1 Lecture 1

Fundamental Accounting Equation

$$\text{Assest} = \text{Liabilities} + \text{Equity}$$
$$\text{Net worth} = \text{Assets} - \text{Liabilities}$$
$$\text{Assets} = \text{Liabilities} + \text{Share Capital} + \text{Retained Earnings}$$
$$\text{Assets} = \text{Liabilities} + \text{Share Capital} + \text{Revenues} - \text{Expenses} - \text{Dividends}$$
$$\text{Equity} = \text{Share Capital} + \text{Retained Earnings}$$
$$\text{Retained Earnings} = \text{Revenues} - \text{Expenses} - \text{Dividends}$$

1.1 Conceptual Framework

Element	Definition
ASSETS	A **resource** controlled by the entity in the **present** Due to **past event** That will give rise to **future benefits**
LIABILITIES	A **present obligation** Arising from **past event** That is **expected** to lead to a **future outflow** of resources **upon settlement** Creditor's claim on assets
EQUITY	**Owner's claim** on the **residual interest** in the assets after deducting all liabilities Representing the **net assets** (total assets – total liabilities) of the company Claims arising from: 1. **Share Capital/Capital Stock** = portion of equity contributed by owners into the company in exchange for shares/stock 2. **Retained Earnings** = equity earned by the company. The accumulated earnings of the business that have not been distributed to owners

2 Lecture 02 - Account Classification & Recording Process

2.1 Basic Financial Statements

(1) Statement of Financial Position (SFP) – also known as the Balance Sheet

Assets = Liabilities + Equity

(2) Statement of Profit & Loss (SPL) – also known as the Income Statement

Net Income = Revenues – Expenses + Gain/(Loss)

(3) Statement of Changes in Equity (SCE)

Beg Equity + Net Changes in Capital + Net Income – Dividends + OCI* = End Equity

(4) Statement of Cash Flows (SCF)

Changes in Cash = CFO + CFI + CFF

2.2 Debit and Credit Structure

Each account has both debit and credit sides. Debit is on the left side and credit is on the right side.

$$\text{Debit} = \text{Credit}$$

Important: Debit does not always mean you owe someone and credit does not always mean increase — it depends on the account type.

2.3 5 Account Types

Account Type	Normal Balance	Debit ↑	Credit ↑
Assets	Debit	Increase	Decrease
Expenses	Debit	Increase	Decrease
Dividends	Debit	Increase	Decrease
Liabilities	Credit	Decrease	Increase
Equity	Credit	Decrease	Increase
Revenues	Credit	Decrease	Increase

2.4 Transaction Definition

A transaction is a past event that has an economic impact on the company.

- **External Event:** An event that involves the exchange of assets/services of one party for assets/services/liabilities of other parties
- **Internal Event:** An event that happens internally and has a direct effect on the accounting entity

2.5 Transaction Recording Process

2.5.1 Step 1: Analyse Transaction

To be able to record a transaction, we need some kind of document, for example: invoice, sales receipts, purchase order, etc.

2.5.2 Step 2: Record Transaction in Journal

We have to create an official dated record in the journal with the accounts, debit first, credits indented, and then a short narration.

2.5.3 Step 3: Post Journals to Ledger Account

Transfer information from journals to ledger accounts at the end of an accounting period. The ledger houses all the different types of accounts.

2.5.4 Step 4: Prepare the Trial Balance

List **all** accounts with their **ending balances** and check **Debit = Credit**.

Every account name once, with its normal-side balance (assets/expenses on the debit side; liabilities/equity/revenues on the credit side).

2.6 Trial Balance Notes

- Trial balance lists accounts in financial statement order: assets, liabilities, stockholders' equity, revenues and expenses
- Trial Balance helps in the preparation of financial statements

2.7 Example Trial Balance

Assets	Amount (Debit)	Liabilities & Equity	Amount (Credit)
Cash	100,000	Accounts Payable	20,000
Accounts Receivable	50,000	Long-term Debt	45,000
		Common Stock	50,000
		Retained Earnings	35,000
Total Assets	**150,000**	**Total Liabilities + Equity**	**150,000**

(Debit = Credit)

2.8 Return on Assets

$$\text{Return on assets} = \frac{\text{Net profit}}{\text{Average total assets}}$$

3 Lecture 3 - Accrual Accounting & Adjustments

3.1 Accrual Accounting

- Revenue: when **earned** (not when paid)
- Expenses: when **incurred** (not when paid)

3.2 Revenue Recognition Criteria

All 4 required:

1. **Goods/services delivered**
2. **Price is fixed**
3. **Payment arrangement exists**
4. **Collection reasonably assured**

3.3 Good Revenue Examples

- PDF subscription \$120/year ⟶ Recognize \$10/month
- Invoice "Pay in 30 days" ⟶ Can recognize now
- Sell to Apple on credit ⟶ Collection assured

3.4 Bad Revenue Examples

- "Pay me when you can" ⟶ No written agreement
- Customer near bankruptcy ⟶ Collection not assured
- Service not delivered yet ⟶ Wait until performed

3.5 Contra asset

3.6 Key Rule: Credit is the Normal Balance

Contra assets have a CREDIT balance (opposite of regular assets)

Account Type	Normal Balance	To Increase
Regular Asset	Debit	Debit
Contra Asset	Credit	Credit

3.7 Why?

Contra assets **reduce** the value of related assets, so they behave opposite to normal assets.

3.8 Depreciation Formula

$$\text{Annual Depreciation} = \frac{\text{Cost} - \text{Residual Value}}{\text{Useful Life}}$$

Key Point: Use contra asset account (XA) - don't reduce asset directly!

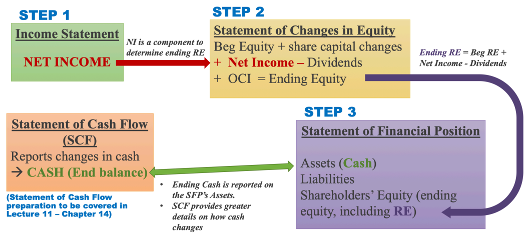
3.9 Depreciation Example

Equipment: \$50,000 Less: Accumulated Depreciation: (\$10,000) **Net Equipment: \$40,000**

		Unearned Revenues	Accrued Revenues
During the period	Cash received before revenue earned	Cash (A) Dr Unearned Rev (L) Cr	None *
End-of-period Adjustments	**Company has earned revenue in the period**	**Unearned Rev (L) Dr Sales Rev (Rev) Cr**	**Receivables (A) Dr Sales Rev (SE) Cr** *
Next Period	Cash received after revenue earned	None	Cash (A) Dr Receivables (A) Cr
Effect on Financial Statements **Prior** to Adjustments *(i.e. if without adjustments, the FS of the company would be under/over stated)*		Balance Sheet: • Liability overstated • Equity understated Income Statement • Revenue understated	Balance Sheet: • Asset understated • Equity understated Income Statement • Revenue understated

		Prepaid Expenses	Accrued Expenses
During the period	Cash paid before expense incurred	Prepaids (A) Dr Cash (A) Cr	None *
End-of-period Adjustments	**Company must recognize expense**	**Expense (Exp) Dr Prepaids (A) Cr**	**Expense (Exp) Dr Payables (L) Cr** *
Next Period	Cash paid after expense incurred	None	Payables (L) Dr Cash (A) Cr
Effect on Financial Statements **Prior** to Adjustments *(i.e. if without adjustments, the FS of the company would be under/over stated)*		Balance Sheet: • Asset overstated • Equity overstated Income Statement • Expense understated	Balance Sheet: • Liability understated • Equity overstated Income Statement • Expense understated

4 Lecture 4 - Financial Statement Preparation & Closing



4.1 Adjusted Trial Balance (ATB)

- Prepared **after adjustments** (accruals, prepaids, depreciation)
- Source document for preparing financial statements

4.2 Financial Statements

4.2.1 Income Statement (IS)

Shows profitability over a period. How much profit or loss a company made over a period of time.

```
Gross Profit = Sales Revenue − COGS
Operating Income = Gross Profit − Operating
Expenses
Net Income = Operating Income − Tax Expense
```

4.2.2 Statement of Changes in Equity (SCE)

Explains movement in equity accounts. The SCE shows how the owners' equity changed during the accounting period.

```
Ending RE = Beginning RE + Net Income − Dividends
```

4.2.3 Statement of Financial Position (SFP)

Snapshot of financial position at period end. what it owns (assets), what it owes (liabilities), and what's left for the owners (equity).

```
Assets = Liabilities + Equity
```

Classification:

- Current Assets vs Non-current Assets
- Current Liabilities vs Non-current Liabilities
- PPE shown at: Cost − Accumulated Depreciation

4.3 Closing the Books

Account Type	Action
Temporary Accounts (Revenues, Expenses, Dividends)	Close to RE
Permanent Accounts (Assets, Liabilities, Share Capital, RE)	Carry Forward

Purpose: Reset temporary accounts to 0 for next period

Accounts We Close (Temporary Accounts):

- All Revenue accounts (Sales Revenue, Service Revenue, etc.)
- All Expense accounts (COGS, Salaries, Rent, Depreciation, etc.)
- Dividends

4.4 Post-Closing Trial Balance

- Prepared **after** closing entries
- Contains only **permanent accounts**
- Confirms books are balanced for next period

4.5 Key Ratio - Net Profit Margin

$$\text{Net Profit Margin} = \frac{\text{Net Profit}}{\text{Net Sales}}$$

- Measures profitability efficiency
- Higher margin = more profit from each dollar of sales

5 Financial Integrity

6 Cash

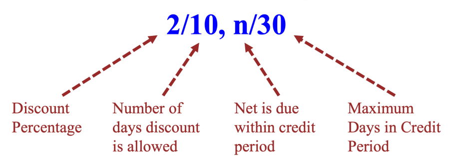
Cash: Currency, coins and amounts on deposit in bank accounts, checking accounts, and some savings accounts. Also includes items such as customer checks, cashier checks, certified checks, and money orders.

Cash Equivalents:

Short-term, highly liquid investments that are:

1. Readily convertible to known amounts of cash.
2. Subject to an insignificant risk of changes in value.

6.1 Credit Terms



6.2 Contra Revenue

Section	Account	Amount
Revenue	Sales Revenue	100,000
	Less: Sales Returns & Discounts	(7,800)
	Net Sales	**92,200**

Concept	Normal Balance	Effect	Appears in	Example
Revenue	Credit	Increases income	Income Statement	Sales Revenue
Contra-Revenue	Debit	Decreases income	Income Statement	Sales Discounts, Sales Returns
Net Sales	–	Actual revenue after reductions	Income Statement	Sales - Discounts - Returns

7 Receivable

Accounts Receivables (Trade Receivables)

- Amounts due from customers for credit sales as a result of selling goods or providing services during the normal course of business.
- Regarded as a fairly liquid asset – usually reported after cash and current investments on the Statement of Financial Position (SFP)

Notes Receivables

- A promissory note to pay a specified amount of money, usually with interest, either on demand or at a definite future date.
- Sometimes an accounts receivable can be converted to a note if a customer requests additional time to pay a past-due accounts receivable account.

7.1 Allowance Method

E.g. At the end of **2024**, Takashimaya estimates that 10% of its $500,000 Accounts Receivable may be uncollectable. (10% x 500,000 = $50,000)

1) Record ECL:

Dec 2024	Expected Credit Loss	$50,000	
	Loss Allowance*		$50,000

2) Write off: In February **2025**, Soft Towel Store has gone bankrupt and Takashimaya determines that Soft Towel's accounts receivable of $2,500 will be uncollectible.

Feb 2025	Loss Allowance	$2,500	
	Accounts Receivable – Soft Towel		$2,500

	Before Write-Off	After Write-Off
Accounts Receivable	500,000	497,500
Less Loss Allowance	50,000	47,500
Accounts Receivable (reported on SFP)	**450,000**	**450,000**

7.2 Accounts Receivables Turnover

$$\text{AR Turnover} = \frac{\text{Net Sales}}{\text{Average Accounts Receivable}}$$

Purpose:

- Measures how often receivables are collected – how many times a year a company converts its average AR into cash
- Assesses efficiency in granting credit to produce revenue

Formula:

$$\text{Average AR} = \frac{\text{Beg AR} + \text{End AR}}{2}$$

7.3 Average Collection Period

$$\text{Average Collection Period} = \frac{365}{\text{AR Turnover}}$$

Purpose:

- Measures average days to collect on AR and convert to cash
- Also known as "Days to Collect AR"
- Assesses efficiency in collecting receivables
- Shorter days preferred (faster cash conversion)
- Indicates liquidity of receivables

8 Chart of Accounts

8.1 Assets (Dr)

8.1.1 Current Assets

- Cash
- Cash Equivalents
- Petty Cash
- Accounts Receivable
- Notes Receivable
- Interest Receivable
- Allowance for Doubtful Accounts (XA - Cr)
- Inventory
- Merchandise Inventory
- Raw Materials
- Work in Process
- Finished Goods
- Supplies
- Prepaid Expenses
- Prepaid Rent
- Prepaid Insurance
- Short-term Investments

8.1.2 Non-Current Assets

- Property, Plant & Equipment
- Land
- Buildings
- Equipment
- Machinery
- Vehicles
- Furniture & Fixtures
- Accumulated Depreciation (XA - Cr)
- Long-term Investments
- Intangible Assets
- Patents
- Trademarks
- Copyrights
- Goodwill
- Accumulated Amortization (XA - Cr)

8.2 Liabilities (Cr)

8.2.1 Current Liabilities

- Accounts Payable
- Notes Payable (Short-term)
- Salaries Payable
- Wages Payable
- Interest Payable
- Income Tax Payable
- Dividends Payable
- Unearned Revenue
- Customer Deposits
- Current Portion of Long-term Debt

8.2.2 Non-Current Liabilities

- Long-term Debt
- Notes Payable (Long-term)
- Bonds Payable
- Mortgage Payable
- Deferred Tax Liability

8.3 Equity (Cr)

- Share Capital / Common Stock
- Preferred Stock
- Additional Paid-in Capital
- Retained Earnings
- Treasury Stock (XE - Dr)
- Dividends (Temporary - Dr)

8.4 Revenue (Cr)

- Sales Revenue
- Service Revenue
- Interest Revenue
- Rental Revenue
- Dividend Revenue
- Gain on Sale of Assets
- Sales Returns & Allowances (XR - Dr)
- Sales Discounts (XR - Dr)

8.5 Expenses (Dr)

8.5.1 Operating Expenses

- Cost of Goods Sold
- Salaries Expense
- Wages Expense
- Rent Expense
- Utilities Expense
- Insurance Expense
- Supplies Expense
- Depreciation Expense
- Amortization Expense
- Bad Debt Expense
- Advertising Expense
- Repairs & Maintenance
- Office Expense
- Telephone Expense
- Travel Expense
- Professional Fees
- Bank Charges

8.5.2 Non-Operating

- Interest Expense
- Loss on Sale of Assets
- Income Tax Expense

Legend: XA = Contra-Asset | XR = Contra-Revenue | XE = Contra-Equity