ACC1701X Midterm Cheatsheet AY23/24 Sem 2

Financial Accounting

Financial Accounting: provides financial information primarily for external users to make decisions.
Management Accounting: provides financial information primarily for external users to make decisions.

- Provides information to management and staff for planning, implementation and control purposes to improve business performance.
- Provides reports which include budgets, cost analysis and divisional performance reports.
- Primarily for internal users, i.e., management and staff.

International Financial Reporting Standards (IFRS) set by IASB (International Accounting Standard Board) is primarily used for this course.

Financial Accounting Concepts and Assumptions

- **Separate Entity Concept:** activities of a business entity are separated from those of the individual owners.
- **Time-period assumption:** Long life of a company can be reported in a shorter time period (annually [fiscal year], quarterly, monthly)
- **Arm's-length transaction assumption:** business dealings between entities are conducted in a rational basis and all parties are acting for their own interests.
- **Cost principle:** financial statement items are measured at their historical costs/original costs at the transaction date. The historical cost is assumed to represent the fair market value of the item at the date of transaction.
- **Fair value principle:** the assets and liabilities should be measured at fair value to improve relevance of accounting information.
- **Monetary measurement concept:** Items in financial statements must have value measurable in dollar value.
- **Going concern assumption:** When preparing the financial statements, the business entity is assumed to be able to sustain itself for the foreseeable future (not under liquidation)

Limitations of Balance Sheet

- Assets are recorded at their purchase cost, not their current market value.
- Not all economic assets are included in the balance sheet. (e.g., internally generated brand, good reputation and human talents)
- The accounting book value of a company (measured by the amount of equity) is usually less than the company's market value (measured by market price per share × number of shares).

Financial Statements

- Statement of Comprehensive Income (SCI)
- Balance Sheet (Statement of Financial Position)
- Statement of Changes of equity
- Statement of Cash Flows
- Notes to Financial Statements

Balance Sheet Items

Assets: Cash, Accounts Receivable, Inventory, Buildings, Property, Plant and Equipment [Liquidity]
Liabilities: Accounts Payable, Income Taxes Payable, Mortgage Payable, Unearned Revenue [Due date]
Equity: Capital Stock, Retained Earnings [Dividends distributed reduce retained earnings]

- $Assets = Liabilities + Equity$
- $Assets = Current\ Asset + Non\text{-}Current\ Assets$
- $Liabilities = Current\ Liabilities + Non\text{-}Current\ Liabilities$
- $Retained\ Earnings(begin) + Net\ Income - Dividends = Retained\ Earnings(end)$
- $Equity(begin) + Increase\ in\ Capital\ Stock + Net\ Income - Dividends + Other\ Comprehensive\ Income = Equity(end)$

SCI Items

- $Expenses = Operating\ expense + Non\text{-}Operating\ Expense$
- $Revenue - Expenses = Net\ Income$
- $Net\ Income + Other\ Comprehensive\ Income = Comprehensive\ Income$
- $Revenue - COGS = Gross\ Profit$

Notes to Financial Statements

- Summary of Significant Accounting Policies
- Additional Information about the Summary Totals
- Disclosure of Information Not Recognized in the financial statements
- Supplementary Information required under the accounting standards

Mechanics of Accounting Cycle

1. Analyse transactions
2. Record effects of transaction
3. Summarise effects of transactions (journal entries & trial balance)
4. Prepare reports (adjusting entries, financial statements, closing the books)

Flow of Accounting Records:
Journal Entries, T Accounts, Trial Balance, Income Statement, Statement of Changes in Equity, Balance Sheet
Criteria for transaction recognition:
1. Involve exchange of resources
2. Conducted at Arm's Length between two independent entities
3. Can be reliably measured

Business Docs such as sales invoices, official receipts, purchases orders, suppliers' invoices capture business transaction. They provide independent objective evidence of transaction, establish dollar amount, and facilitate analysis of business events.

Journal Entry

A recording of a business transactions; usually includes a debit entry and a credit entry to the relevant accounts with amount, a date and sometimes an explanation of the transaction.
Asset Accounts:
Typically has debit balances.
DR Asset (Increase) CR Asset (Decrease)
Liability or Equity Accounts:
Typically has credit balances.
DR Liability/Equity (Decrease) CR Liability/Equity (Increase)
Revenue and Expenses Accounts:
Expenses typically has debit balances.
Revenue typically has credit balances
DR Expense (Increase) CR Expense (Decrease)
DR Revenue (Decrease) CR Revenue (Increase)
Capital Stock, Retained Earnings, Dividends
DR Capital Stock (Decrease) CR Capital Stock (Increase)
DR Retained Earnings (Decrease) CR Retained Earnings (Increase)
DR Dividends (Increase) CR Dividends (Decrease)
Personal journal entries notes:
- Try to think in terms of cash flow
- DR Cash – CR Revenue
- DR Expense – CR Cash
- DR Cash – CR Capital Stock
- DR Cash – CR Revenue; DR COGS – CR Inventory
- DR Notes Payable, Interest Expense – CR Cash (paying back notes)
- DR Dividends – CR Cash

T-Accounts

- Basically combine all journal entry transactions by accounts used and calculate ending balances (can be debit or credit).

Trial Balance

- Prepare trial balance using the ending balances from all T-accounts.
- Total debit balance should be equivalent to total credit balance.

Accrual Accounting

System of accounting in which revenues are recognized when certain criteria are satisfied (i.e., revenues are earned); and expenses are recorded as they are incurred to generate the revenue (matching principle). This is regardless of when cash is paid or received.
- Revenues can be recognized **even cash is not received**.
- Expenses can be recorded **even cash is not paid**.
- The matching principle requires that all costs and expenses incurred in generating revenues must be recognized in the same reporting period as the related revenues.
- **Follows the time-period assumption** which is that the life of a business is divided into distinct and relatively short time periods(e.g., 12-month) so that accounting information can be timely.

Adjusting entries

Prepared at the end of each accounting period to adjust accounts to their proper amount on an accrual basis.
Do not involve cash. Involves a BL account or SCI account.

- Accrued/Unrecorded receivable
- Accrued/Unrecorded liabilities
- Prepaid expenses and supplies
- Unearned revenue

Unrecorded receivable (asset)

In Arrears. Revenues earned during a period that have not been recorded by the end of that period. Represent amount of cash or resources to be collected by the entity in the future.
DR Accounts Receivable – CR Revenue

Unrecorded liabilities (liability)

Expenses incurred and not paid during a period and are not recorded at the end of that period. Represents entity's obligation to pay for the expense in the future.
DR Expense – CR Payable
Example: DR Interest Expense – CR Interest Payable (Adj Entry)
Dr Interest Payable, Loan Payable – CR Cash

Prepaid Expense (asset)

Payments made in advance for expense items, e.g., prepaid insurance or rent.
Journal Entry (day of payment):
DR Prepaid Expense – CR Cash
Adjusting Entry (expense incurred up to date)
DR Expense – CR Prepaid Expense
- Calculate fraction of prepaid expense used up at current date
- Supplies Example: DR Supplies – CR Cash; DR Supplies Expense – CR Supplies;

Unearned Revenue (liability)

Cash amounts received from customers before its corresponding revenue can be recognized.
Journal Entry (Customer advance payment):
DR Cash – CR Unearned Revenue
Adjusting Entry (revenue earned up to date):
DR Unearned Revenue – CR Revenue - Calculate fraction of revenue earned using time

Closing the books

Adjust trial balance → Prepare SCI → Ending Retained Earnings → Closing books
Making all the Revenue, Expense, Retained Earnings and Dividends account balance to zero.
Debit and Credit balances are swapped for these entries.

- **DR Revenue – CR Expense, Retained Earnings (Net income)**
- **DR Retained Earnings – CR Dividends**