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Lecture 2

- → Primary users are resource providers, non-primary users have other aims
- → Some businesses are "partnership incorporated" (between partnership and company)
  - This involves many partners → eg. KPMG
- → Questions (Quick Recap)
  - Entity principle → business accounted for as separate from the owner
  - Revenue recognition principle and expense recognition principle → All revenues are reconciled with appropriate expenses
  - Revenue recognition → revenue should only be earned when the G/S are provided
  - Cost principle (historical cost) → best objective system to record costs of goods
    - ↳ Fair value principle estimates the value of a good at a moment in time
  - Company → has limited liability
    - ↳ Public company - listed on securities exchange
    - ↳ Private company - generally family owned
  - Qualitative characteristics:
    - ↳ Faithful representation
    - ↳ Comparability
    - ↳ Reliability
    - ↳ Timeliness
- → Accounting equation: >>> Assets = Liabilities + Owners' Equity <<< (A=L+OE)
  - Assets are economic resources
  - Liabilities and owners' equity are claims to economic resources
- → **Asset:** something a company owns/controls that has future economic value
  - Can be tangible (eg. cash, land) or intangible (eg. goodwill)
  - Eg. cash, land, equipment, accounts receivable, bills receivable, goodwill
  - When you buy a company you often also 'buy' the customers (this is goodwill)
  - Accounts receivable is fixed → often has a defined date to 'pay' by
  - Bills receivable is variable → arises from negotiations with the company
  - Prepaid expenses → paid for expenses before they are used, eg. prepaid insurance
  - An asset becomes an expense once you have finished enjoying the benefits
    - ↳ Eg. fuel is an asset until you empty tank then it becomes an expense
    - ↳ When buy fuel: asset (fuel) increases, but asset (cash) decreases
    - ↳ When use fuel: asset (fuel) decreases, so owners equity decreases (expense)
- → **Liability:** something a company owes
  - Eg. accounts payable, bills payable, loan payable, accrued liabilities
  - Accrued liabilities are for expenses incurred but NOT paid (eg. electricity bill)

- ‘Current liabilities’ must be repaid in less than 12 months
- ‘Non-current liabilities’ can be repaid over 12 months (eg. mortgage)

→ **Owners’ Equity:** the leftover assets after all liabilities have been deducted
- OE = + revenues - expenses - drawings + capital (- dividends + share-capital for co.)
- **Revenue:** amounts received or to be received from customers for the sale of G/S
  - ↳ Unearned revenue (revenue received in advance) is a Liability (eg. tickets)
- **Expenses:** amounts that have been paid or will be paid for costs that have been incurred to earn revenue
  - ↳ When you purchase supplies it becomes an asset, but as you use the supplies, they become expenses (A decrease and OE decrease)

→ **Principle of duality:** All debits must equal all credits
- OE is considered a credit as the business must pay it back to the owner

→ When asset goes up it is a debit, when it goes down it is a credit

→ When L + OE goes up it is a credit, when it goes down it is a debit

→ T Accounting: for each of A, L nd OE a ‘T-table’ is created with debits and credits
- When you make a purchase (eg. for supplies), cash goes down and supplies go up
  - ↳ Therefore, the ↓ in cash is a credit and the ↑ in supplies is a debit

→ To pay “on account” means to pay off a loan with cash

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Tutorial 2

→ Accounts receivable = trade debtors

→ **Patent:** an intellectual property asset

→ Accounts payable = trade creditors → money owed to suppliers

→ Mortgages are secured by property, whereas debentures are secured by a company’s assets

→ Profits do not carry forward into the next financial year, unlike assets and liabilities

→ **Cash flow statement:** report of cash receipts and cash payments during a period

→ Benefits of Proprietorship:
- No need to split profits / meet shareholders expectations
- Easy to set up

→ Negatives of Proprietorship:
- Limited lifespan of owner’s life
- **Unlimited liability:** owners are personally liable for the liabilities of the business
- Limited access to funds, tough to raise capital → tough to expand

→ Benefits of Partnerships:
  - Shared risk, more pooling of resources (monetary and intellectual)
  - Easier and cheaper to set up than proprietorship

→ Negatives of Partnerships:
  - Unlimited liability
  - Disputes among management and owners

→ Benefits of Company:
  - Easy to raise capital (issue new shares)
  - Long (possible) lifespan of company
  - Limited liability on the part of the shareholders

→ Negatives of Company:
  - Shareholders (owners) have minimal/negligible input into operations of company
  - More bureaucracy, more 'red tape'

→ **Accounting Entity Principle:** Entity can be separately identified and accounted for

→ **Cost principle:** Assets should be recorded at their historical cost

→ **Revenue recognition:** revenue is recognised when goods are delivered or services are rendered

→ **Going concern:** Financial statements are prepared on the assumption that the business will continue to operate into the near future

→ **Accrual basis:** Income or revenue is recorded irrespective of a cash receipt. Expenditure are recorded irrespective of a cash payment

→ **Accounting period:** An entity's life is split up into equal time periods (eg. financial years) and transactions are recorded in the periods they occur

→ **Monetary principle:** Items in financial statements must be reported at monetary values

→ **Full disclosure principle:** All significant events that are relevant to users of the financial statements must be disclosed to the public

→ Manual records are important as they can assist in audits and in detecting errors

→ It is important to organise accounting information into accounts with account numbers as it allows individual accounts to be easily identified and relevant data to be aggregated