FINANCIAL ACCOUNTING: FOUNDATIONS

OKTAY URCAN



Recording Transactions and Financial Statement Preparation

Introduction



MODULE OVERVIEW



- Recording financial transactions
- Preparing balance sheet
- Preparing income statement



RECORDING FINANCIAL TRANSACTIONS

Fundamental accounting equation:
 Assets = Liabilities + Shareholders' equity

• Thus, we have for over any period of time:

 Δ Assets = Δ Liabilities + Δ Shareholders' equity

 This equation constitutes the foundation of recording financial transactions.



RECORDING FINANCIAL TRANSACTIONS

How to record financial transactions:

- ✓ Identify which accounts are impacted
- ✓ Determine the impact on each account
- ✓ Ensure that fundamental accounting equation $[\Delta \text{ Assets} = \Delta \text{ Liabilities} + \Delta \text{ Shareholders'}]$ equity] holds



A firm purchases a truck for \$65,000 with a bank loan.

This transaction impacts two accounts:

- ✓ Fixed assets (which is a part of assets) increases by \$65,000
- ✓ Bank loan (which is a part of liabilities) increases by \$65,000



HOW TO RECORD FINANCIAL TRANSACTIONS



Transaction Worksheet										
	Assets	=	Liabilities	+	Shareholders' equity					
Opening balance										
Transactions										
Closing balance										



of a truck

Afi	A firm purchases a truck for \$65,000 with a bank loan.										
	Assets	=	Liabilities	+	Shareholders' equity						
Purchase	ቀ ርር		ФСБ ООО								

\$65,000

Fixed Assets

\$65,000

Bank Loan



EXAMPLE 1

A firm purchases a truck for \$65,000 with a bank loan.								
	Assets = Liabilities + Shareholde							
Purchase of a truck	\$65,000		\$65,000					

ΔAssets = \$65,000

Δ Liabilities = \$65,000



EXAMPLE 2

A firm sells goo	ds which originally	v cost \$1000	for \$1,500 in cash.
			T 1,5 5 5 5 5 5 5 5 5 5 5 5 5 5 5 5 5 5 5

	Assets	=	Liabilities	+	Shareholders' equity
Sales Cost of sales					



A firm sells goods which originally cost \$1000 for \$1,500 in cash.

	Assets	=	Liabilities	+	Shareholders' equity
Sales	\$1,500				\$1,500
Cost of					
sales					

Cash

Income Statement



A firm sells goods which originally cost \$1000 for \$1,500 in cash.

	Assets	_	Liabilities	+	Shareholders' equity
Sales	\$1,500				\$ 1,500
Cost of	(\$1,000)				(\$ 1,000)
sales					

Inventories

Income Statement



A firm sells goods which originally cost \$1000 for \$1,500 in cash.

	Assets	_	Liabilities	+	Shareholders' equity
Sales	\$1,500				\$1,500
Cost of	(\$1,000)				(\$ 1,000)
sales					

 Δ Assets = \$500

 Δ SHE = \$500



EXAMPLE 3



A firm receives a utility bill of \$850.										
Assets = Liabilities + Shareholders' equity										
Utility bill										



A firm receives a utility bill of \$850.								
	Assets	=	Liabilities	+	Shareholders' equity			
Utility bill			\$850		(\$850)			

Accounts Payable

Income Statement



EXAMPLE 3



A firm receives a utility bill of \$850.									
Assets = Liabilities + Shareholders' equity									
Utility bill			\$850		(\$850)				

Δ Liabilities = \$850

 $\Delta SHE = (\$850)$

 $\sqrt{1}$ Fundamental accounting equation [Δ Assets = Δ Liabilities + Δ Shareholders' equity] holds



FINANCIAL ACCOUNTING: FOUNDATIONS

OKTAY URCAN



Recording Transactions and Financial Statement Preparation

Example: Illinois Supermarket



EXAMPLE: ILLINOIS SUPERMARKET

Jack sets up a supermarket on January 1, 2016, which sells groceries in Central Illinois by investing \$15,000 of his own money and getting a \$30,000 bank loan with 10% annual interest rate. Bank loan is payable in 6 years.



EXAMPLE: ILLINOIS SUPERMARKET

The supermarket has the following transactions in Year 1:

- Purchase a shop for \$10,000 cash
- Purchase groceries for \$5,000 on credit
- Pay annual insurance premium of \$1,000
- Sell groceries (originally costing \$3,000) for \$5,000 in cash
- Pay creditors \$4,000
- Pay utilities \$2,000
- Pay employees \$2,000
- Pay annual interest of the bank loan



	Assets			Liabili	ties	Shareholders' equity		
	Cash	Inventory	PPE	Accounts Payable	Bank Loan	Common Stock	Income Statement	Retained Earnings
Initial capital Bank loan	15					15		
Shop Groceries Insurance								
Sales Cost of sales Creditors								
Creditors Utilities Employees								
Interest								
Transfer to retained profit								
Ending Balance								



		Assets			Liabilities		Shareholders' equity		
	Cash	Inventory	PPE	Accounts Payable	Bank Loan	Common Stock	Income Statement	Retained Earnings	
Initial capital	15					15			
Bank loan	30				30				
Shop									
Groceries									
Insurance									
Sales									
Cost of sales									
Creditors									
Utilities									
Employees									
Interest									
Transfer to									
retained profit									
Ending Balance									



		Assets		Liabili	ties	Share	nolders'	equity
	Cash	Inventory	PPE	Accounts Payable	Bank Loan	Common Stock	Income Statement	Retained Earnings
Initial capital Bank loan	15 30 (40)		40		30	15		
Shop Groceries Insurance	(10)		10					
Sales Cost of sales Creditors								
Utilities Employees								
Interest Transfer to								
retained profit								
Ending Balance								



		Assets			Liabilities		Shareholders' equity		
	Cash	Inventory	PPE	Accounts Payable	Bank Loan	Common Stock	Income Statement	Retained Earnings	
Initial capital Bank loan Shop	15 30 (10)		10		30	15			
Groceries Insurance Sales Cost of sales Creditors		5		5					
Utilities Employees Interest									
Transfer to retained profit									
Ending Balance									



		Assets		Liabili	Liabilities		Shareholders' equity		
	Cash	Inventory	PPE	Accounts Payable	Bank Loan	Common Stock	Income Statement	Retained Earnings	
Initial capital Bank loan	15 30				30	15			
Shop	(10)		10		30				
Groceries Insurance Sales	(1)	5		5			(1)		
Cost of sales Creditors									
Utilities Employees									
Interest									
Transfer to retained profit									
Ending Balance									



	Assets			Liabili	Liabilities		Shareholders' equity		
	Cash	Inventory	PPE	Accounts Payable	Bank Loan	Common Stock	Income Statement	Retained Earnings	
Initial capital	15					15			
Bank loan	30				30				
Shop	(10)		10						
Groceries		5		5					
Insurance	(1)						(1)		
Sales	5						5		
Cost of sales		(3)					(3)		
Creditors									
Utilities									
Employees									
Interest									
Transfer to									
retained profit									
Ending Balance									



	Assets		Liabili	Liabilities		Shareholders' equity		
Cash	Inventory	PPE	Accounts Payable	Bank Loan	Common Stock	Income Statement	Retained Earnings	
15					15			
30				30				
(10)		10						
	5		5					
(1)						(1)		
5						5		
	(3)					(3)		
(4)			(4)					
	15 30 (10) (1) 5	Cash Inventory 15 30 (10) 5 (1) 5 (3)	Cash Inventory PPE 15 30 (10) 5 (1) 5 (3)	Cash Inventory PPE Accounts Payable 15 30 (10) 5 (1) 5 (3)	Cash Inventory PPE Accounts Payable Loan 15 30 (10) 5 (1) 5 (3)	Cash Inventory PPE Accounts Payable Bank Loan Stock 15 30 (10) 5 (1) 5 (3)	Cash Inventory PPE Accounts Payable Loan Common Stock Income Statement 15 30 (10) 5 (1) 5 (3) (3)	



		Assets		Liabili	ties	Sharel	nolders'	equity
	Cash	Inventory	PPE	Accounts Payable	Bank Loan	Common Stock	Income Statement	Retained Earnings
Initial capital	15					15		
Bank loan	30				30			
Shop	(10)		10					
Groceries		5		5				
Insurance	(1)						(1)	
Sales	5						5	
Cost of sales		(3)					(3)	
Creditors	(4)			(4)				
Utilities	(2)						(2)	
Employees								
Interest								
Transfer to								
retained profit								
Ending Balance								



	Assets		Liabili	Liabilities		Shareholders' equity		
Cash	Inventory	PPE	Accounts Payable	Bank Loan	Common Stock	Income Statement	Retained Earnings	
15					15			
30				30				
(10)		10						
	5		5					
(1)						(1)		
5						5		
	(3)					(3)		
(4)			(4)					
(2)						(2)		
(2)						(2)		
	15 30 (10) (1) 5 (4) (2)	Cash Inventory 15 30 (10) 5 (1) 5 (3) (4) (2)	Cash Inventory PPE 15 30 (10) 5 (1) 5 (3) (4) (2)	Cash Inventory PPE Accounts Payable 15 30 10 5 5 6 10 5 6	Cash Inventory PPE Accounts Payable Bank Loan 15 30 30 (10) 5 5 (1) 5 (3) (4) (2) (4)	Cash Inventory PPE Accounts Payable Bank Loan Common Stock 15 30 30 15 (10) 5 5 5 (1) 5 (3) (4) (4) (2) (4) (4) (4)	Cash Inventory PPE Accounts Payable Bank Loan Common Stock Income Statement 15 30 30 15 30 15	



		Assets		Liabili	ties	Shareholders' equity		
	Cash	Inventory	PPE	Accounts Payable	Bank Loan	Common Stock	Income Statement	Retained Earnings
Initial capital	15					15		
Bank loan	30				30			
Shop	(10)		10					
Groceries		5		5				
Insurance	(1)						(1)	
Sales	5						5	
Cost of sales		(3)					(3)	
Creditors	(4)			(4)				
Utilities	(2)						(2)	
Employees	(2)						(2)	
Interest	(3)						(3)	
Transfer to retained profit	\$30,000 * 10% =\$3,000							
Ending Balance								



		Assets		Liabili	ties	Sharel	nolders'	equity
	Cash	Inventory	PPE	Accounts Payable	Bank Loan	Common Stock	Income Statement	Retained Earnings
Initial capital	15					15		
Bank loan	30				30			
Shop	(10)		10					
Groceries		5		5				
Insurance	(1)						(1)	
Sales	5						5	
Cost of sales		(3)					(3)	
Creditors	(4)			(4)				
Utilities	(2)						(2)	
Employees	(2)						(2)	
Interest	(3)						(3)	
Transfer to							6	(6)
retained profit								
Ending Balance								



		Assets		Liabili	ities	Share	nolders' e	equity
	Cash	Inventory	PPE	Accounts Payable	Bank Loan	Common Stock	Income Statement	Retained Earnings
Initial capital	15					15		
Bank loan	30				30			
Shop	(10)		10					
Groceries		5		5				
Insurance	(1)						(1)	
Sales	5						5	
Cost of sales		(3)					(3)	
Creditors	(4)			(4)				
Utilities	(2)						(2)	
Employees	(2)						(2)	
Interest	(3)						(3)	
Transfer to retained profit							6	(6)
Ending Balance	28	2	10	1	30	15		(6)



		Assets		Liabili	ities	Share	nolders'	equity
	Cash	Inventory	PPE	Accounts Payable	Bank Loan	Common Stock	Income Statement	Retained Earnings
Initial capital	15					15		
Bank loan	30				30			
Shop	(10)		10					
Groceries		5		5				
Insurance	(1)						(1)	
Sales	5						5	
Cost of sales		(3)					(3)	
Creditors	(4)			(4)				
Utilities	(2)						(2)	
Employees	(2)						(2)	
Interest	(3)						(3)	
Transfer to retained profit		Ending Ba	alances a	re used to	prepare	the Balanc	ce Sheet.	
Ending Balance	28	2	10	1	30	15		(6)



1

ILLINOIS SUPERMARKET: BALANCE SHEET

Current Assets Cash Inventories Fixed Assets	\$28,000 \$2,000 \$10,000
Total Assets	\$40,000
Current Liabilities	
Accounts payable	\$1,000
Long-term Liabilities	
Bank loan	\$30,000
Shareholders' equity	
Common stock	\$15,000
Retained earnings	(\$6,000)
Liabilities and Shareholders' equity	\$40,000



	Assets			Liabili	ties	Shareholders' equity			
	Cash	Inventory	PPE	Accounts Payable	Bank Loan	Common Stock	Income Statement	Retained Earnings	
Initial capital	15					15			
Bank loan	30				30				
Shop	(10)		10						
Groceries		5		5					
Insurance	(1)						(1)		
Sales	5						5		
Cost of sales		(3)					(3)		
Creditors	This columr	n is used to prepai	re the Income	Statement.					
Utilities	(~)						(2)		
Employees	(2)						(2)		
Interest	(3)						(3)		
Transfer to retained profit							6	(6)	
Ending Balance	28	2	10	1	30	15		(6)	



ILLINOIS SUPERMARKET: INCOME STATEMENT

Year	20	16
------	----	----

\$5,000

Cost of Goods Sold (\$3,000)

Gross Profit \$2,000

Operating Expenses (\$5,000)

Profit before Interest (\$3,000)

Interest Expense (\$3,000)

Net Income (\$6,000)



ILLINOIS SUPERMARKET

Illinois Supermarket has the following transactions in year 2017:

- Purchase groceries for \$10,000 on credit
- Pay annual insurance premium of \$1,000
- Sell groceries (originally costing \$7,000) for \$25,000 on credit
- Pay creditors \$8,000
- Pay utilities \$3,000
- Pay employees \$5,000
- Pay annual interest of the bank loan
- Declare (but not pay) dividends of \$2,000
- Corporate tax rate is 50%





	Assets			Dividends Payable	Liabi	lities	Shareholders' equity			
Cash	INV	AR	PPE	DP	TP	AP	Bank Loan	Common Stock	IS	RE
	Inventories	Accounts Receivable	Plant, Prope and Equipm	erty, nent	Tax Payable	Accounts Payable			Income Statement	Retained Earnings



		Ass	sets			Liabi	lities		Shareholders' equity			
	Cash	INV	AR	PPE	DP	TP	AP	Bank Loan	Common Stock	IS	RE	
Beginning balance Groceries Insurance Sales Cost of sales Creditors Utilities Employees Interest Dividends Tax Transfer to RE	28	2		10				30	15		(6)	
Ending Balance												



		Assets				Liabi	lities		Shareholders' equity			
	Cash	INV	AR	PPE	DP	TP	AP	Bank Loan	Common	IS	RE	
Beginning balance	28	2	0	10	0	0	1	30	15		(6)	
Groceries Insurance Sales Cost of sales Creditors Utilities Employees Interest Dividends Tax		10					10					
Transfer to RE												
Ending Balance												



		Ass	ets			Liabi	lities		Shareholders' equity			
	Cash	INV	AR	PPE	DP	TP	AP	Bank Loan	Common	IS	RE	
Beginning balance	28	2	0	10	0	0	1	30	15		(6)	
Groceries Insurance Sales Cost of sales Creditors Utilities Employees Interest Dividends Tax	(1)	10					10					
Transfer to RE Ending Balance												



		Ass	sets			Liabi	lities		Shareholders' equity		
	Cash	INV	AR	PPE	DP	TP	AP	Bank Loan	Common Stock	IS	RE
Beginning balance	28	2	0	10	0	0	1	30	15		(6)
Groceries Insurance	(1)	10	25				10			(1) 25	
Sales Cost of sales Creditors		(7)	25							(7)	
Utilities Employees Interest											
Dividends Tax											
Transfer to RE											
Ending Balance											



		Ass	sets			Liabi	lities		Shareholders' equity		
	Cash	INV	AR	PPE	DP	TP	AP	Bank Loan	Common	IS	RE
Beginning balance	28	2	0	10	0	0	1	30	15		(6)
Groceries	(4)	10					10			(4)	
Insurance Sales	(1)		25							(1) 25	
Cost of sales Creditors Utilities	(8)	(7)					(8)			(7)	
Employees Interest											
Dividends Tax											
Transfer to RE											
Ending Balance											



		Ass	sets			Liabi	lities		Shareholders' equity		
	Cash	INV	AR	PPE	DP	TP	AP	Bank Loan	Common Stock	IS	RE
Beginning balance	28	2	0	10	0	0	1	30	15		(6)
Groceries		10					10				
Insurance	(1)									(1)	
Sales			25							25	
Cost of sales	(0)	(7)					(0)			(7)	
Creditors	(8)						(8)			(0)	
Utilities	(3)						J.			(3)	
Employees Interest											
Dividends											
Tax											
Transfer to RE											
Ending Balance											



		Ass	sets			Liabi	lities		Shareholders' equity		
	Cash	INV	AR	PPE	DP	TP	AP	Bank Loan	Common Stock	IS	RE
Beginning balance	28	2	0	10	0	0	1	30	15		(6)
Groceries Insurance	(1)	10					10			(1)	
Sales Cost of sales	(1)	(7)	25							25 (7)	
Creditors Utilities	(8) (3)	(*)					(8)			(3)	
Employees Interest	(5)									(5)	
Dividends Tax											
Transfer to RE											
Ending Balance											



		Assets				Liabilities				Shareholders' equity		
	Cash	INV	AR	PPE	DP	TP	AP	Bank Loan	Common Stock	IS	RE	
Beginning balance	28	2	0	10	0	0	1	30	15		(6)	
Groceries		10					10					
Insurance	(1)									(1)		
Sales		/ →\	25							25 (7)		
Cost of sales	(9)	(7)					(9)			(7)		
Creditors Utilities	(8)						(8)			(3)		
Employees	(5)									(5) (5)		
Interest	(3)									(3)		
Dividends												
Тах												
Transfer to RE												
Ending Balance												



		Assets				Liabi	lities		Shareholders' equity		
	Cash	INV	AR	PPE	DP	TP	AP	Bank Loan	Common Stock	IS	RE
Beginning balance	28	2	0	10	0	0	1	30	15		(6)
Groceries Insurance	(1)	10					10			(1)	
Sales Cost of sales		(7)	25							25 (7)	
Creditors Utilities	(8) (3)						(8)			(3)	
Employees Interest Dividends	(5) (3)				2					(5) (3)	(2)
Tax											
Transfer to RE											
Ending Balance											



		Assets Cash INIV AP DDE				Liabilities				Shareholders' equity		
	Cash	INV	AR	PPE	DP	TP	AP	Bank Loan	Common Stock	IS	RE	
Beginning balance	28	2	0	10	0	0	1	30	15		(6)	
Groceries Insurance Sales Cost of sales Creditors Utilities Employees Interest	(8) (3) (5) (3)	10 (7)	25				(8)			 (1) 25 (7) (3) (5) (3) (5) (3) 		
Dividends Tax Transfer to RE Ending Balance					2	3 Ta	t Income b x Rate = 50 x Expense		66,000	(3)	(2)	



		Assets				Liabi	lities		Shareholders' equity		
	Cash	INV	AR	PPE	DP	TP	AP	Bank Loan	Common	IS	RE
Beginning balance	28	2	0	10	0	0	1	30	15		(6)
Groceries Insurance	(1)	10					10			(1)	
Sales Cost of sales		(7)	25							25 (7)	
Creditors Utilities Employees	(8) (3) (5)						(8)			(3) (5)	
Employees Interest Dividends	(3)				2					(3)	(2)
Tax						3				(3)	
Transfer to RE Ending Balance										(3)	3





		Ass	ets			Liabi	lities		Shareholders' equity		
	Cash	INV	AR	PPE	DP	TP	AP	Bank Loan	Common	IS	RE
Beginning balance	28	2	0	10	0	0	1	30	15		(6)
Groceries		10					10				
Insurance	(1)									(1)	
Sales			25							25	
Cost of sales		(7)								(7)	
Creditors	(8)						(8)				
Utilities	(3)									(3)	
Employees	(5)									(5)	
Interest	(3)									(3)	
Dividends					2						(2)
Tax						3				(3)	
Transfer to RE										(3)	3
Ending Balance	8	5	25	10	2	3	3	30	15		(5)



		Assets				Liabilities				Shareholders' equity			
	Cash	INV	AR	PPE	DP	TP	AP	Bank Loan	Common	IS	RE		
Beginning balance	28	2	0	10	0	0	1	30	15		(6)		
Groceries Insurance Sales Cost of sales Creditors	(1) (8)	10 (7)	25				(8)			(1) 25 (7)			
Utilities Employees Interest Dividends	(3) (5) (3)				2		(0)			(3) (5) (3)	(2)		
Transfer to DE			Ending	Balance	es are	used to	prepa	are the	Balance St				
Transfer to RE Ending Balance	8	5	25	10	2	3	3	30	15	(3)	(5)		



1

ILLINOIS SUPERMARKET: BALANCE SHEET

Current Assets Cash	December 2017 \$8,000
Inventories	\$5,000
Accounts receivables	\$25,000
Fixed Assets	\$10,000
Total Assets Current Liabilities	\$48,000
Dividends payable	\$2,000
Tax payable	\$3,000
Accounts payable	\$3,000
Long-term Liabilities	
Bank loan	\$30,000
Shareholders' equity	
Common stock	\$15,000
Retained earnings	(\$5,000)
Liabilities and Shareholders' equity	\$48,000



		Ass	sets		Liabilities				Shareholders' equity			
	Cash	INV	AR	PPE	DP	TP	AP	Bank Loan	Common	IS	RE	
Beginning balance	28	2	0	10	0	0	1	30	15		(6)	
Groceries Insurance Sales	(1)	10	25				10			(1) 25		
Cost of sales Creditors Utilities	(8)	(7)					(8)			(7) (3)		
Employees Interest Dividends	This co	olumn is u	ised to pr	epare the	e Income	Stateme	nt.			(5) (3)	(2)	
Tax Transfer to RE						3				(3)	3	
Ending Balance	8	5	25	10	2	3	3	30	15		(5)	



ILLINOIS SUPERMARKET: INCOME STATEMENT

	Year 2017
Sales	\$25,000
Cost of Goods Sold	(\$7,000)
Gross Profit	\$18,000
Operating Expenses	(\$9,000)
Profit before Interest and Tax	\$9,000
Interest Expense	(\$3,000)
Profit before Tax	\$6,000
Tax Expense	(\$3,000)
Net Income	\$3,000



FINANCIAL ACCOUNTING: FOUNDATIONS

OKTAY URCAN



Recording Transactions and Financial Statement Preparation

Individual Accounts



HOW DO INDIVIDUAL ACCOUNTS CHANGE?



Individual accounts change during a period as follows:

Beginning Balance

- + Additions during the period
- Reductions during the period
 - = Ending Balance



EXAMPLE: INDIVIDUAL ACCOUNTS

What is the cash paid to suppliers in year 2017 for Illinois Supermarket?

Accounts Payable

Beginning Balance \$1,000

- + Additions during the period \$10,000
 - Reductions during the period (?)
 - = Ending Balance \$3,000

? = \$8,000



FINANCIAL ACCOUNTING: FOUNDATIONS

1

OKTAY URCAN



Recording Transactions and Financial Statement Preparation

Accrual Accounting





Recall the following transactions of Illinois Supermarket in Year 2:

- Pay annual insurance premium of \$1,000
- Pay employees \$5,000



IN-VIDEO QUESTION



What happens if:

- Half of the insurance payment (\$500) is prepayment for the next year's insurance?
- Employees earn \$5,000 but are not paid yet?



Original Solution

		As	sets		Liabilities				Shareholders' equity		
	Cash	INV	AR	PPE	DP	TP	AP	Bank Loan	Common Stock	IS	RE
Insurance Employees	(1) (5)									(1) (5)	



Original Solution

		Ass	sets		Liabilities				Shareholders' equity		
	Cash	INV	AR	PPE	DP	TP	AP	Bank Loan	Common Stock	IS	RE
Insurance Employees	(1) (5)									(1) (5)	

Updated Solution

		Assets	Liabilities	Shareholders' equity			
	Cash	Prepaid expenses	Accounts payable	Bank Loan	Common Stock	IS	RE
Insurance Employees							



Original Solution

		Ass	sets		Liabilities				Shareholders' equity		
	Cash	INV	AR	PPE	DP	TP	AP	Bank Loan	Common Stock	IS	RE
Insurance Employees	(1) (5)									(1) (5)	

Updated Solution

		Assets	Liabilities	Shareholders' equity			
	Cash	Prepaid expenses		Bank Loan	Common Stock	IS	RE
Insurance Employees	(1)	0.5				(0.5)	



Original Solution

		Ass	sets		Liabilities				Shareholders' equity		
	Cash	INV	AR	PPE	DP	TP	AP	Bank Loan	Common Stock	IS	RE
Insurance Employees	(1) (5)									(1) (5)	

Updated Solution

		Assets	Liabilities	Shareholders' equity			
	Cash	Prepaid expenses	Accounts payable	Bank Loan	Common Stock	IS	RE
Insurance Employees	(1)	0.5	5			(0.5) (5)	



- Accrual accounting uses adjusting entries to reflect economic reality even when there is no cash involved in the transaction.
- Under accrual accounting, revenues are recognized when earned and expenses are recognized when incurred.
- Thus, profits are NOT equal to cash over a period.



		Ass	sets			Liabilities				Shareholders' equity			
	Cash	INV	AR	PPE	DP	TP	AP	Bank Loan	Common Stock	IS	RE		
Beginning balance	28	2	0	10	0	0	1	30	15		(6)		
Groceries Insurance	(1)	10	25				10			(1)			
Sales Cost of sales Creditors	(8)	(7)	25				(8)			25 (7)			
Utilities Employees Interest	(3) (5) (3)		Cha	nge in Cash	=-\$20,000			Net Incom	e = \$3,000	(3) (5) (3)			
Dividends Tax					2	3				(3)	(2)		
Transfer to RE										(3)	3		
Ending Balance	8	5	25	10	2	3	3	30	15		(5)		





- Cash accounting is simple but does not reflect economic reality.
- Accrual accounting reflects economic reality but it may require managers' judgement.
- Managerial judgement in accounting may result in earnings manipulation.



In this module, we:

- Learned how to code a business transaction in accounting language using "transaction worksheet"
- Used the transaction worksheet to prepare a balance sheet and income statement
- Critically compared accrual versus cash accounting

In the next module, we will cover the fundamental accounting concepts and revenue recognition.

