

## Week 1: The Recording Process

### Why is accounting important?

- Accounting plays a significant role in society, providing information for decision-making.
- **Financial Accounting:** The provision of accounting info (f/s and related info) to parties outside of the organisation like investors, customers. F/s need to be prepared in accordance to GAAP. Includes process of classifying/recording all bz transactions which enables preparation of financial statements and related disclosures.
- **Management Accounting:** Provision of accounting information to parties within org, usually managers.

**Accounting:** Process of identifying, measuring, recording and communicating the economic transactions and events of a business operation.

**Conceptual Framework:** Defines nature, purpose and content of GPFR.

### Purpose of AASB Conceptual Framework (2019):

- Assist IASB to develop accounting standards based on consistent underlying concepts.
- Assist preparers to develop consistent accounting policies when no accounting standard applies to a particular transaction or event.
- Assist all financial statement preparers and users interpret, understand and apply accounting standards.

### Objective of GPFR

#### 1. Information Usefulness

Provide financial info about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions related to providing resources to the entity. Those decisions involve decisions about:

- Buying, selling or holding equity and debt instruments.
- Providing or selling loans and other forms of credit.
- Exercising rights to vote on, otherwise influence, management's actions that affect the use of entity's economic resources.

#### 2. Stewardship

To make assessments, existing and potential investors, lenders and other creditors need info about the:

- Economic resources of the entity, claims against the entity and changes in those resources and claims.
- How efficiently and effectively the entity's management and governing board have discharged their responsibilities to use the entity's economic resources.

**Reporting Entity:** An entity required or chooses to prepare f/s. Can be a single entity or a portion of an entity or can comprise more than one entity. Not necessarily a legal entity.

- Prepares GPFS that comply with Corporations Act and Australian accounting standards.
- AASB1053 further refines this professional judgment based on public accountability. Tier 1 applies all accounting standards. Tier 2 applies reduced number of accounting standards.

\*AASB is NON-EXAMINABLE in ACCT1006.

**General Purpose Financial Statements (GPFS):** Intended to meet the needs of users who are not in a position to require an entity to prepare reports tailored to their particular information needs.

### Public Accountability Characteristics

- Debt or equity instruments are traded in a public market or in the process of issuing such instruments for trading in a public market (domestic or foreign stock exchange or an over-the-counter market, including local and regional markets).
- Hold assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses.

**Asset:** Present economic resource controlled by the entity as a result of past events.

**Economic Resource:** Right that has the potential to produce economic benefits.

### **Characteristics of Asset:**

- Economic resource controlled by the entity.
- Exists as a result of past events.
- Right has the potential to produce economic benefits.

### **Rights can take many forms:**

- Rights to receive cash such as property, PPE or inventories.

Control relates to capacity of a reporting entity to benefit from an asset and to deny or regulate access of others to that benefit. Does not necessarily mean ownership.

Potential means an economic benefit must occur in at least one circumstance or possible use.

**Liability:** Present obligation of the entity to transfer an economic resource as a result of past events. Can be settled in diff ways, paying cash, transferring g/s or issuing shares.

### **Characteristics of Liability**

- Present obligation of entity
- Exists as a result of past event
- Obligation is to transfer an economic resource

**Obligation:** Duty or responsibility that entity has no practical ability to avoid. Arises after transaction has taken place and cannot be an intention for a future transaction.

**Equity:** Residual interest in the assets of the entity after deducting all its liabilities. Cannot be independently defined as it's directly dependent on definition of assets and liabilities.

**Type of Equity Accounts:** Contributed equity, reserves, retained earnings.

Equity = Assets - Liabilities.

**Income:** Increases in assets, or decreases in liabilities that result in increases in equity other than those relating in contributions from holders of equity claims. **Includes:**

- **Revenue:** Increases in economic benefits arising in the course of ordinary activities like sales revenue, rent, dividends.
- **Gains:** Other increases in economic benefits that don't arise from ordinary course of bz like gains from the sale of NCA.
- Definition of income is linked to definition of assets and liabilities.

**Expenses:** Decrease in assets, or increases in liabilities that result in decreases in equity other than those relating to distributions to holders of equity claims. **Include:**

- **Expenses:** Decreases in economic benefits that arise in the ordinary activities of the entity like cost of sales, salaries.
- **Losses:** Expenses that don't necessarily arise in the ordinary course of bz, like loss from natural disasters.
- Definition of expenses is linked to the definition of assets and liabilities.

**Recognition:** Process of capturing and including a transaction or event in financial statements.

### **Recognition Criteria**

Transaction or event is only recognised in f/s when:

- Meets definition of an asset, liability, equity, income or expense.
- Satisfies Conceptual Framework (2019) recognition criteria of:
  - Relevant info about assets, liabilities, equity, income and expenses. This is affected by low probability of an inflow/outflow of economic benefits and existence uncertainty.

- Faithful representation of those items because the aim is to provide useful info to investors, lenders and other creditors. May be affected by measurement uncertainty.

## The Recording Process: Double Entry Accounting (Bookkeeping)

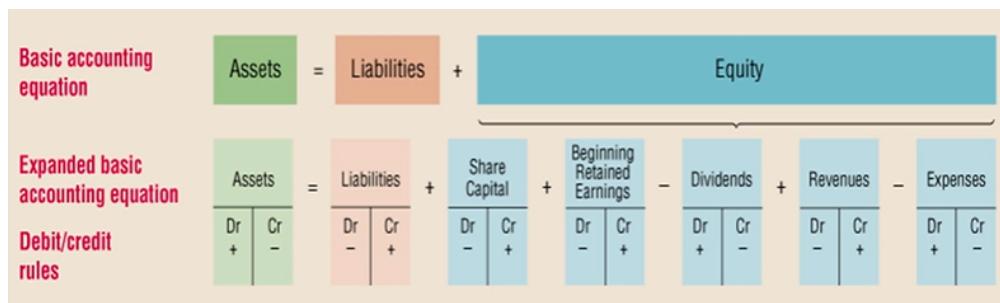
- Classify bz transactions with at least two impacts on the accounting equation.  
$$A = L + OE$$
- Flow of information from recording process is source documentation (transactions) to journals to general ledger accounts through posting.

**Source Documents:** Evidence of transaction, some form of documentation with the description of the transaction (including timing) and financial amount of the transaction.

## STEP 1 ACCOUNTING CYCLE

## Analysing Transactions

- Expanding accounting equation involves: Opening R/E + Profit - Dividends.
- The expenses used to find profit involves retained earnings and share capital.
- Rules of double entry is when debit increases, asset increases. When credit increases, either liability or equity increases too. Vice versa, so when credit decreases, assets are affected. Decrease in debit affects liability and equity.



## General Ledger Account

- Basic record of account.
- All assets, liabilities and equity categories have different accounts.
- Transaction info is entered into these records as debit and credit.
- When writing out the account, there are two formats: T-account and running balance format.

## 1. T-Account format:

**Account Title**

The diagram illustrates a T-account structure. It features a central vertical line with a horizontal bar extending from its top. The left side of the T-account is labeled "Left / debit side" and the right side is labeled "Right / credit side". Each side contains a red oval labeled "Transaction entries". Below each oval, the text "Balance (Dr)" and "Balance (Cr)" is written, followed by a dollar sign and three underscores ("\$xxx").

## 2. Rolling balance format

Bank Account					
Date	Account	Folio	Debit	Credit	Balance
1-Jun-13	Opening balance		15000		15000 Dr
2-Jun-13	Rent			10000	5000 Dr
3-Jun-13	Sales		20000		25000 Dr
4-Jun-13	Salaries			15000	10000 Dr
5-Jun-13	Repairs			13000	3000 Cr
6-Jun-13	ABC Ltd		25000		22000 Dr

**Chart of Accounts:** Complete listing of accounts in the accounting system. Numerical reference for each account which will be used in recording the transaction.

ASSETS		LIABILITIES		EQUITY		REVENUES		EXPENSES	
Ref	Account	Ref	Account	Ref	Account	Ref	Account	Ref	Account
100	Cash	200	Accounts payable	300	Share capital	400	Service revenue	501	Salaries expense
101	Accounts receivable	201	Wages payable	310	Retained earnings	402	Commissions revenue	502	Supplies expense
102	Prepayments	205	Revenue received in advance	320	Dividends	405	Other income	503	Rent expense
104	Supplies	210	Bank loan	330	Profit/loss summary	410	Investment income	510	Interest expense
110	Intangibles							515	Other operating expenses

## Introduction to Recording Process

## Steps

1. Analyse each transaction.
2. Enter a transaction in a journal.
3. Transfer journal information to ledger accounts.

## STEP 2 ACCOUNTING CYCLE

### Journalising Transactions

Initial entry into accounting system of transaction information:

- Listed in date order (chronological listing), called general journal.
- Contains info for each transaction and effect on asset, liability, owner's equity accounts.
  - Standard format includes a description of the transaction (called narration)

<b>The journal</b>					
Initial entry into accounting system of transaction information: +1/01/24 → owner contributes cash 13,000					
DATE	Dr Account Cr Account (Narration – simple description)	\$ xxx	\$ xxx	\$ 13,000 Cr Share capital (Contribution of capital by owner)	\$ 13,000

## Week 2: The Recording Process (Cont)

**STEP 3 Posting to Ledger Accounts:** When information is transferred from journals to respective ledger accounts.

### Steps:

- Locate general ledger account to be debited (use acc no from chart of accounts).
- On debit side, enter transaction date, cross reference and amount in account.
- Locate general ledger account to be credited.
- On credit side, enter transaction date, cross reference and amount in account.

**STEP 4 Trial Balance:** Listing of all general ledger accounts and their balances. Essential step in accounting cycle because it checks the integrity of the double entry process (debits = credits).

### Trial Balance Does NOT:

- Pick up missing journal entries
- Pick up journal entries that weren't posted
- Incorrect amounts in journal entries & Dr/Cr wrong way
- Pick up offsetting errors or posting to wrong accounts

### Accrual VS Cash Basis of Accounting

**Accrual-based Accounting:** Reflect transactions when they occur.

- Revenue recognised when earned (when goods are delivered, services provided).
- Expenses recognised when incurred (when assets are consumed or liabilities incurred).

### Cash-based Accounting

- Revenue recognised when cash is received or paid.
- Expenses recognised when cash is received or paid. Profit or Loss is diff between cash in and cash out.

**Example:** Taylor's Shop services a car on 30 April. Customer picks up vehicle on 1 May and pays via EFT on 5 May. Taylor's mechanic is paid wages on 1 May for work they performed in April.

Taylor would show revenue was earned if cash accounting was used when it occurred, so 5 May. Wage expense would be recorded 1 May. If accrual accounting is used, it would show revenue was earned on 30 April, when the service was performed. So would the wages expense (April).

### Accrual Accounting

- **Period Assumption:** Economic life of business can be divided into artificial periods.
- **Expense Recognition Criteria:** Expenses recognised in the period when the reduction in assets or increase in liabilities become probable and can be measured reliably.
- **Revenue Recognition Criteria:** Revenues recognised in the period in which the increase in assets or decrease in liabilities become probable and can be measured reliably.
- **Revenue & Expense Criteria:** Form part of GAAP.

## Accrual Accounting: Adjusting Entries

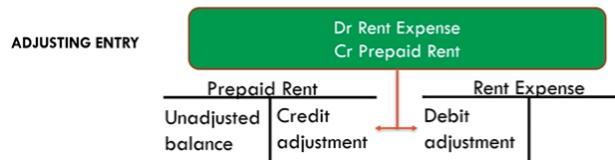
- **WHY?** Needed to ensure recognition criteria is followed for assets, liabilities, revenues and expenses. Revenue and expenses are then recorded in the correct accounting period.
- **WHEN?** Adjust entries are required every time financial statements are prepared.
- Without adjusting entries, financial info would not be accurate.

## STEP 5 ACCOUNTING CYCLE

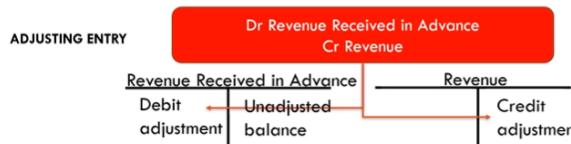
### Types of Adjusting Entries: Prepayments & Accruals

#### Prepayments

1. **Prepaid Expenses:** Cash outflow precedes the entity receiving goods or services. Initially treated as either assets or expenses. Adjustment needed for economic benefits which have “expired”.
  - BEFORE ADJUSTING: Dr Prepaid Rent | Cr Cash at Bank
  - ADJUSTING ENTRY: Dr Rent Expense | Cr Prepaid Rent



2. **Revenue Received in Advance:** Cash inflow precedes the entity supplying goods or services to customers. Initially treated as a liability or revenue. Adjustment needed.
  - BEFORE ADJUSTING: Dr Cash | Cr Revenue Received in Advance
  - ADJUSTING ENTRY: Dr Revenue Received in Advance | Cr Revenue



#### Accruals

1. **Accrued Revenues:** Amounts not yet received or recorded for which goods or services have been provided (not yet recorded).
  - **Example:** At the end of financial year (30 June) services are performed but not yet invoiced. An invoice of \$12,500 is being prepared and will be sent out on 2 July.
  - ADJUSTING ENTRY: Dr Accounts Receivable \$12,500 | Cr Service Revenue \$12,500
2. **Accrued Expenses:** Receipt of goods or provision of services precedes cash outflow to suppliers (not yet recorded).
  - **Example:** Salaries outstanding for October, salaries total to \$30,000 per week, paid fortnightly. So,  $\$30,000 / 5 \text{ days} = \$6,000 / \text{day}$ .  $\$6,000 \times 3 = \$18,000$ .
  - **Journal Entry:** Dr Salaries Expense \$18,000 | Cr Salaries Payable \$18,000
  - General Ledger Entry

Salaries Expense		Salaries Payable
12/10	60,000	
26/10	60,000	
31/10	Adj. 18,000	31/10 Adj. 18,000

## Week 3: Completing the Accounting Cycle

## STEP 6 ACCOUNTING CYCLE

### Adjusted Trial Balance

- Listing of all general ledger accounts and their balances. Run after adjusting entries have been posted. Check debits = credits in the system.
  - Internal document
  - Accountant check for reasonableness
  - Run many times to ensure numbers are ready for financial statement preparation

## STEP 7 ACCOUNTING CYCLE → Prepare Financial Statements