Lecture 2 (14/03) – Key accounting concepts

Key principles

- **Entity principle** – transactions associated with a business must be recorded separately from those of its owners'
- **Revenue recognition principle** – revenues should only be recorded once they have been earned (when g/s exchanged for payment not when payment received)
- **Expense recognition principle** – expenses should be recorded in the period in which they are incurred
- **Matching principle** – expenses should be recorded in the same period as the matching revenue e.g. sales revenue and wages expense
- **Cost principle** – assets should be recorded at the cash amount at the time it was acquired not its estimated current value

Enron

- Created subsidiary companies
- Always recognised revenues – projected profits from built assets recorded
- Expenses recognised by subsidiaries – if revenue < projected profit
- Parent company always profitable

Explain the accounting equation

The accounting equation

$A = L + OE$

where A assets (debits = Dr – own money)
L liabilities (credit = Cr – someone else's money)
OE owners' equity (credit = Cr)

Asset – something a company owns, has the following characteristics…

1. Probable future economic benefit
2. Business has exclusive rights over benefit
3. Benefit arises from past transaction i.e. already acquired
4. Able to be reliably measured in financial terms i.e. value can be determined

Tangible e.g. land, building, equipment, accounts receivable, bills receivable (negotiated),	vs.	***Intangible*** e.g. goodwill (benefit from customers), trademarks
Current – gives benefit for less than 12 months e.g. accounts receivable	vs.	***Non-current*** – gives benefit for more than 12 months e.g. land, buildings, equipment

Liability – something a company owns, has same characteristics as an asset

- ***Current*** – amounts due for settlement in <12 months e.g. accounts payable, bank loan
- ***Non-current*** – amounts due for settlement in 12+ months e.g. mortgage

Owners' equity – what's left of the assets after liabilities have been deducted (net assets), i.e. owner's claim on the entity's assets

- e.g. capital, drawings, revenues, expenses, dividends
- Accounting equation can be rewritten as:
  assets + expenses = liabilities + OE + revenues
  OR
  assets + expenses + drawings + dividends = liabilities + equity (at period start) + revenue + capital

Revenue – amounts received or to be received from customers for sales of g/s

- Sales
- Performance of sales
- Rent received
- Interest received

Note: recorded when earned (exchange)

Expense – amounts that have been paid or will be paid later for costs that have been incurred to earn revenue

- Salaries, wages
- Electricity, gas
- Supplies used
- Advertising

Note: recorded when incurred

Classify assets and claims

Claim – an obligation on part of the business to give cash/some other benefit to an outside party

- ***External*** claims i.e. liabilities
- ***Internal*** claims – claim of the owner/s against the business i.e. owners' equity

Provide an overview of the recording processes

Recording processes

- **Journal** – list in chronological order of all the transactions for a business, to record a journal entry
    1. Identify transaction from source documents (documentary evidence that a transaction has occurred e.g. receipts, invoices)
    2. Undertake transaction analysis
    3. Specific accounts affected
    4. Apply debit/credit rules
    5. Record transaction – date, details of accounts to be debited and credited (name, account number, amount), narration

Date	Description	Account Number	Debit ($)	Credit ($)

- **Posting** – the procedure where info is transferred from general journal to general ledger accounts, to post to the general ledger
    1. Find the account to be debited
    2. Enter the transaction date in the account
    3. Enter the name of account that will be credited
    4. Enter amount of the debit
    5. Go back to journal and enter account number to show that part of the entry has been posted and tick next to the line in the journal
    6. Repeat 1-5 for account to be credited
- **Ledger accounts** – a system that uses amounts and pluses and minus to record transactions

Account name	
debit	credit
Dr	Cr