

(c) Prudence

The cost of the inventory is lower than its current resale value. For the sake of prudence, it should be stated at a lower value, i.e., its cost.

(d) Consistency

Businesses should keep making an allowance for doubtful debts. It is not reasonable to abolish this policy just to increase the net profit for the year.

(e) Realisation principle

Under this principle, a sale is recognised when the goods are delivered by the supplier and accepted by the customer. Once the sale is recognised, the goods belong to the customer. Goods that remained unsold by the year end and were held by the agent should be counted in K Chan's closing inventory as they belonged to him.

(f) The business entity concept was violated. The two shops are operated independently and therefore should be treated as separate entities, even though they are owned by two sisters.

2. P Cheung owns a trading business. The financial year ends on 31 March. In February 2011, he bought office furniture costing \$3,800 with cash taken from the business for his personal use. The cost of the office furniture was then treated as a business expense in the calculation of net profit for the year ended 31 March 2011, which amounted to \$35,600.

- (a) What accounting concept or principle was violated?
- (b) Explain the accounting concept stated in (a)
- (c) What must be done by P Cheung's business in order to comply with the accounting concept or principle stated in (a)?
- (d) What will the net profit figure be after corrective actions are taken in (c)?

(a) Business entity concept

(b) The business entity concept states that a business is treated as an entity separate from other entities, including its owner(s). Only transactions affecting the business should be recorded in the books of the business. The incomes and expenses of the owner(s) should not be treated as those of the business.

(c) The \$3,800 expenditure should have been recorded as drawings instead of business expenses. The correcting entries are as follows:

Dr Drawings \$3,800

Cr Business expenses \$3,800

(d) The corrected net profit for the year will be \$39,400 (i.e., \$35,600 + \$3,800).