

*Only snippets of certain chapters have been shown for purpose of preview ☺

Chapter 1- Introduction

People involved in financial acct:

- Info users (decision makers)
- Info preparers
- Auditors - assist users by enhancing the credibility of the info

A user's main demand is for the credible periodic reporting of an enterprise's financial position & performance

- Credible: info is to be trustworthy & competent for decision making - but worth its cost
 - Cost-benefit: Costs money to perfect reports but money comes from enterprise's funds, thus perfecting also lowers financial performance & position
 - Users i.e. owners & managers mightn't want that so credibility is a relative cond.
Not an absolute
- Periodic: longer the wait, more solid the info - but we don't want to wait too long
- Owners: indiv business owners i.e. proprietors partners and other entrepreneurs, shareholders, companies investing in other companies, supra funds, quasi-ownerships interests (members of clubs or voters in local councils)
 - Shareholders making money: receiving portion of companies profits (dividends) & selling their shares in future at higher price than paid
 - Creditors/potential creditors: suppliers, banks, bondholders, employees etc.
 - Don't have legal control of enterprise that owners have. Sometimes hard to discern creditors & owners b/c it depends on subtle legalities, some may play both roles
 - Large say in enterprise decisions. Might have right to take over control in cases of extreme diff.
 - Employees & their unions: assess job security
 - Regulators & gov: to assess if company following various rules/agreements
 - Competitors
 - Customers - important when customers are required to pay amounts in adv. Or relying on warranties
 - Misc: judges (ability to pay lawsuit), journalists, politicians (industry efficiency and tax levels)

Preparers (decision facilitators)

- Managers: responsible for running enterprise include issuing acct & other info & its controlling affairs
 - They're also users: conflict of interest -> led to development of auditing
- Accountants: shape financial statements by applying principles of acc to enterprise's records, under direction of management.

Auditors (credibility enhancers)

- Assists users by certifying that the financial statement's been prepared fairly, competently & in manner consistent and accepted with accounting principles
- External auditors are appointed by owners i.e. annual shareholders meeting.
 - Prohibited to be somewhat part of firm → Independence & objective

Accrual accounting method

1. Records impacts on transaction on the financial statements depending on the period in which revenues & expenses occur NOT WHEN CASH IS RECEIVED/PAID
2. Expenses incl costs of services & resources consumed in the process of generating rev
 - a. Orgs deprec. Cost of an asset over the useful life of the asset; each year a % of the cost of the asset becomes an expense
 - b. Depreciation expense is matched to the revs earned during the period (each period) rather than making it a cost/expense in the first year
 - i. i.e. printing machine cost 480k would have annual depreciation of 120k if its estimated life is 4 years

Accrual vs Cash accounting

- Cash acc: records revs & expenses at time the cash is paid/received

EXAMPLE

In June, a company makes cash sales of \$10 000 and credit sales of \$20 000 (all to be collected in July). It pays wages of \$6000 and owes \$1000 for June expenses (to be paid in July). 1 What is profit using cash accounting? 2 What is profit using accrual accounting?

Your answers should be: 1 $\$10\,000 - \$6000 = \$4000$ 2 $\$10000 + \$20000 - \$6000 - \$1000 = \$23000$.

The key financial statements:

- Info required: financial position, financial performance, financing activities, investing activities
- **Balance sheet:** shows financial position at a point in time
- **Income statement:** financial performance over a defined period
- **Statement of cash flows:** shows sources & uses of cash during the period (both financing & investing activities are included in this)

Balance sheet:

- 3 main elements of balance sheet: assets, liabilities & shareholder's equity (OE) (if org was sole trader/partnership, it'll be called proprietor's equity or partners equity respectively)

EXHIBIT 1.1		
XYZ LTD		
BALANCE SHEET AS AT 30 JUNE 2016		
	2016 \$000	2015 \$000
Assets		
Cash at bank	2 000	1 400
Accounts receivable	16 000	13 000
Inventory	12 000	10 000
Property, plant and equipment	90 000	91 000
Total assets	120 000	115 400
Liabilities and shareholders' equity		
Liabilities		
Accounts payable	17 000	16 800
Wages payable	2 000	2 000
Provision for employee entitlements	4 000	3 000
Long-term loans	30 000	33 600
Total liabilities	53 000	55 400
Shareholders' equity		
Share capital	40 000	36 000
Retained profits	27 000	24 000
Total shareholders' equity	67 000	60 000
Total liabilities and shareholders' equity	120 000	115 400

- **Assets:** future economic benefits that are controlled by org due to past transactions/events
 - Cash at bank
 - Accounts receivable (aka debtors) - Customers' account
 - Inventory
 - Property, plant and equipment (PPE)
 - *Can be financed in one of 2 ways: liabilities and/or shareholders' equity*
 - $A = L + E$ (SHAREHOLDER'S EQUITY)
- **LIABILITIES:** *future sacrifices of eco benefits that an org is presently obliged to make to other orgs/individuals due to past transactions/events*

Chapter 5 – Accrual Accounting Adjustments

Ch 5.1: Conceptual foundation of accrual accounting

Remember that expenses are outflows of eco resources to employees, suppliers, taxation authorities and others, resulting from business activities, to generate rev & serve customers (cost of earning rev)

- Think of events during before cash flows, during cash flow and after cash flow

A conceptual system for accrual profit measurement

- Accrual accounting's purpose: extend the measurement of financial perf & position by recognising phenomena BEFORE and AFTER cash flow as well as AT POINT of cash flow
 - o **REMEMBER TO WRITE BEFORE & AFTER IN EXAM**
- Recognition of rev or exp prior to cash flow: when cf occurs, there is no longer need to recognise rev & expense. They will be recorded as offsets to A & L created when rev & exp initially recorded
- Cash collections or payments related to previously recognized rev & expenses

Expenses:

- The manufacturer makes payments under the warranty in July 2016.

↓ Warranty liability \$3000
↓ Cash \$3000

		\$	\$
DR	Warranty liability	3 000	
CR	Cash		3 000

- The company pays a cheque to the Australian Taxation Office on 10 October 2016.

↓ Income tax payable \$1850
↓ Cash \$1850

		\$	\$
DR	Income tax payable	1 850	
CR	Cash		1 850

Revenues

- The lawyer receives full payment from her client in July 2016.

↑ Cash \$500
↓ Accounts receivable \$500

		\$	\$
DR	Cash	500	
CR	Accounts receivable		500

Cash inflow or outflow BEFORE rev & exp recognition: i.e. recognition after the cash inflow/outflow.

Summary:

- Accrual accounting makes much of B/S into 'holding area' for incomplete rev & exp events. I.e. record credit sale as rev & set up related acc receivable till cash is collected
- Pattern behind recognition system:
 - o Recog. Of rev before cash collection: create asset account which stands in for eco value gained till cash collected

- Recog. Of unearned rev when cash is collected is provided for by creating a L acc (unearned rev or rev received in adv), which reps commitment to customer til eco val gained by providing G/S. Rev later recognized when G/S is provided
- An asset acc (i.e. prepayment, inventory) created when cash is paid. They rep the available resources until the eco val is lost by consuming the asset
 - Recognises exp when consumption happens not when asset is acquired
- Not all cf involve revs & exp. Such flows have to be incl in acc but don't affect profit hence only appear in B/S accounts.
- Following are all examples of asset consumption:
 - Reduction in eco val of building (CR acc deprec.; DR dep exp)
 - Reduction in inventory as goods are sold (CR inv, DR COGS)
 - Reduction in supplies assets as supplies are used (CR supplies inv, DR Supplies exp)
 - Reduction of prepaid insurance asset as the coverage is used (CR prepaid insurance; debit insurance expense)

Ch 5.2 Accrual accounting adjustments

- Accrual acct adjustments follow the same double entry format as do the transaction records: eq must balance, same acc are DR/CR, sum of CR & DR must equal
- Purpose: improve measurement of financial perf & position
- Diff choices can be made about what accts need to be adjusted & by how much, accrual acct can manipulate and lead to misleading reports
 - Criticism of subjective accrual adjustments

4 main types of routine adjustments that need to be accounted for:

- Expiration of assets
 - Prepayments: expenditure that's been made but there's still value extending into future - usually current assets
 - Prepaid expenses: arise whenever payment schedule for an expense doesn't match company's financial period
 - Prepayments not assets in same way as receivables or inventories – arise from accrual acct, in cases where expense recog. follows cf
 - As asset is consumed in process of earning rev (i.e. prepaid insurance), a portion of cost is written off as expense (insurance expense) in each period
- Unearned rev: future rev where cash's received before earning rev
 - Example: when it first occurs – cash (+A ie DR) and Unearned rev (+L i.e CR) AND THEN Unearned Rev (-L i.e DR) & +Sales rev (CR)
- Accrual of unrecorded expenses
 - Adjustment involves determining which expenses have been incurred but not paid till following period (e.g wages)
 - Accrued wages or wages payable
- Accrual of unrecorded rev
 - When a service has been provided but cash won't be received till following period (interest receivable=accrued interest ie on loans)

Ch 5.3 Multi-column worksheets

EXAMPLE – 10 column adjusted worksheet: starts with pre-adjusted trial balance (column 1&2), then adjusting entries (3&4) then adjusted trial balance (5&6), I/S numbers (7&8) and then B/S numbers (9&10)

1. Adjusting entries refer to particular ledger acc in pre-adjusted trial bal
2. Amount of adjusting entry should be entered in appropriate adjustment column OPPOSITE the relevant ledger account
3. When the DR or CR part of adjusting entry refers to a ledger acc not in unadjusted trial balance, the name of that ledger account should be added to bottom of the trial balance & amount entered opposite it, in the appropriate adjustment column

5.4 The financial period

- B/S prepared as at specific points in time
- I/S cover specified periods of time
- Majority of companies have 30 June as their financial year end
- Effort put into determining whether revs placed in right years, if there are bills outstanding for expenses that should be taken into account, whether inventories & supplies are at hand etc
 - Harder to do this if firm has larger & less freq rev & exp transaction & thus easier if there's many short & simply transactions

Ch 5.5 Contra accounts

- Every balance sheet account can be considered as a control account
- Value of all these accounts is that the amounts in them should be supported by detailed lists/subsidiary ledgers
- Why and when we might change an asset account or reluctant to:
 - Want to recognise probable 'bad debts' expenses but don't want to change the acc receivable control account (b/c it should correspond to the list of customers' accounts)
 - PPE asset being used up – depreciation expense as part of profit measurement. Their costs aren't changing so don't want to change asset cost account
- Asset valuation & profit mgnt vs maintaining accounts for control purpose
- Contra accounts allow us to recognise changes w/o changing control account
- Accumulated depreciation = amortisation
- L.T asset account – accumulated depreciation = net book value
- Salvage value: how much you can get back if you sell it now?
- Straight line depreciation: where depreciation is the same each year
- If asset i.e. truck is sold, cost would be removed from ledger & so would contra account → gain from sale of this item is part of revenue!

EXAMPLE: truck costs \$50,000 & depreciated \$8000 a year. If it were sold at end of year 2 for 37,000

	Assets		= Liabilities	+ Equity	
	Cash	Truck		Revenue	Expense
Purchase	-50 000	+50 000			
Year 1			-8 000		-8 000
Year 2			-8 000		-8 000
Subtotal	-50 000	+50 000	-16 000		-16 000
Sale of truck	+37 000	-50 000	+16 000	+3 000	

The journal entry is:

		\$	\$
DR	Cash (the proceeds)	37 000	
CR	Truck asset (removing the cost)		50 000
DR	Truck accumulated depreciation	16 000	
CR	Gain on sale of truck		3 000

- Can also have a loss on sale (turn into an 'other exp' on I/S)

Chapter 8- Accounts receivable and further record-keeping

Receivables

- Receivables are an asset that occurs when a service has been provided but cash will not be received until the following period.

Accounts Receivable

- Current asset
- Arise from sale of G&S on **credit**
- Also known as debtors, trade debtors, trade receivables

Sales on Credit

- Benefits
 - Earn more revenue if willing to sell to customers who wish to buy on credit
- Costs
 - Additional record keeping
 - **Risk of not being paid**
 - Time value of money – delaying cash inflow and lending to customers “interest free”

Risks of not being paid

- **Bad Debts** – part of customer's **debts** to the company not collected
 - i.e. An **Expense** to the company (Bad Debts Expense)
- Current asset should not be recorded at greater than realisable amount
- Don't want to change the accounts receivable control account because it should correspond to the list of customers' accounts, and we have not yet given up on collecting any accounts receivable, so the control feature is still useful
- Matching principle
 - Recognising **bad debts expense** at the same time as **sales revenue**

Accounting for bad debts expense

1. Direct write off method

- Directly 'writing' off Accounts Receivable
- Chances of collecting cash for all accounts is very high
- Small number of credit sales, few customers

2. Allowance method

- Debts may not be collected
- Recognising a potential risk – part of internal control
- Large number of credit sales, many customers
- Accounts receivable account doesn't change

No allowance for Doubtful Debts

Example: A customer owing \$100 has entered liquidation (bankruptcy) proceedings

1. Direct write off method

Dr Bad Debts Expense 100
Cr Accounts receivable 100

Acc Receivable			
Bal. b/d	5000	BD Exp	100
		Bal. c/d	4900
	5000		5000

Allowance for doubtful debts

Allowance for doubtful debts is a **contra asset** account

- Estimate AR that are '**doubtful**', i.e. payment **may not** be received

- Accounts Receivable account does not change
- E.g. Current assets
 - Accounts receivable \$5000
 - Allowance for DD (\$400)
 - Net accounts receivable \$4600

Allowance for doubtful debts

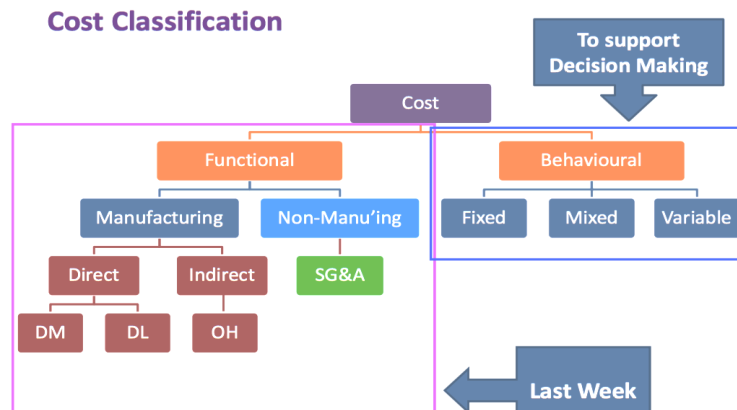
- Create an allowance for doubtful debts (ADD) as a contra account
 Dr bad debts expense 400
 Cr Allowance for doubtful debts 400
- Note: ADD is a **credit** account

Acc Receivable				Allowance for DD			
Bal. b/d	5000					Bal. b/d	0
		Bal. c/d	5000	Bal. c/d	400	BD Exp	400
	<u>5000</u>		<u>5000</u>		<u>400</u>		<u>400</u>

- A portion of the sales on account will be doubtful, and that portion should be deducted from rev in determining profit – bad debts expense.
- **Writing off** bad debts of 100 against the allowance
 Dr allowance for doubtful debts 100
 Cr accounts receivable 100

Acc Receivable				Allowance for DD			
Bal. b/d	5000	Allow DD	100	Acc Rec	100	Bal. b/d	0
		Bal. c/d	4900	Bal. c/d	300	BD Exp	400
	<u>5000</u>		<u>5000</u>		<u>400</u>		<u>400</u>

Chapter 2M Management Accounting: Cost-volume- profit Analysis



Cost behaviour:

- Deals with how costs change with respect to changes in activity levels
- Essential knowledge for planning, control & decision making:
 - o Costing
 - o Pricing
 - o Product mix
 - o Make or buy
 - o Performance evaluation
 - o Financial planning

Cost driver:

A factor that causes (drives) activity costs

Example:

- Work on the production line (activity)
 - ⇒ Direct labour costs (costs caused by the activity)
 - ⇒ Direct labour hour (cost driver)
- Petrol → how many kilometres you travelled? (cost driver)

Cost classification

(For Cost-volume-profit analysis)

- Fixed
- Variable

Semi-fixed (step variable)

Mixed (semi-variable)

Fixed cost

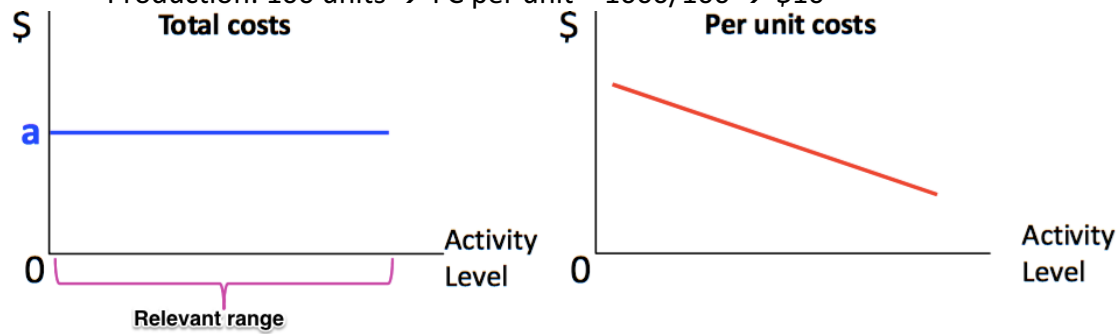
- **In total**, remain constant within the **relevant range** as (despite) the level level of cost driver varies
 - o Relevant rage – range over which the assumed **fixed cost relationship is valid** for the normal operations for an org
 - o Where the relationship remains the same!

- **Fixed costs per unit vary** inversely with activity → unit cost changes as the level of cost driver changes
 - o Higher the level of activity, fixed cost per unit will be lower!

Examples: rent per month & insurance per year

Example: If FC = 1000

- Production: 10 → Fixed cost per unit = $1000/10 \rightarrow \$100$
- Production: 100 units → FC per unit = $1000/100 \rightarrow \$10$



.... TO BE CONTINUED 😊