Lesson 7.

Profit and Transformation entries

Ph.D in Economic sciences,

Associate Professor

Ulan Moldokmatov

AGENDA

I. Profit formation procedure

II. Two important assumptions related to the calculation of profits

I.

Profit and transformation entries in accounting refer to adjustments made to the financial statements to reflect the true economic performance and position of a business. These entries are often used to convert accounting records from one set of accounting standards to another (like from local GAAP to IFRS), or to make other adjustments that better align reported results with economic reality.

Here's a brief overview of what each term might involve:

1. Profit Entries

- Profit entries are typically adjustments that affect the income statement, impacting the reported profit for the period. These could include:
- **Revenue Recognition Adjustments:** Ensuring that revenue is recognized in the correct accounting period, possibly requiring adjustments for accrued or deferred revenue.
- **Expense Adjustments:** Including or excluding certain expenses to align with proper accounting treatment, such as adjusting for prepayments or accruals.
- **Depreciation and Amortization Adjustments:** Changes in the way depreciation or amortization is calculated to reflect the useful life or residual value of assets.
- **Provision Adjustments:** Adjustments for expected losses or provisions, such as bad debt or warranty provisions.

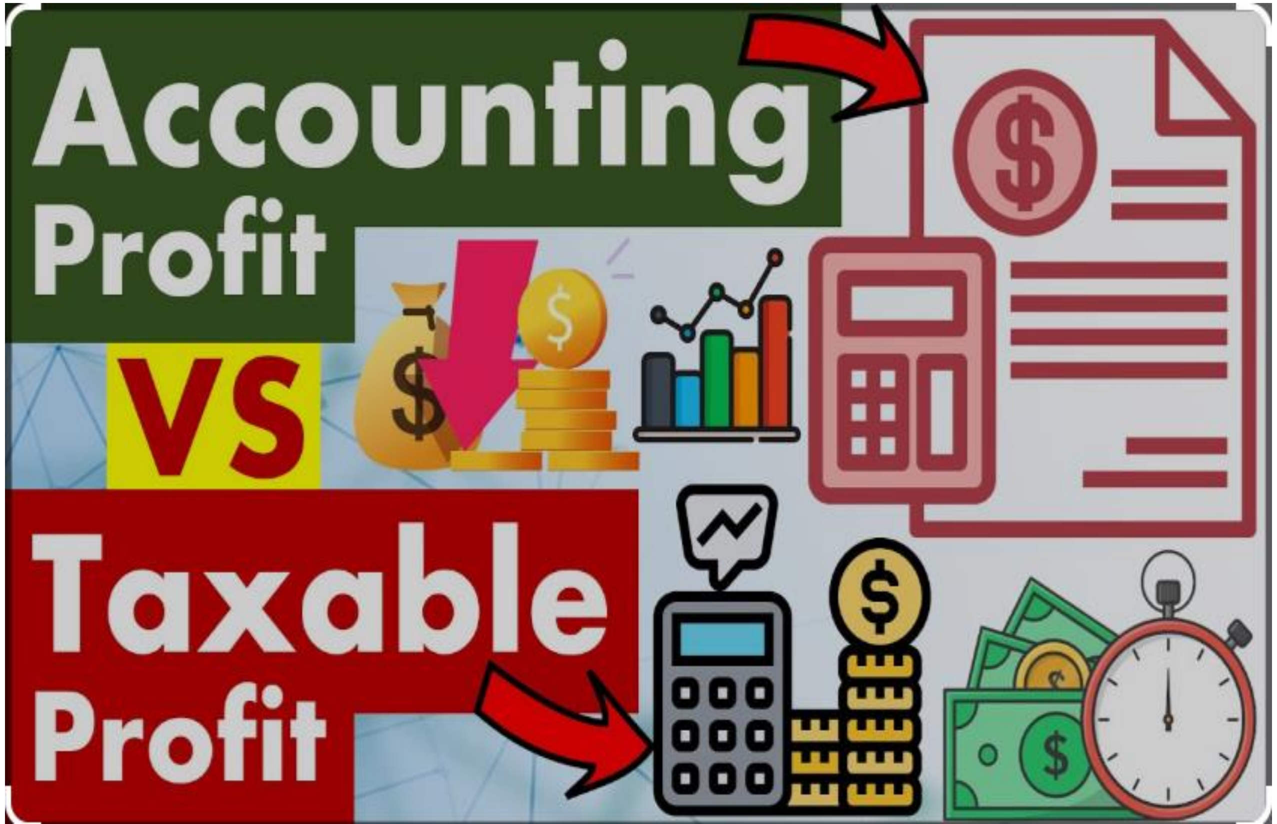
What is Accounting Profit ?

- an accounting profit is the excess of business income over the business expenses.
- The business earns money after selling their goods or services.
- If the money they earn is more than the money they spend for making/providing the goods/services, it is said that the business has made an accounting profit.

- Thus we can say that an accounting profit is the excess of accounting income over accounting expenses.

Accounting Profit = Total Revenue – Total Expenses

Tax Income =
Total annual Income –
- Deductions under the Tax Code



- Economic profit is not just the excess of total accounting income over the total accounting expense. To the cost of an investment, it also adds the opportunity lost cost of another investment option.

- Thus an economic profit means that not only did you make a profit on your investment, but you made more profit than you would have made otherwise.

Economic Profit = Total Income – Total Expenses – Opportunity Lost Cost

II.

Transformation Entries

Transformation entries are made to convert financial statements from one accounting basis to another or to reclassify items for clearer presentation. These might include:

- **Converting from Local GAAP to IFRS:** Adjusting financials to meet International Financial Reporting Standards (IFRS) requirements, such as changes in revenue recognition, lease accounting, or financial instruments.
- **Reclassification Entries:** Moving items between accounts to reflect their nature more accurately. For example, reclassifying certain expenses from operating to non-operating expenses, or moving items from short-term to long-term liabilities.
- **Currency Translation Adjustments:** For multinational companies, transforming financial statements from one currency to another, involving adjustments for exchange rate differences.
- **Consolidation Adjustments:** When financial statements of subsidiaries are combined with the parent company, transformation entries may be needed to eliminate intercompany transactions and adjust for any minority interest.

These entries are critical for ensuring that financial statements provide a true and fair view of the company’s financial position and performance, especially when presenting financial results to stakeholders who require adherence to specific accounting standards.

Transformation arises when facts of economic life affect changes in assets, liabilities and equity during more than one reporting period. during more than one reporting period. Transformation is formalized accounting entry, which is called a transformation entry. It consists of at least one balance sheet (permanent) account entry and one account entry from the Income Statement (temporary account). In this case, the transformation never affects the Cash account. Transformation is carried out in the form of deferral or accrual.

Deferral is a deferred expense or deferred income. Itis necessary: When costs are incurred that can be allocated to two or more accounting periods. For example, the cost of a building, auxiliary materials, insurance paid in advance. The transformation affects asset accounts (credited) and expense accounts (debited)Where income arises that must be allocated to two or more accounting periods. For example, the receipt in advance of commissions for services to be rendered later. The transformation affects the liability account (debited) and the revenue account (credited).Accrual (assgaa1) - a statement of expenditure or income that has already occurred but has not yet been recorded and posted to the cash account.

Accrual is required:

In the case of income due but not reported or received income. For example, earned but not yet received commissions or commissions that have not been billed to clients. The transformation affects the asset account (debit)and the revenue account (credited);

In the case of expenses incurred but not recorded and not incurred expenses. For example, salaries of employees for the current accounting period but payable in the next accounting period. The transformation affects the expenditure account (debited) and the liability account(credited).

Examples:

At the beginning of the accounting period, the advertising agency “D.Art”. paid an 800 dollars in advance as rent for two months. This payment resulted in the creation of an asset consisting of the right of the agency to occupy the premises for two months. As each day of the month expired each day of the month, a portion of the amount paid was used and became an expense for the period. By January 31, half of the amount was used up, becoming January's expense. The accountant makes an entry:

Debet (8030) Rent expense 400$

Credit (1830) Rent paid in advance 400

Suppose that the advertising agency “D.Art“ has agreed to place a series of advertisements for the firm “Mir”. In this case This agency did not receive any money. The first ad appeared January 31, the last day of the month. The fee for this ad is 200 dollars.

However, the invoice for payment by the company “D.Art“ will be billed only after the publication of the entire series of advertisements. For the month of January, the following posting:

Debet(1410) Fee receivable 200$

Creidt (6110)Remuneration for advertising 200$

Thanks for your attention!!!