

Topic 1 Double-Entry Accounting System

Nature of Accounts

Assets normally have a debit balance

liabilities and equity normally have a credit balance

Revenues have a credit balance

expenses have a debit balance

Examples

Assets DR	Liabilities CR	Equity CR	Revenue Cr	Expenses DR
Cash	Accts Payable	Share Capital	Sales	Electricity exp
Acct Rec	Loan	Retained Profits	Dividend Revenue	Income tax exp
Inventory	Income Tax Payable	Reserves	Interest Revenue	Rent expense
Furn & Fittings	Wages Payable		Other Revenue	Sundry expense
Land & Buildings	Revenue Received in Advance			Depreciation exp
Investments	Mortgage			Amortisation exp
Intangibles	Provisions			
Prepayments				

Accounting equation

Assets = Liabilities + Equity

An increase in an asset is a Debit, therefore the other side of the transaction needs to be a Credit.

Possible credits include:

- Another asset may have decreased
- A liability may have increased and/or
- Shareholders' equity may have increased

External users

Existing/potential shareholders

Creditors

Suppliers

Customers

Employees

Competitors

Analysts

Media

Government agencies

Accrual accounting

Transactions are recorded when the event has happened/ been incurred, regardless of when cash is paid or received

Profit = Income – Expenses

Cash accounting

Transactions are recorded when cash is paid or received

Cash Profit = Cash inflows – Cash outflows

Financial Performance

The enterprise's ability to generate new resources from day-to-day operations over a period of time, via dealing with customers, employees and suppliers

Measured by the net profit figure in the income statement

Financial Position

The enterprise's set of assets, liabilities and owners' equity at a point in time

Measured by the balance sheet

5 Account Types in Accounting

1. Asset
2. Liability
3. Equity
4. Income
5. Expenses

Recognition Criteria for Assets

An item is recorded as an asset if:

- (1) It is probable that any future economic benefit associated with the item will flow to the entity
- (2) The item has a cost or value that can be measured with reliability.

Asset Examples

Cash

Inventory

Accounts Receivable

Recognition Criteria for Liabilities

An item is recorded as a liability if:

- (1) It is probable that any future economic benefit associated with the item will flow from the entity
- (2) The item has a cost or value that can be measured with reliability

Liability Examples

Accounts Payable

Provisions

Tax Liabilities

Income

Increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities

Result in increases in equity

Revenue

Gross inflow of economic benefits during the period arising in the course of the ordinary activities of an entity
inflows result in increases in equity

4 elements:

1. Inflow of economic benefit.
2. Increase in assets/decrease in liabilities.
3. Increase in equity.
4. Not contribution by owners (i.e. not capital).
E.g., sales/services/interest revenue.

Gains

Other items that meet the definition of income.
May or may not arise in the course of the ordinary activities of an entity.
E.g., gain on sale or disposal of non-current assets, gain on revaluation of assets.

Expense

Decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrance of liabilities
result in decreases in equity
eg. wages, advertising

Topic 2: Accounting Cycle Completed

Purpose of Accrual Accounting Adjustments

Make the financial statements as reliable as possible.

Identify with each accounting period the revenue earned in that period and to determine the expenses associated with generating the period's revenue.

Revenue - expense = profit or loss for the period

Purpose of depreciating non-current assets

The depreciating of noncurrent assets spreads the costs of the assets over their useful lives to match the consumption of those costs to the revenue gained from their use.

Depreciation

Allocation of the cost of a noncurrent asset to expense over the life of the asset to recognise the consumption of the asset's economic value.

Accumulated depreciation

Ledger account that accumulates total depreciation expense over a number of years.

The account balance is deducted from the asset's cost to arrive at book value.

Adjusting entries

Adjust revenues and expenses (& the related asset and liability accounts)

to:

record revenue in the period in which it is 'earned'

record expenses in the period in which they have been 'incurred'

Deferrals

Prepaid expenses eg. rent in advance, prepaid insurance or depreciation

Initially recorded as an asset.

Adjustment → to recognise the portion of asset used by end of period

Adjusting entry:

Dr. Expense

Cr. Prepaid asset

Unearned revenue eg. airfares or newspaper subscription fees paid for in advance by customers

Initially recorded as a liability

Adjustment → to recognise the portion of revenue earned by end of period

Adjusting entry:

Dr. Unearned Revenue

Cr. Revenue

Accruals

Accrued expenses eg. wages owed but not yet paid at balance day

Adjustment → to recognise expense incurred but not yet paid.

Adjusting entry:

Dr. Expenses

Cr. Payable (Accrued expense)

Accrued revenue eg. interest earned but not yet received at balance day

Adjustment → to recognise revenue earned but not yet received

Adjusting entry:

Dr. Receivable (Accrued revenue)

Cr. Revenue

Closing entries

Close revenue accounts

Dr Revenue

Cr P&L Summary

Close expense accounts

Dr P&L Summary

Cr Expense

Transfer net profit from P&L Summary to Retained Profits

Dr P&L Summary

Cr Retained Profits

Close Dividends account

Dr Retained Profits

Cr Dividends

Journal Entry for Depreciation

Dr Depreciation expense – Asset

Cr Accumulated depreciation – Asset

For intangible assets

Dr Amortisation expense – Asset

Cr Accumulated amortisation – Asset

Directly write off an account

Dr Bad Debts Expense

Cr Accounts Receivable

Allowance Method

Dr Bad or Doubtful Debts Expenses

Cr Allowance for Doubtful Debts

When debt is deemed uncollectible

Dr Allowance for Doubtful Debts

Cr Accounts Receivable