TOPIC -1 Chapter-1 and Chapter-12

Accounting in action and Accounting Principle

Accounting

'Recording, classifying, and reporting'

> This traditional definition is known as 'book-keeping'

Modern definition

'Identifying, recording and communicating economic information to permit informed decisions by users'

Accounting is a communication tool and language of business

Corporate Governance:

- > A system in which the business is controlled or managed
- > Influences the goals and hence the decisions made by the management to ensure they are aligned with those of the shareholders
- > It is needed to help protect investors from managers who may not always act in the best interests of stakeholders
- Past examples of problems include corporate failure, collapses and fraud. Eg Enron and World Com

Financial Accounting (external users)

- > Production of financial statements (general purpose)
- > Production of special reports (specific purpose) e.g. tax
- > Focus on past

Management Accounting (internal users)

- > Production of specific purpose reports
- > Not regulated, not time constrained, no strict format
- > Focus on current and future

Ethics

The standards of conduct by which your actions are judged as right or wrong, honest or dishonest, fair or not fair

For solving an ethical dilemma you should apply three steps:

1. Recognise Situation

2. Identify and Analyse Elements

3. Identify and Weigh Alternatives

Sustainability

Meeting the needs of the present without compromising the ability of future generations to meet their needs. Also known as **Corporate Social responsibility reporting (CSR)**

Triple Bottom Line

3 components:

- 1. Social (indicator of how entity deals with issues such as employee working condition)
 - 2. Environmental (how an entity's products or operations impact on the environment)
 - 3. Economic (entity's profitability & business strategy-Financial Reporting)

Recent Initiative: Integrated Reporting (improve sustainability reporting)

Who is involved: IIRC (International Integrated Reporting Committee)

Generally accepted accounting principles (GAAP)

What IS GAAP: set of rules and standards that are recognised as a general guide for financial reporting purposes.

Who develops Accounting Standards: AASB Australian Accounting Standards Board actual authority to develop authoritative Australian accounting standards

FRC Financial Reporting Council responsible for the overall administration and management of the AASB

IFRSs International Financial Reporting Standards

National standard setting board

Key items of Conceptual Framework are broken into 6 areas-

- 1. Objective of Financial Reporting
- 2. Assumptions underlying financial statements
- 3. Qualitative characteristics of financial reporting
- 4. Elements
- 5. Recognition criteria

6. Measurement

Monetary Unit Assumption

Only transaction data that can be expressed in terms of money can be included in the accounting records

Economic Entity Assumption

The activities of an entity must be kept separate and distinct from the activities of its owner and all other economic entities

Going Concern

The business will continue to operate in the future in order to carry out its objectives

Accrual Accounting

Transactions are recorded when they have been entered into and not when the settlement takes place

Asset: resources controlled by the business to provide future services or benefits to the business

<u>Liabilities:</u> existing debts or obligations; creditors' claim on assets

Owner's equity: owner's claim on assets.

Assets = Liabilities + Owners Equity

 $\underline{\textbf{Income:}} \text{ increase in owner's equity from business activities}$

Expense: costs incurred in the process of generating income

Owner's Equity = Contributed equity - Withdrawal + Income - Expense

Objective of Financial Reporting

Provide information that is useful to existing and potential investors, lenders and other creditors in making economic decisions.

Characteristics-

- > Relevance
- > Faithful representation
- Comparability
- Verifiability
- > Timeliness
- Understandability

Measurement basis-

- Historical cost
- Current Cost
- Realisable value
- Present Value

Revenue Recognition Principle

Costs incurred / Total estimated cost = Percent complete

(Current period) (Current period)

Percent complete * Total revenue = Revenue recognized

(Current period) (Current period)

Revenue recognized – Costs incurred = Gross profit recognized

(Current period) (Current period) (Current period)

Relevant

Provides feedback and serves as a basis for predictions.

<u>Faithful</u>

Reports substance over form, presents a complete depiction of the event and is free from bias and error.

Differential Reporting

Consists two tiers of reporting requirements

Tier 1- Australian Accounting Standards

Tier 2- Australian Accounting Standards – Reduced Disclosure Requirements

ASIC- Australian Securities and Investment Commission

SEC- Securities and Exchange Commission

 $\underline{\textbf{GRI-}} \ \mathsf{Global} \ \mathsf{Reporting} \ \mathsf{Initiative}$

Bookkeeping V/s Accounting

Accounting process includes bookkeeping function.

Bookkeeping usually involves only the recording of economic events. It is therefore one part of the accounting process.

Accounting involves the entire process of identifying, recording and communicating economic events.

Income statement also called Profit and loss statemet.

TOPIC-2 CHAPTER-18

The Statement of Cash Flows

Cash Flow

A statement of cash flows provides information about an entity's cash receipts and cash payments during a period

Creditors, investors and other interested parties comes to know about the entities-

- Ability to generate future cash flows
- Ability to pay dividends and meet obligations
- Reasons for difference between profit and net cash provided (used) by operating activities
- Cash investing and financing transactions for the period

Operating activities

Cash effects of transactions that create income and expenses from the main business

- Cash from sales
- Cash paid to purchases (inventories)
- Cash paid for expenses

Investing activities

Cash effects resulting from

- acquisition and disposal of property, plant and equipment, and
- lending money and collecting repayments

Financing activities

Cash effects resulting from

- issuing debt and repayments of borrowings
- obtaining cash from shareholders and providing them with a return on their investment (dividends)

Examples of non-cash activities:

- Issue of shares to purchase assets
- Conversion of bonds into shares
- Issue of debt to purchase assets
- Exchanges of assets
- Depreciation of PPE

COMPANY NAME

Statement of Cash Flows Period Covered

Cash flows from operating activities (List of individual items)	XX	
Net cash from (used by) operating activities Cash flows from investing activities (List of individual inflows and outflows)	XX	XXX
Net cash from (used by) investing activities Cash flows from financing activities (List of individual inflows and outflows)	XX	XXX
Net cash from (used by) financing activities	_	XXX
Net increase (decrease) in cash		XXX
Cash at beginning of period		XXX
Cash at end of period		XXX
Listed elsewhere in the financial report		
Material non-cash investing and financing activities (List of individual non-cash transactions)		<u>xxx</u>

Direct Method

There are 3 steps in the preparation:

- 1. Operating activities
 - Determine net cash provided/used by operating activities by converting from accrual basis to cash basis
- 2. Investing and financing activities
 - Analyse changes in non-cash assets and liabilities
- 3. Net change in cash
 - Compare net change in cash in statement of cash flows with change on the statement of financial position

Operating activity

Operating Activities = Cash Receipts – Cash Payments

- Cash Receipts
 - Cash from sale goods and services
 - from other income such as: interest on dividends

Cash Payments

- To suppliers
- Employers
- Expenses
- Interest
- Taxes

Converting Sales Revenue to Cash Receipts from Customers

Cash payments to Suppliers

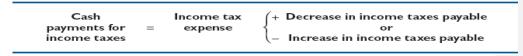
+ Decrease in accounts payable or
- Increase in accounts payable

Cash payments for Expenses

Please note: Depreciation expense and loss on sale of equipment

- Expenses are shown exclusive of depreciation because depreciation is a non-cash expense
- Gain or loss on sale of equipment increases or reduces profit, but does not effect cash and is therefore is not reported on statement of cash flows

Cash payments for Income taxes



Investing and Financing activities

Increase or decrease in bonds payable

- Cash inflow = cash received from issue of bonds
- Cash outflow = cash paid for bond repayments

Increase or decrease in ordinary shares

■ If non-cash transaction, check that details account for changes to issued share balances

Increase or decrease in retained earnings

■ Profit not reported in statement of cash flows

Payment of dividends will reduce retaining earnings

Increase or decrease in land

 If ordinary shares are issued to purchase land, this will be significant non-cash transaction

Free Cash Flow

Free cash flow is the cash remaining from operations after adjustment for capital expenditures and dividends

Free cash flow	=	Net cash from operations	-	Capital expenditures	-	Cash dividends

Disposal of assets

Cost of asset + Gain - Loss - Accumulated Depreciation - Sale Proceed

Question

The income statement for the year ended 30 June 2014 for Gee Electronics Ltd contains the following condensed information.

GEE ELECTRONICS LTD Income Statement for the month ended 30 June 2014					
Sales revenue Expenses (excluding depreciation)	\$4920000	\$6 583 000			
Depreciation expense	880 000	5 800 000			
Profit before income taxes		783 000			
Income tax expense		353 000			
Profit		\$_430 000			

Included in expenses is a \$24000 loss resulting from the sale of machinery for \$27000 cash. Machinery was purchased at a cost of \$750 000. The following balances are reported on Gee Electronics Ltd's comparative statement of financial position as at 30 June.

GEE ELECTR Statement of Financia		
	2014	2013
Cash	\$672 000	\$130 000
Accounts receivable	775 000	610 000
Inventory	834 000	867 000
Accounts payable	521 000	501 000

Income tax expense of \$353 000 represents the amount paid during the year. Dividends declared and paid during the year totalled \$200 000. Required

(a) Prepare the statement of cash flows using the direct method.

Staten	EE ELECTRONICS LTD ment of Cash Flows — Direct Method for the year ended 30 June 2014	
Cash flows from operating activities Cash receipts from customers Cash payments: For expenses For income taxes Net cash from operating activities Cash flows from investing activities Sale of machinery Purchase of machinery Net cash used by investing activities Cash flows from financing activities	270 000 (750 000)	\$6418000* \[\frac{5196000}{1222000} \] (480000)
Payment of cash dividends Net increase in cash Cash at beginning of period Cash at end of period		(200 000) 542 000 130 000 \$ 672 000
Direct method calculations: *Calculation of cash receipts from customates Sales revenue per the income state		\$6583000
Less increase in accounts receivable Cash receipts from customers **Calculation of cash payments for ex		165 000 \$ <u>6 418 000</u>
Expenses per the income statemen Deduct loss from sale of machinery Deduct decrease in inventory Deduct increase in accounts payabl Cash payments for expenses	y	\$4920 000 (24 000) (33 000) (20 000) \$4843 000

(b) GEE ELECTRONICS LTD Statement of Cash Flows — Indirect Method for the year ended 30 June 2014

Cash flows from operating activities \$ 430 000 Adjustments to reconcile profit to net cash from (used by) operating activities: \$ 880 000 Depreciation expense 24 000 (165 000) 33 000 Loss on sale of machinery Increase in accounts receivable Decrease in inventory 792 000 Increase in accounts payable 20 000 I 222 000 Net cash from operating activities Cash flows from investing activities 270 000 Sale of machinery Purchase of machinery (750 000) Net cash used by investing activities Cash flows from financing activities (480 000) Payment of cash dividends (200 000) Net increase in cash 542 000 Cash at beginning of period 130 000 \$ 672 000 Cash at end of period

Receipts

Sales - Increase in Accounts Receivable

Payment

Cost of Sales - Increase in Accounts Payable- Decrease in Inventory

Total expense

Expense - Depreciation

INDIRECT METHOD

Net cash from operating activity = Profit + Depreciation expense + Amortisation of intangible assets+ Loss on sale of equipment – Profit on sale of equipment+ Decrease in current assets- Increase in current asset - Decrease in current liability+ Increase in current liability

Current Assets= Inventory, Accounts receivable, Prepaid expenses, Provision for Doubtful Debts,

Current Liabilities=Accounts Payable, Income taxes payable, Accumulated depreciation- PPE

TOPIC-3 Chapter-2

The Recording Process

Account

An account is an individual accounting record of increases and decreases in a specific asset, liability, or equity item.

Assets

To record an increase in an asset, a debit entry is made

To record a decrease in an asset, a credit entry is made

Liabilities

To record an increase in a liability, a credit entry is made

To record a decrease in a liability, a debit entry is made

Revenue

To record an increase in a revenue account, a credit entry is made

To record a $\mbox{\bf decrease}$ in a $\mbox{\bf revenue}$ account, a $\mbox{\bf debit}$ entry is made

Expense

To record an increase in an expense account, a debit entry is made

To record a decrease in an expense account, a credit entry is made

Capital

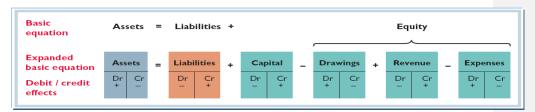
To record an increase in owner's equity, a credit is made

To record a decrease in owner's equity, a debit is made

Owners Drawing/Additional Capital

Increase drawing- Debit (Same as asset means when owner withdraws)

Additional Capital- Credit (means when owner adds capital to business- Additional Capital)



Steps in the Recording Process

- 1. Identify the transaction from source documents
- 2. Analyse each transaction for its effect on the accounts
- 3. Enter the transaction information in a journal
- 4. Transfer the journal information to the appropriate account in the ledger

<u>Journal</u>

Transactions are initially recorded in chronological order before they are transferred to the ledger

Every business has a general journal (but may also have other types of journals)

Ledger

A ledger is a series of accounts

- **▼** Transactions are **recorded** in the journal, transactions are then **posted** to a ledger
- **☀** Posting is the procedure of transferring journal entry amounts to the ledger accounts

Chart of Accounts

It serves as an index to the ledger and each account is numbered for easy reference

Trial Balance

- Prepared at the end of accounting period
- It lists in one place the balances of all accounts in the general ledger
- ▶ Accounts are listed in the order they appear
- Checks that total of debit balances equals total of credit balances, you should not proceed if it does not balance
- Used to prepare financial statements

<u>Unadjusted Trial Balance:</u> once all the day-to-day transactions have been posted (but prior to balance day adjustments)

<u>Adjusted Trial Balance</u>: after all transactions have been posted including balance day adjustments but prior to doing the closing entries

<u>Post-Closing Trial Balance:</u> this will list all the balances of all accounts after closing entries have been performed in the ledgers

TOPIC-4 Chapter-7

Accounting Information System

Accounting Information System

The system that collects and processes transaction data and disseminates financial information to interested parties

Subsidiary Ledger

- > General ledger is normally supported by subsidiary ledgers
- Subsidiary ledgers contain more detail and therefore enable the general ledger to be maintained in summary form
- Subsidiary ledger is not of double entry format
- > Total of individual account balances in the subsidiary ledger can be reconciled with the balance in the control account of the general ledger, thus improving accounting control
- > The general ledger is reduced in size, thus promotes efficiency and accessibility of data
- · Used to record sales of inventory on account
- All entries are made from numbered sales invoices

Sales Journal

Posting the sales journal

- Posting are made daily as debits to individual account receivables in the subsidiary ledger and monthly to the general ledger
- At the end of the month column totals from the sales journal are posted to the general ledger:
 - Debit Accounts Receivable control and credit sales revenue
 - When a perpetual inventory system is used an additional column is required to debit cost of sales and credit inventory

Sold inventory on credit in which selling price and cost price differs

Cost of sales (Dr)

Inventory (Cr)

Accounts Receivable and sales are debited and credited by the cost of Selling Price respectively

Cost of Sales and Inventory are debited and credited by the cost of actual Cost Price respectively

Daily posting- Subsidiary Ledger (Accounts Receivable- Ledger account of A, B, C, D separate ledger accounts)

Monthly posting General Ledger (Accounts receivable- Leger accounts of A, B, C, D together in one ledger, Cost of sales, Inventory, Sales Revenue etc.) (Also it contains the sum of all accounts receivable – Ledger of A+ Ledger of B + Ledger of C + Ledger of D= Main Accounts Receivable)

Sales Journal

Date	Account	Invoice	Ref.	Accts Receivable	Cost of Sales Dr
	debited	no.		Dr	Inventory Cr
				Sales Cr	
May 3	Andrews Ltd	101	٧	10 600	6 360
7	Brant Ltd	102		11 350	7 370
24	Delish Ltd	106		21 210	15 900

Purchase Journal

- Used to record purchases of inventory on account
- All entries are made from purchase invoices

Posting the purchases journal

- Postings made daily as credits to individual accounts payable in the subsidiary ledger and monthly to the general ledger
- At the end of the month column totals from the purchases journal are posted to the general ledger:
 - Debit to inventory account
 - Credit to accounts payable control account

Cash Receipts Journal

C	Date	Account Credited	Ref	Cash	Sales	Accounts	Sales Discounts	Other Accounts	Cost of Sales Dr
		Credited		Dr	Cr	Receivable	Dr	Cr	Inventory
						Cr			Cr

Cash Payments Journal

	Chq		Other	A/Cs	Disc.	Cash
Date	No. Account debited	Ref.	A/Cs Dr	Payable Dr	Rec.Cr	Cr
2010						
May 1	101 Prepaid Insurance	130	1 200			1 200
3	102 Freight-in	425	100			100
8	103 Inventory	120	4 400			4 400
10	104 Jordon Manuf. Ltd	$\sqrt{}$		11 000	220	10 780
19	105 Ernie and Evans Ltd	$\sqrt{}$		7 200	216	6 984
23	106 Fellini and Sons Ltd	$\sqrt{}$		6 900	69	6 831
28	107 Jordon Manuf. Ltd	\checkmark		17 500	350	17 150
30	108 AL Bellevue, Drawings	306	500			500
			6 200	42 600	855	47 945
			(x)	(201)	(405)	(101)

Goods and Services Tax

- The Goods and Services Tax (GST) was introduced on 1st July 2000.
- It is a 10% tax on the sale of goods or provision of services within Australia.
- All goods and services must be shown GST inclusive (ie the price must include the GST).
- To determine the amount of GST paid, simply divide the amount by 11.
 - A business buys a machine for \$2,200. The GST paid on the machine is \$200 (\$2,200/11).

GST Collected

- GST is collected from customers when selling a good or providing a service.
- This amount must be paid to the Australian Taxation Office (ATO) within three months.
- Classified as a current liability.

GST Paid

- GST is paid when acquiring a good or receiving a service.
- Classified as a current asset.

TOPIC-5 Chapter-5

Accounting for Retail Operations

Sales Revenue – COGS = Gross Profit

Cost of Goods Sold (COGS) also called Cost of Sales

Two key methods for recording inventory:

Perpetual method

Maintains a continuous record of inventory

Provides a balance of inventory

at any time

Periodic method

Does not continuously update inventory and normally used by those entities that have low value stock items sold in great volume eg supermarket

Entity has no record of inventory on hand at any one particular time

Enables a calculation of stock loss at any time

A physical stock take (counting of stock) takes place each period to determine the inventory level and, the amount

sold

COS is determined at time a sale

occurs

Perpetual method is also called Asset approach.

COGS is an expense account

Sale of Inventory: Two entries

i. Accounts Receivable Dr

Sales Cr.

(Sales Amount)

ii. Cost of Goods Sold Dr.

Inventory Account Cr.

(Cost of the Inventory)

purchased	audeu to the cos	t of inventory where freight is charged to the buyer- doods
Freight in	Dr	
	Cash	Cr
Freight charged I	by the seller- Goo	ds sold
Freight Out	Dr	
	Cash	Cr
Net sales =Sales	– Sales return and	d allowance-Sales discount
Total cost of sale	es=Cost of sales+ F	Freight in – Discount received
Gross profit =Ne	t sales – Total cos	st of sales
Sales Revenue- C	COGS = Gross Prof	fit
If the balance of	the inventory acc	count is higher than the amount from physical count .
Debit Inventory	Loss (Cost of sale	es)
Credit Invent	ory	
If the balance of	the inventory acc	count is lower than the amount from physical count.
Debit Inventory	,	

Credit Inventory Gain (Cost of sales)

Closing temporary accounts with credit balances

Debit Sales

Discount received

Credit Profit and loss summary

Closing temporary accounts with debit balances.

Debit Profit and loss summary

Credit Sales returns & allowances

Sales discounts

Cost of sales

Freight-in

Inventory Loss

Freight-out

Expenses

SELLERS ELECTRICS Cost of Sales for the year ended 31 December 2013

Cost of sales

Inventory, I January Purchases Less: Purchase returns and \$325 000

\$10400 allowances Discount received

6 800 17200 307 800

Net purchases Add: Freight-in Cost of goods purchased Cost of goods available for sale Inventory, 31 December

12200 320 000 356 000 **40 000**

\$ 36 000

Cost of sales

\$316000

COGS = Opening Stock + Purchases - Purchase return and allowance + Freight in - Discount Received - Closing Stock

Gross Profit Ratio =
$$\frac{Gross \, Profit}{Net \, Sales}$$

Administrative/ General Expense= Salaries Expense, Utilities Expense, Insurance Expense

Selling/ Distribution Expense= Advertising Expense, Shop Salaries Expense, Freight-out, Depreciation Expense

TOPIC-6 Chapter-3 & Chapter-9

Adjusting the Accounts & Accounting for Receivables

Time Period Assumption

- Economic life of business can be divided into artificial time periods
- Every transaction must be allocated to a specific accounting period
- Some transactions will affect more than one accounting period
- Accounting periods can be a month, a quarter, semi-annual or a year

Cash Based Accounting

> only records transactions when there are actual cash flows

Profit = cash received - cash paid out

Accrual method

> not when cash is received or paid but when revenue is earned or expenses are incurred regardless of whether cash has been received or paid

Estimate that the depreciation of the office equipment is \$480 a year, or \$40 per month.

Adjusting Entry

Debit Depreciation Expense \$40

Credit Accumulated Depreciation - office equipment \$40

Liability account is commonly called accrued/outstanding expenses

Type of adjustment	Accounts before adjustment	Adjusting entry
Prepaid Expense	Assets overstated Expense understated	Dr Expense Cr Assets
Unearned Revenue	Liabilities overstated Revenue understated	Dr Liabilities Cr Revenue
Accrued Revenue	Assets understated Revenue understated	Dr Assets Cr Revenue
Accrued Expense	Expense understated Liabilities understated	Dr Expenses Cr Liabilities

Types of Receivables

- Receivables refers to amounts due from individuals and other entities that are expected to be collected in cash
- · Types of receivables:
 - Accounts receivable are amounts owed by customers on account
 - Notes receivable are claims for which formal instruments of credit are issued evidencing the debt
 - Other receivables include non-trade receivables such as interest receivable, loans, advances and GST receivable
- Impairment loss is recognised by comparing carrying amount of receivable with present value of estimated cash flows from receivable
- · The impairment loss must be recognised in the income statement as a loss

Lanchai Ltd writes off M Chua's \$200 balance as impaired on 12 December

Dec.	12	Bad Debts Expense Accounts Receivable — M. Chua (To record write-off of M. Chua account)	200	200	
		(To record write-off of M. Chua account)	1 1		ı

Allowance method

- Impaired accounts receivable are estimated
 - Treated as an expense and charged against revenue
- Estimated uncollectables debited to Bad Debts Expense and credited to Allowance for Impairment (contra asset account) through an adjusting entry at end of each period
- When a specific amount is written off, actual uncollectables are debited to Allowance for Impairment and crediting to Accounts Receivable

June	30	Bad Debts Expense Allowance for Impairment	12 000	12000	
		(To record estimate of impaired receivables)			

Recording write- off of uncollectable account

Sept. I Allowance for Impairment Accounts Receivable — R. A. Ware (Write-off of R. A. Ware account)	500	500
---	-----	-----

Recovery of uncollectable account

Dec.	1	Accounts Receivable — R.A.Ware Allowance for Impairment (To reverse write-off of R.A.Ware account)	500	500
Dec.	1	Cash Accounts Receivable — R.A. Ware (To record collection from R.A. Ware)	500	500

Interest= Face value of note* Annual interest rate* Time in terms of 1 year

Cash Dr

Notes Receivable Cr

Interest Revenue Cr

Notes Receivable Dr

Interest Revenue Cr

Dishonoured notes receivable

Accounts Receivable Dr

Notes Receivable Cr Interest Revenue Cr

TOPIC-7 Chapter-4 & Chapter-8

Completion of the Accounting Cycle & Internal Controls

Temporary (Nominal) Accounts	Permanent (Real) Accounts
Accounts are closed	Accounts are not closed
All revenue accounts	All asset accounts
All expense accounts	All liability accounts
Owner's drawings accounts	Owner's capital accounts

Closing a sales revenue account

Date	Account Name	Debit	Credit
30/6/2014	Sales	15,000	
	Income Summary Account		15,000
	(Transfer of sales to income summary account)		

To close the income summary account

Date	Account Name	Debit	Credit
30/6/2014	Income Summary Account	9,000	
	Owners Equity – Capital		9,000
	(Transfer of income summary account	 to capital accoui	 nt)

Internal Control

- Internal control consists of the plan of the organisation and all the related methods and measures of the business to:
 - safeguard the assets of the business
 - enhance accuracy and reliability of accounting records
- It is an essential part of risk management

Principles of Internal Control

- 1. Establishment of responsibility
- 2. Segregation of duties
- 3. Documentation procedures
- 4. Physical, mechanical and electronic controls
- 5. Independent internal verification
- 6. Other controls

Cash payments are also known as cash disbursements.

Petty cash fund

- A petty cash fund is a cash fund to pay relatively small amounts but still maintain satisfactory control
- Three steps
- 1. Establishing the fund
- 2. Making payments from the fund
- 3. Replenishing the fund

Establishing the fund

Mar.	1	Petty Cash Cash	100	100
		(To establish a petty cash fund)		I

Making payments from the fund

Note: Sum of cash receipts and monies in fund should equal the petty cash total

Replenishing the fund

Mar. I.	Postage Expense	44	ĺ
	Stationery	38	
	Miscellaneous Expense	5	
	Cash		87
	(To replenish petty cash fund)		

Commented [AA1]: Most important question for exam. Also do the explanations of each heading. Will definitely come in exam.

Bank Reconciliation

- Lack of agreement between the books of the business and the bank statement can result from:
 - Time lags preventing both parties recording transactions in the same period
 - Errors by either party in recording transactions
 - Balance per books and balance per bank must be reconciled to their adjusted or correct balances

Steps in the reconciliation procedure

- 1. Identify outstanding deposits
 - Recorded by the business but not by bank
- 2. Identify unpresented cheques
 - Issued by the business but not recorded by bank
- 3. Note any errors discovered in previous two steps
- 4. Trace direct debits and credits
 - Any direct entries recorded by bank but not by business

Operating cycle- Average time that is required to go from cash to cash in producing revenue.

Intangible assets- Non-current resources that do not have physical substance.

DANCE EZY LTD Bank Reconciliation as at 30 April 2013		
Cash balance per bank statement		\$19134.41
Add: Outstanding deposits		2 201.40
Less: Unpresented cheques		
No. 453	\$3 000.00	
No. 457	1 401.30	
No. 460	1 502.70	5 904.00
Adjusted cash balance per bank		\$15431.81
Cash balance per books		\$14816.41
Add: Collection of note receivable \$1000, plus interest		* 0.00
earned \$50, less collection fee \$15	\$1035.00	
Error in recording cheque no. 443	36.00	1 071.00 15 887.41
Less: Dishonoured cheque	425.60	
Account service charge	30.00	455.60
Adjusted cash balance per books		\$15431.81

Outstanding deposits- added back to bank (Cr)

Unpresented Cheques- Deducted from bank

Example:

The cash at bank account in the general ledger of G. Newton & Associates shows a debit balance of \$4000 on 1 December 2013. The total in the cash receipts journal for the month of December is \$3380 and in the cash payments journal is \$3372. The bank statement of 31 December shows a credit balance of \$4636.

After a check of the two sets of records, the following differences were found:

- (i) Cheques shown in the cash payments journal, but not appearing in the bank statement were no. 411 for \$700, no. 412 for \$324, no. 413 for \$86 and no. 414 for \$54.
- (ii) An amount of \$308 appears in the cash receipts journal, but not in the bank statement.
- (iii) A cheque for \$200 from M. Murray that had been entered in the cash receipts journal was dishonoured, due to insufficient funds in Murray's account. No entry has been made in the cash journals to record the dishonoured cheque.
- (iv) Bank and government charges of \$28 appeared in the bank statement, but not in the cash journals.

Required:

- (a) Calculate the balance in the bank ledger account at 31 December 2013.
- (b) Prepare a bank reconciliation statement as at 31 December 2013.

WE NEED TO DETERMINE THE BALANCE OF THE CASH ACCOUNTING (receipts- payments) AFTER THE ADJUSTMENTS TO THE CASH JOURNALS ARE MADE.

ONCE THAT IS ACHIEVED WE CAN COMPLETE THE RECONCILIATION STATEMENT.

Extract of cash receipts journal

Date	Particulars	Bank.	
2013			
Dec 31	Total to date.	\$3380	
	Accounts Receivable		
	(Dish.Cheque)	(200)	
TOTAL	• •	3180	

Extract of Cash Payments Journa	ıl.
---------------------------------	-----

Date	Particulars	Bank.
Dec 31	Total to date	3372
	Bank Charges	28
TOTAL	-	3400

CASH AT BANK ACCOUNT.

2013 Dec 1 Balance Dec 31 CRJ	4000 <u>3180</u>	2013 Dec 31 CPJ	Balance.	\$3400 <u>3780</u>
	<u>\$7180</u>			\$ <u>7180</u>
Jan 1 Balance	3780			

BANK RECONCILIATION STATEMENT AS AT 31st December, 2013.

4944 Less Unpresented Cheques No. 411 700 412 324 413 86 414 54 1164	Balance as per Bank Statement.		\$4636 CR	
Less Unpresented Cheques No. 411 700 412 324 413 86 414 54 1164	Add deposits not credited.			
412 324 413 86 414 54 <u>1164</u>	Less Unpresented Cheques		.,	
413 86 414 54 <u>1164</u>	No. 411	700		
414 54 <u>1164</u>	412	324		
	413	86		
Adjusted cash balance as per bank 3780CR	414	54	1164	
	Adjusted cash balance as per bank		3780CR	

TOPIC-8 Chapter-10

Property, Plant and Equipment and Intangible Assets

- Property, plant and equipment (PPE) are resources that
 - Have a physical substance
 - Are used in the operation of a business
 - Are not intended for sale to customers
- They are also called fixed assets
- They are expected to provide services for a number of years but decline in service potential over their useful lives

Depreciation is the process of allocating to expenses the cost of a PPE asset over its useful (service) life in a rational and systematic manner

Carrying amount (book value) equals cost less accumulated depreciation

Depreciation methods

- 1. Straight-line
- 2. Units-of-activity or production
- 3. Diminishing Balance

Straight-line method

- Depreciation expense same each year as benefits are consumed at same rate each year
- Calculation for annual charge:

Cost of asset – residual value useful life of the asset

Flora's Florists example

• Annual depreciation

(\$13 000 - \$1 000) / 5 = \$2 400

To record Depreciation Expense

Jun 30 Depreciation Expense – Delivery Truck 2 400
Accumulated Depreciation – Delivery Truck
(To record depreciation expense for the year)

2 400

Statement of Financial Position

Delivery Truck	\$13 000
Less Accumulated Depreciation – Delivery Truck	2 400
	\$ <u>10 600</u>

Units-of-production method

- Useful life is expressed in terms of total units of production or use expected from the asset
- Calculation of depreciation cost per unit:

<u>Depreciable cost of asset</u> useful life of the asset

• Depreciation expense:

Depreciation cost	x yearly units of
per unit	production

Flora's Florists example

- · Depreciation per unit
- = \$12 000/100 000 units
- = \$0.12 per unit
 - Depreciation expense
- = \$0.12 x 15 000 units
- = \$1 800

PPE assets may be disposed of by

- Retirement
- Sale
- Exchange

Ex: Hobart Ltd, retires it computer servers. Cost \$ 32,000 and accumulated depreciation \$32,000.

Accumulated Depreciation – Computer Equipment 32 000
Computer Equipment 32 000
(To record retirement of fully depreciated equipment)

Accumulated Depreciation – Delivery Equipment 14 000 Loss on Disposal 4 000

Delivery Equipment

18 000

(To record retirement of delivery equipment at a loss)

Cash proceeds > carrying value

Gain on Disposal (credited)

Cash proceeds < carrying value

Loss on Disposal (debited)

Gain on disposal

o Example

- On 1 January 2014 Wright Ltd sells office furniture for \$16,000 cash
- Original cost was \$60,000
- As at 30 June 2013, accumulated depreciation was \$41,000
- Depreciation expense for first 6 months of 2014 financial year is \$8,000

Jan 1 Depreciation Expense – Office Furniture	8 000		
Accumulated Depreciation – Office Furniture		8 000	
(To record depreciation expense for first 6 mths			
of financial year)			

Cost of office furniture	\$60 000
Less: Accumulated depreciation (\$41 000 + \$8000)	49 000
Carrying amount at date of disposal	11 000
Proceeds from sale	16 000
Gain on disposal	\$ 5 000

Jan 1 Cash	16 000		
Accumulated Depreciation – Office Furniture	49 000		
Office Furniture		60 000	
Gain on Disposal		5 000	
(To record sale of office furniture at a gain)			

Goodwill (Unidentifiable)

Goodwill arises in the acquisition of another business, is not identifiable and cannot be separated from the business and sold (cannot be separated from entity itself)

- Amortisation is the term used to describe the allocation of the cost of an intangible asset to expense
- Intangible assets are assumed to have a limited life and are amortised
- · Patents are amortised over legal or useful life, whichever is shorter

Classes of Intangible Assets

1. Patents

Exclusive right granted by IP Australia enabling recipient to manufacture, sell or otherwise control an invention

2. Copyrights

Gives the owner exclusive right to reproduce & sell an artistic or published work

3. Brand names and trade names

Words, phrases, jingles or symbols that distinguish or identify a particular business or product

4. Franchises and licences

A contractual arrangement under the franchisee is granted certain rights

5. Research and development costs

Expenditures that may lead to patents, copyrights, new processes and new products

- **▼** Goodwill is not amortised but it must be tested at least annually for impairment
- Mineral resources consist of underground deposits of non-regenerating resources such as oil and gas

Two distinguishing characteristics:

- o Physically extracted in operations
- o Replaceable only by an act of nature

The IASB is currently completing a comprehensive project on extractive activities with the aim of producing an IFRS on accounting for extractive activities

- > Capitalisation of pre-production costs is not permitted until a resource is extracted
- Once production has begun, pre-production costs are charged to inventory by amortisation
- > The units-of-production method is generally used to compute amortisation
- > Amortisation expense is the periodic allocation of the cost of natural resources to reflect the units removed
- > Amortisation Expense is reported as a part of the cost of producing the product
- An agricultural activity refers to an entity's management of the biological transformation of biological assets for sale, into agricultural produce or into additional biological assets
- > A biological asset is a living animal or plant
- Biological assets must be recognised
 - when the assets can be reliably measured,
 - it is probable future economic benefits will eventuate, and
 - fair value or cost can be reliably measured
- When harvested, biological assets become agricultural produce and are treated as inventory

Analysis

Ratios are computed to analyse how efficiently an entity uses its assets to generate sales

Asset turnover ratio analyses the productivity of an entity's assets by showing the dollar of net sales produced for each dollar invested

TOPIC-10 Fraud

Fraud

Fraud is any intentional act committed to secure an unfair or unlawful gain.

Errors are caused unintentionally, perhaps arising out of carelessness, oversight, or misinterpretation of facts.

- Anti-fraud professionals such as ACFE define fraud as any attempt to deceive another party to gain a benefit.
- · Formal definition of occupational fraud is:
 - The use of one's occupation for personal enrichment through the deliberate misuse or misapplication of the employing organization's resources or assets.

Forensic Accountant

They are experienced <u>auditors</u>, <u>accountants</u>, and <u>investigators</u> of <u>legal</u> and <u>financial documents</u> that are hired to look into possible suspicions of <u>fraudulent</u> activity within a company; or are hired by a company who may just want to prevent fraudulent activities from occurring.

Types of Fraud

- Asset misappropriation (within firm fraud), employee steals or misuses the organization's
 resources (e.g., theft of company cash, false billing schemes or inflated expense reports
- Corruption, an employee misuses his/her influence in a business transaction in a way that
 violates his/her duty to the employer in order to gain a direct or indirect benefit (e.g., schemes
 involving bribery or conflicts of interest) (RBA banknote scandal)
- Financial statement fraud schemes, in which an employee intentionally causes a misstatement
 or omission of material information in the organization's financial reports (e.g., recording
 fictitious revenues, understating reported expenses or artificially inflating reported assets)

Common Financial Statement Fraud

- · Revenue, accounts receivable and cash
 - Fictitious revenues
 - Early revenue recognition
 - Sales returns
 - Unauthorised credit notes
 - Receivables written off
 - Stolen cash

Commented [AA2]: Most important theory question for exam

Examples of Misappropriation of Assets

- · Skimming, cash larceny
- · Fraudulent disbursements (payments) of cash
- Billing, cheque tampering, payroll, expense reimbursement
- Non cash misappropriations

Six Common Myths about Fraud

1. Anyone capable of committing fraud.

Albrecht et. al. (1984) Fraud perpetrator theory.

- Incentive/Motive (usually financial).
- Perceived opportunity to avoid detection.
- Ability to rationalise theft.

2. Fraud is not material

"There are no immaterial frauds, only ones with insufficient time to grow"

3. Most fraud goes undetected

But as the fraud grows perpetrators become careless.

4. Fraud is usually well concealed

While some frauds are well concealed, the majority are not.

Many discovered by accident or through co-worker inquiry or complaint.

- Employee tips the most common way occupational fraud is detected

5. Prosecuting fraud perpetrator deters others

Mixed results

6. The auditor can't do a better job in detecting fraud

ACFE (2012) found that external auditors detected only 3% of the frauds, and they ranked poorly in limiting fraud losses



Figure 1-Most important

- Hitesh Patel, fraud investigation partner with KPMG Forensic in London, says that companies are
 placing employees under increasingly intense performance scrutiny in an effort to make profits
 during the worst economic downturn since the Great Depression.
- Ironically, as the global financial crisis succeeds in exposing more widespread fraudulent
 activities, Patel expects that desperate individuals and businesses under growing financial
 pressure will keep triggering waves of new frauds. These range from company bosses falsely
 inflating sagging profits to less-senior executives inflating their sales figures to keep muchneeded bonuses.

Risk Factors for Fraudulent Financial Reporting

- Opportunities,
 - Industries where significant judgements and estimates are involved
 - Turnover in accounting personnel
 - High growth company
 - Poor internal controls
 - Poor auditing
 - Poor tone at the top
- Attitudes/rationalisation, e.g.:
 - Poor corporate governance
 - CEO or top manager displays a significant disregard for the financial reporting process
 - Management's character or set of ethical values
 - · Priorities of top management
 - · "Everybody does it"

Examples of Fictitious Revenue

- Fabricating revenue
- Improper recording of sales with conditions (e.g. consignment)
- Improper recording of sales returns and discounts

Tools to identify financial statement fraud - Financial Statement Analysis!

Horizontal Analysis - Trend analysis

Compares ratios or line items in a company's financial statements over a certain period of time that can allow for comparison

Vertical Analysis

A method of financial statement analysis in which each entry for each of the three major categories of accounts (assets, liabilities and equities) in a balance sheet is represented as a proportion of the total account. The main advantages of vertical analysis is that the balance sheets of businesses of all sizes can easily be compared. It also makes it easy to see relative annual changes within one business.

Horizontal analysis

- Used to evaluate a series of financial statement data over a period of time.
- Analyses increases or decreases that have occurred from a particular base year.
- Changes may be expressed as either dollar amounts or percentages.

One year is selected as the base year and then increases or decreases are based on the formula:

Change since = Current year amount – Base year amount base period Base year amount

Alternatively, formula can be expressed as the current year in relation to the base year.

Current results in = Current year amount relation to base period Base year amount

The trend in net profit is influenced by the trend in gross profit and total expenses.

To conduct a *vertical analysis of income statement*, sales figure is generally used as the base and all other components of income statement like cost of sales, gross profit, operating expenses, income tax, and net income etc. are shown as a percentage of sales

Vertical analysis states financial statements in a comparable common-size format (percentage form). One of the advantages of common-size analysis is that it can be used for inter-company comparison of enterprises with different sizes because all items are expressed as a percentage of some common number

TOPIC-9 Chapter-14 & Chapter-15

Shares and Dividends

Characteristics of company

- · Separate legal entity
- No mutual agency
- · Limited liability of shareholders
- · Transferable ownership rights
- Ability to acquire capital
- · Continuous life
- · Separation of ownership and management
- Subject to government regulations
- · Company taxation

Par and no-par value shares

- Par value is an arbitrary amount assigned to each share
- Par value has no relationship with market value and is usually immaterial
- In Australia and New Zealand shares are issued with no par value
- In other countries (eg USA) shares can be issued with or without par value

Profit and Loss Summary 130 000
Retained Earnings 130 000
(To close Profit and Loss Summary and transfer profit to retained earnings)

Cash Dr. 1 000
Ordinary share capital Cr. 1 000
(To record issue of 1000 ordinary shares at issue price of \$1)

Steps to record Share issue in Installment

- 1. Money receive on applications
- 2. Reject Money on application (if applicable)
- 3. Transfer the application and allotment (if applicable) amounts to share capital
- 4. Transfer the balance in the cash trust account to cash account
- 5. Receive allotment money
- 6. Calls and
- 7. Receive call money

Cash Trust account Dr. **Application Account** Cr. (Receive application money) **Application Account** Cash Trust account Cr. (Reject additional application money) **Application Account** Dr. Allotment Account Dr. Share Capital account Cr. (Transfer to share capital) Cash Account Dr. Cash Trust account Cr. (Transfer balance on cash trust to cash account) Cash account Dr. Allotment account Cr.

(Receive allotment money)

Calls Account(s) Dr.

Share Capital Account Cr.

(Request for calls)

Cash account Dr.

Call(s) account(s) Cr.

(Receive call money)

Example

- Company wishes to issue 1000 shares at issue price of \$10 per share
 - \$4 on application
 - \$4 on allotment
 - \$2 call at date to be decided by Directors
- Applications for shares are received on 30 April
- On 25 May, shares are issued (allotted)
- Subsequent payment received 31 May

Apr 30 Cash (Trust Account) Application (To record receipt of application monies, held in trust)	4 000	4 000
May 25 Application (1000 x \$4) Allotment (1000 x \$4) Ordinary Share Capital (To record the issue of 1000 shares)	4 000 4 000	8 000
May 25 Cash Cash (Trust Account) (Transfer of application money to bank account)	4 000	4 000
May 31 Cash Allotment (To record cash received due on allotment)	4 000	4 000

- o On 25 June, Directors decide to call up money still owing on shares
- o On 30 June, monies are received

Journal entries:

Jun 25 Call (1000 x \$2) Ordinary Share Capital (To record the balance outstanding on partly paid shares)	2 000	2 000
Jun 25 Cash Call (To record receipt of call monies)	2 000	2 000

Oversubscription of Shares

- Action Limited is incorporated on Feb 3, 2013
- Mar 1 A prospectus is issued for the issue of 100 000 shares at \$1 each. Applications close on March 31.
- Mar 31 Applications for 150 000 shares have been received.
- Apr 5 Directors allot the 100 000 shares and refund those who are unsuccessful.

Date	Account Name	Debit	Credit
31/3/2013	Bank – Trust Account	150,000	
	Application		150,000
	(Cash received on application)		

Date	Account Name	Debit	Credit
5/4/2013	Application	100,000	
	Allotment		100,000
	(Allotment of 100,000 \$1 shares)		
Date	Account Name	Debit	Credit
5/4/2013	Cash At Bank	100,000	
	Bank – Trust Account		100,000
	(Transfer of cash on allotment of shares)		
Date	Account Name	Debit	Credit
5/4/2013	Application	50,000	
	Bank – Trust Account		50,000
	(Refund of application monies for excess		

MARYSVILLE LTD Statement of Financial Position (partial)		
Shareholders' equity		
Share capital 400 000 ordinary shares, fully paid	\$	800 000
30 000 preference shares,	φ	000 000
\$1.70 per share annual dividend, fully paid		45 000
Total share capital		845 000
Retained earnings		058 000
Total shareholders' equity	<u>\$1</u>	903 000

Dividends

Dec 1	Retained Earnings Dividends Payable	50 000	50 000
	(To record declaration of cash dividend of 50c per share on 100 000 shares)		

Entries for cash dividends

• Four dates are important in connection with dividends

1. Declaration date

o Board of Directors formally declares a cash dividend and a liability is recorded

2. Record date

 Date on which company closes its share register and determines the shareholders entitled to receive the dividend

3. Ex-dividend date

- o Usually 4th business day before company's record date
- o Dividend only paid to shareholders who purchase shares before record date

4. Payment date

- o Date dividend cheques are mailed or transferred electronically to shareholders
- o Date on which payment of dividend is recorded

Jan 20	Dividends Payable	50 000
	Cash	50 000
(To record payment of cash dividend)		

For non-cumulate preference shares, only current year's dividend must be paid before paying any dividends to ordinary shareholders

Example

- As at 30 June 2013
 - 1000 8% \$100 cumulative preference shares
 - 50 000 ordinary shares issued at \$10
 - Directors declares \$6000 cash dividend

Jun 30	Retained Earnings	6 000	
	Dividends Payable		6 000
	(To record \$6 per share cash dividend to		
	preference shareholders)		

- Preference dividend should have been 8% x \$100 = \$8
- Therefore, \$2 per share are in arrears

- As at 30 June 2014
 - Directors declare \$50 000 cash dividend
 - Allocation between classes of shares:

Total dividend		\$50 000
Allocated to preference shares		
Dividends in arrears, 2013 (1000 x \$2)	\$2000	
2011 dividend (1000 x \$8)	8000	10 000
Remainder allocated to ordinary shares		\$40 000

Entry to record Declaration of Dividend

o Entry when dividend is declared

Dec 1	Retained Earnings (or Share Dividends Declared)	75 000
	Share Dividends Payable	75 000
(To record declaration of 10% share dividend)		

o Entry when dividend is paid

Jan 20 S	Share Dividends Payable	75 000	
	Ordinary Share Capital	75 000	
(To record the issue of 5000 shares valued at \$75 000 as a share dividend)			

Retained Earnings

- Retained earnings is profit that is retained in the company
- The balance in retained earnings is part of the shareholders' claim on the total assets of the company
- It does not represent a claim against any specific asset

A loss for a period is recorded in Retained Earnings by a closing entry in which Retained Earnings is debited and Profit and Loss Summary is credited

Shareholders' equity with deficit:

Statement of Financial Position (partial)

Shareholders' equity
Share capital
Retained earnings (deficit)
Total shareholders' equity

\$800 000 (50 000) \$750 000

Income Tax Expense 46 800
Income Taxes Payable
(To record income taxes for 2013)

46 800