# General Definitions

## Asset

**OWNED by a business.**  
Holds monetary value. Used to produce economic benefit.

## Liability

**OWES to a 3rd party.**  
Represents the net funds invested into a business from 3rd parties. Ultimately, it is a promise to the 3rd party that the borrowing of said funds will be repaid.

## Equity

**OWES to the owners.**  
Represents the net funds invested into a business by its owners.

## Owner’s Equity

Cash provided to the business by its direct owners / shareholders.

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## Residual Value / Net Assets

The remaining value of an entity after the after the removal of the entity’s liabilities from its assets.

## Account

A place where we record, sort, and store all financial transactions that affect a related group of items.

## Debit

The destination account of a transaction in double-entry accounting

## Credit

The source account of a transaction in double-entry accounting

## Double-Entry Accounting

An accounting concept which states that a transaction MUST include the debit or credit of at least 2 different accounts. The total of debits must equal the total of credits.

## Journal Entry

Used to record a double-entry accounting transaction. Will include a date, the accounts affected by the transaction, the appropriate debits and credits of the transaction, and a narration explaining what journal entry is of.

## General Ledger

Stores a complete record of accounts and journal entries.

# Accounting Cycle

A simple breakdown of the order of the accounting cycle within an accounting period. This includes the steps that accountants must perform to achieve the 4 key outcomes of accounting: **Identifying, Measuring, Recording,** and **Communicating** a business’ economic transactions and events of their business operations.

DURING AN ACCOUNTING PERIOD

1. Identify Transactions
2. Prepare Journal Entries
3. Post to General Ledger
4. Post to T-Accounts (Closing balances of accounts)

END OF ACCOUNTING PERIOD

1. Unadjusted Trial Balance (Collection of closing balances)
2. Posting Adjusting Journal Entries (Accrual based accounting)
3. Adjusted Trial Balance (New collection of closing balances after adjustments)
4. Closing Entries (Creating Financial Statements)
5. Post-Closing Entries

# Week 1

## Accounting

Process of Identifying, measuring, recording, and communicating economic transactions and events of a business operation.

### Identifying

* Taking into consideration all economic transaction which affect a business.

### Measuring

* Quantifying in monetary terms.

### Recording

* Analysing, recording, classifying, and summarising transactions.

### Communicating

* Preparing the accounting reports; analysing and interpreting.

## Stakeholders

* Owners / shareholders
* Customer
* Employees
* Environment
* Local community
* Unions
* Creditors (banks)
* Government

## Financial Accounting

The preparation and presentation of financial reports for **external** users.

## Management Accounting

Provides information for **internal** decision makers of a business.

## Auditing

Independent examination of the accounting data presented by an entity.

## Tax Accounting

Preparation of tax returns and tax payments.

## Business Structures

* Sole Proprietorship (sole trader)
* Partnership
* Company (limited liability)
  + Private (Pty Ltd) – Financial data not public, max 50 owners, not listed on exchange
  + Public (Ltd) – Financial data is public, any number of owners (shareholders), listed on exchange to allow for purchase and liquidation of shares

# Week 2

## Ethics

In a broader sense, deals with human conduct in relation to what is morally good, bad, right, and wrong. It is the application of values to decision making. (**Ethics are external, Morals are internal (individual)**).

* **Honesty**
* **Fairness**
* **Responsibility**
* **Respect**
* **Compassion**

### Teleological / Consequential ethics (ends justify the means, consequence based)

### Deontological / Non-Consequential ethics (intention based)

## Ethical Decision-Making Process:

1. Identify ethical issues
2. Gather information and consider ethical principles
3. Identify and evaluate alternative courses of action
4. Decide a course of action

## Accounting Professional and Ethics Standard Board (APESB) - *Code of Ethics*:

### Integrity

Straightforward and honest

### Objectivity

Business judgements without compromise of bias, conflict of interest or undue influence of others

### Professional competence and due care

Must attain and maintain professional and technical knowledge for clients or employees (requires diligence, training, and supervision)

### Confidentiality

Must not disclose information classified confidential or sensitive outside of the firm)

### Professional behaviour

Comply with relevant laws and regulations, avoid any action or omission which may discredit the image of the profession

# Week 3

## The Accounting Cycle:

1. Analyse transactions
2. Journalise transactions
3. Post ledger accounts
4. Prepare trial balance
5. Prepare financial statements

## Transaction:

* An external exchange of something of value between two or more entities.
* Accounting transactions or events are those occurrences which must be recorded / recognised because they have an effect on **Assets, Liabilities, or Equity**.
* Not all transactions are recorded (E.G., hiring a new employee)
* Evidence of a transaction comes in the form of a **Source Document**.

## Assets

A present economic resource controlled by the entity as a result of past events. An economic resource is a right that has the potential to produce economic benefits.

## Liabilities

A present obligation of the entity to transfer an economic resource as a result of past events.

## Equity

The residual interest in the assets of the entity after deducting all its liabilities.

## Income / Revenue

Amounts received / receivable from selling goods or services. Income is increases in assets, or decreases in liabilities, that result in increases in equity, other than those relating to capital share.

## Expenses

Costs that a business incurs to generate income. Expenses are decreases in assets, or increases in liabilities, that result in decreases in equity, other that those relating to distributions to shareholders.

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Debit** | **Credit** | **Normal Balance** |
| Assets | **+** | **-** | Debit |
| Liabilities | **-** | **+** | Credit |
| Equity | **-** | **+** | Credit |
| Income/Rev | **-** | **+** | Credit |
| Expenses | **+** | **-** | Debit |

**DEBIT (DESTINATION ACCOUNT)  
CREDIT (SOURCE ACCOUNT)**

**D.E.A.L.E.R**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Debit (Normal Balance)** | | | **Credit (Normal Balance)** | | |
| **Dividends** | **Expenses** | **Assets** | **Liabilities** | **Equity** | **Revenue** |

**Extended Accounting Equation:**

**Assets = Liabilities + Owner’s Capital + Income – Expenses – Drawings**

## Accounting Concepts and Principles

### Going Concern Principle

The business will remain in operation for the foreseeable future. ***This also means that the business can value assets on a purchase price basis, not a current cost basis (considering depreciation) and assumes that an asset will provide value beyond its current resell value***

### The Accounting Period Concept

The life of a business is divided into artificial periods. Profit is determined for particular periods of time in order to be comparable.

### Accounting Entity Concept

Clearly identify the boundaries of the entity being accounted for. (E.G., personal transactions of the owner must be separate from the entity).

### Accrual Basis Accounting

The effects of transactions are recognised when they occur, not when the cash is received / paid.

### Cash-Basis Accounting

Records transactions and events only at the time of receipt / payment of cash. (I.E., no payables or receivables).

### Cost Principle

States that all assets are initially recorded in the accounts at their purchase price or cost.

## Qualitative Characteristics:

### Fundamental Qualitative Characteristics

1. **Relevance** (Information is considered relevant if it is capable of making a difference in the decision made by the users)
2. **Faithful Representation** (Information is a faithful representation of the economic phenomena it purports to represent if it complete, neutral, and free from material error.

### Enhancing Qualitative Characteristics

1. **Comparability** (Users can identify similarities and difference between two sets of economic data.
2. **Verifiability** (Information is verifiable if it represents the economic phenomena without bias or material error.
3. **Timeliness** (Whether the information is available to users before it ceases to be relevant)
4. **Understandability** (Users who have reasonable knowledge of business and accounting can comprehend its meaning.

# Week 4

## General Journal

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **General Journal** | | | | |
| **Date** | **Account Name (narration)** | **Ref.** | **Debit** | **Credit** |
| 1/3/21 | Office Supplies (Asset) | 101 | 250 |  |
|  | Cash (Asset) | 100 |  | 250 |
|  | (Bought office supplies with cash) |  |  |  |
|  |  |  |  |  |
| 4/3/21 | Building Supplies (Asset) | 200 | 10000 |  |
|  | Cash (Asset) | 100 |  | 2000 |
|  | Accounts Payable (Liability) | 130 |  | 8000 |
|  | (Bought building supplies with cash and on account) |  |  |  |

The general journal is a form of double entry accounting, displaying that a transaction must consist of at least 2 forms of a debit or credit from account. A single entry CANNOT include more than 1 debits or credits.

**Example Questions**

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**Basic Analysis & Debit-Credit Analysis** **(EXAMPLE)**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Basic Analysis** | | **Debit /Credit analysis** |
| 1 August | Cash (asset)  Share Capital (equity) | Increase Increase | Debits increase assets Credits increase equity |
| 4th August | Cash (asset)  Prepaid Insurance (asset) | Decrease  Increase | Credits decrease assets  Debits increase assets |
| 16th August | Cash (asset)  Service Revenue (revenue) | Increase  Increase | Debits increase assets  Credits increase revenue |
| 27th August | Cash (asset)  Salary Expense (expense) | Decrease  Increase | Credits decrease assets  Debits increase expense |

Journalising these transactions

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Date** | | **Description** | | **Debit** | | **Credit** | |
| 1 | Cash (Asset) | | 15 000 | |  | |
|  | Share Capital (Equity) | |  | | 15 000 | |
|  | (Share Capital received from investors) | |  | |  | |
|  |  | |  | |  | |
| 4 | Prepaid Insurance (Asset) | | 1 800 | |  | |
|  | Cash (Asset) | |  | | 1 800 | |
|  | (6 months of prepaid insurance) | |  | |  | |
|  |  | |  | |  | |
| 16 | Cash (Asset) | | 9 000 | |  | |
|  | Service Revenue (Revenue) | |  | | 9 000 | |
|  | (Cash received for services rendered) | |  | |  | |
|  |  | |  | |  | |
| 27 | Salary Expense (Expense) | | 500 | |  | |
|  | Cash (Asset) | |  | | 500 | |
|  | (Salary paid to secretary) | |  | |  | |

# Week 5

## T-Accounts

* Title
* Place for recording increases
* Place for recording decreases

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Cash at Bank** | | | | | |
| **Date (year)** | **Explanation** | **Amount** | **Date (year)** | **Explanation** | **Amount** |
| 3/10 | Chris, Capital | 60 000 | 4/10 | Vehicle | 30000 |
| 15/10 | Income | 6000 | 16/10 | Wages | 5000 |
| 21/10 | Accounts Receivable | 1000 | 20/10 | Accounts Payable | 2000 |
|  |  |  | 25/10 | Chris, Drawing | 1400 |
|  |  |  | Balance c/d (difference) |  | 28600 |
| Balance b/d (normal balance) |  | 28600 |  |  |  |
| **Debit (Dr) Side** | | | **Credit (Cr) Side** | | |

**Normal Balance is on the debit side because we are working with the Cash account (Asset). And the normal balance for Assets is Debit.**

**General Ledger Running Balance ( DO NOT USE THIS IS ACCG 1000 )**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **ACCOUNT: Cash at Bank** | | | **Account No. 100** | |
| **Date** | **Explanation** | **Debit** | **Credit** | **Balance** |
| 2016 Oct. 3 | Capital, Chris | 60000 |  | 60000 |
| 4 | Vehicle |  | 30000 | 30000 |
| 15 | Income | 6000 |  | 36000 |
| 16 | Wages expense |  | 5000 | 31000 |
| 20 | Accounts Payable |  | 2000 | 29000 |
| 21 | Accounts Receivable | 1000 |  | 30000 |
| 25 | Chris, Drawings |  | 1400 | 28600 |

## T-Accounts Examples

“CLOSING BALANCE” ON **NON-NORMAL BALANCE SIDE (FOR EVERY SINGLE T-ACCOUNT)**  
“OPENING BALANCE” FOR PERMANENT ACCOUNTS – ON **NORMAL BALANCE SIDE (ASSETS, LIABILITIES, CAPITAL)**“BALANCE” FOR TEMPORARY ACCOUNTS – ON **NORMAL BALANCE SIDE (REV, EXPENSES, DRAWINGS)**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Cash at Bank** | | | | | |
| Date | Account | $ | Date | Account | $ |
| 1 Aug | Share Capital | 17 000 | 12 Aug | Office Equipment | 1 000 |
| 10 Aug | Service Revenue | 12 400 | 31 Aug | Closing Balance | 29 000 |
| 31 Aug | Accounts Receivable | 600 |  |  |  |
|  |  |  |  |  |  |
| 1 Sept | Opening Balance | 29 000 |  |  |  |
|  |  |  |  |  |  |
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|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Office Equipment** | | | | | |
| Date | Account | $ | Date | Account | $ |
| 12 Aug | Cash / Bank Loan | 4 000 | 31 Aug | Closing Balance | 4 000 |
|  |  |  |  |  |  |
| 1 Sept | Opening Balance | 4 000 |  |  |  |
|  |  |  |  |  |  |
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|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Bank Loan** | | | | | |
| Date | Account | $ | Date | Account | $ |
| 31 Aug | Closing Balance | 3 000 | 12 Aug | Office Equipment | 3 000 |
|  |  |  |  |  |  |
|  |  |  | 1 Sept | Opening Balance | 3 000 |
|  |  |  |  |  |  |
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|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Share capital** | | | | | |
| Date | Account | $ | Date | Account | $ |
| 31 Aug | Closing Balance | 17 000 | 1 Aug | Cash | 17 000 |
|  |  |  |  |  |  |
|  |  |  | 1 Sept | Opening Balance | 17 000 |
|  |  |  |  |  |  |
|  |  |  |  |  |  |

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Sales Revenue** | | | | | |
| Date | Account | $ | Date | Account | $ |
| 31 Aug | Closing Balance | 13 900 | 10 Aug | Cash | 12 400 |
|  |  |  | 25 Aug | Accounts Receivable | 1 500 |
|  |  |  |  |  |  |
|  |  |  | 1 Sept | Balance | 13 900 |
|  |  |  |  |  |  |

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Accounts Receivable** | | | | | |
| Date | Account | $ | Date | Account | $ |
| 25 Aug | Service Revenue | 1 500 | 31 Aug | Cash | 600 |
|  |  |  | 31 Aug | Closing Balance | 900 |
| 1 Sept | Balance | 900 |  |  |  |
|  |  |  |  |  |  |
|  |  |  |  |  |  |

## Unadjusted Trial Balance Example (based on above)

|  |  |  |
| --- | --- | --- |
| **Unadjusted Trial Balance as of 31 Aug 2022** | | |
| **Account Name** | **Debit ($)** | **Credit ($)** |
| Cash | 29 000 |  |
| Office Equipment | 4 000 |  |
| Accounts Receivable | 900 |  |
| Bank Loan |  | 3 000 |
| Share Capital |  | 17 000 |
| Sales Revenue |  | 13 900 |
| **Total** | **33 900** | **33 900** |

# Week 6

## Cash Basis Accounting

The process of recording revenue and expenses only when cash exchanges hands / entities.

## Accrual Basis Accounting

The process of recording revenue and expenses when they occur. As these occurrences do not necessarily see an exchange of cash or similar asset, adjusting entries are made at the end of an accounting period to account for these revenues and expenses.

## Why adjusting entries?

* Arise when accrual-based accounting is adopted
* Occurs when cash was paid or received during a different period of the matching expense and income are recognised
* Adjustment **must be made on the last day** to properly recognise the expense or income

## Classification of adjusting entries

|  |  |  |
| --- | --- | --- |
| **Deferrals (Prepayments)** | **Prepaid Expense**  Costs/expenses paid for before they are consumed (E.G., **prepaid insurance**) | **Unearned revenue**  Revenues that are collected or received but not yet earned (E.G., **subscription revenue**) |
| **Accruals (Unrecorded)** | **Accrued Expense**  Expenses incurred but not yet paid (E.G., **accrued salaries**) | **Accrued Revenue**  Revenue earned by not yet received (E.G., **accounts receivables**) |

## How to record

|  |  |  |
| --- | --- | --- |
| **Deferrals (Prepayments)** | **Prepaid Expense**  ***Initial Entry***  **Dr** – Prepaid expense (asset)  **Cr** – Cash  ***Adjusting Entry***  **Dr** – Expense  **Cr** – Prepaid expense (asset) | **Unearned revenue**  ***Initial Entry***  **Dr** – Cash  **Cr** – Unearned revenue (liability)  ***Adjusting******Entry***  **Dr** – Unearned revenue (liability)  **Cr** – Revenue |
| **Accruals (Unrecorded)** | **Accrued Expense**  ***Adjusting Entry***  **Dr** – Expense  **Cr** – Expense payable (liability) | **Accrued Revenue**  ***Adjusting Entry***  **Dr** – Receivable (asset)  **Cr** – Revenue |

## Depreciation

Depreciation is considered a **contra-asset** and has a Cr normal balance (assets have a Dr normal balance). As this is an accrual (unrecorded), no initial entry is required.

### Adjusting Entry

**Dr** – Depreciation Expense (expense)

**Cr** – Accumulated Depreciation (non-current asset)

**Example of Adjusting Entry (Deferral – Prepaid Expense)**

Graphical user interface

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**Example of Adjusted Trial Balance**

Table

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# Week 7

### **CLOSING ENTRIES IN SIMPLETON TERMS:**

* ***There are temporary accounts (REVENUE, EXPENSES, DRAWINGS/DIVIDENDS)***
* ***There are permanent / real accounts (ASSETS, LIABILITIES, EQUITY (CAPITAL / RETAINED EARNINGS)***
* ***On the balance sheet, we DO NOT want any temporary accounts***
* ***Temporary accounts are for the Profit and/or Loss Statement***
* ***Permanent / real accounts are for the balance sheet***
* ***Closing entries is just simple math***
  + ***1 – Create a temporary and special account called the P&L Summary***
  + ***2 – Move all income, expenses, and drawings to the P&L Summary***
  + ***3 – Once you have combined all of these, if there is a profit, add that to the capital / retained earnings of the balance sheet***
  + ***THAT’s LITERALLY IT!***

**CLOSING ENTRIES STEPS:**

1. ***Close ALL Income Accounts to the P&L Summary (Dr INCOME, Cr P&L)***Table

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2. ***Close ALL Expense Accounts to the P&L Summary (Dr P&L, Cr EXPENSES)***Table

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3. ***Close the P&L Summary to Capital / Retained Earnings  
   (WE MUST BRING THE NEW TEMP P&L SUMMARY ACCOUNT TO NIL)  
   (Step 3 – Profit [Dr P&L, Cr CAPITAL])*** Table

   Description automatically generated ***(Step 3 – Loss [Dr CAPITAL, Cr P&L])***Table

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4. ***Close Drawings / Dividends to Capital / Retained Earnings (Dr CAPITAL, Cr DRAWINGS)***Table

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## Closing Entries

* Occurs at the end of a period
* This is the closing of the books
* Needed to make sure income or expenses from a previous accounting period don’t carry over to the current accounting period
* A business must start from zero in order to measure its business performance in the following period
* Closing entries are recorded in the general journal and then posted to the general ledger
* “Effectively ‘close’ all temporary accounts to the permanent equity account (Capital) at the end of the accounting period”
* “A special temporary account, ‘**Profit or(and) Loss Summary**’ account, is created to facilitate the closing period”
* “Income and expense accounts then begin the next accounting period with a zero balance”

## Temporary Accounts (EXPENSES + REVENUES)

* Relate to only a given accounting period
* Must be ‘closed’ to set the account balance to zero balance at the end of each accounting period
* E.G., revenues, expenses, drawings/dividends

## Permanent (Real) Accounts (ASSETS + LIABILITIES + EQUITY)

* Carried forward to future accounting periods
* E.G., assets, liabilities, equity (capital, retained earnings)

## Closing Entry Steps (4 Steps) ???

1. **Close all income accounts (🡪 zero balance) to the P&L Summary account:**

**DR** (EACH INDIVIDUAL) INCOME ACCOUNT

**CR** P&L SUMMARY

This is because ‘INCOME’ accounts have a Cr normal balance, we must Dr to move to zero

1. **Close all expense accounts (🡪 zero balance) to the P&L Summary account:**

DR P&L SUMMARY

CR (EACH INDIVIDUAL) EXPENSE ACCOUNT

This is because ‘EXPENSE’ accounts have a Dr normal balance, we must Cr to move to zero

1. **Close P&L Summary account to the Capital account (FOR SOLE TRADER)**
   1. If the P&L Summary account has a Cr balance (i.e., net profit)

**DR** P&L SUMMARY

**CR** CAPITAL

* 1. If the P&L Summary account has a Dr balance (i.e., net loss)

**DR** CAPITAL

**CR** P&L SUMMARY

**We INCREASE Capital account if profit is made, decrease for a loss  
P&L Summary account MUST BE ZERO after this step**

1. **Close P&L Summary account to the Retained Earnings account (FOR COMPANY)**
   1. If the P&L Summary account has a Cr balance (i.e., net profit)

**DR** P&L SUMMARY

**CR** RETAINED EARNINGS

* 1. If the P&L Summary account has a Dr balance (i.e., net loss)

**DR** RETAINED EARNINGS

**CR** P&L SUMMARY

**We INCREASE Retained Earnings account if profit is made, decrease for a loss  
P&L Summary account MUST BE ZERO after this step**

1. **Close Drawings account (🡪 zero balance) to the Capital account (FOR SOLE TRADER)**

**Dr** Capital

**Cr** Drawings

Drawings are also temporary – the balance of drawings MUST EQUAL ZERO after this step

1. **Close Dividends account (🡪 zero balance) to the Retained Earnings account (FOR COMPANY)**

**Dr** Retained Earnings

**Cr** Dividends

Dividends are also temporary – the balance of dividends MUST EQUAL ZERO after this step

## Closing Entries (End Result)

* **ALL** income accounts will have zero balance
* **ALL** expense accounts will have zero balance
* The drawings (dividends) account will have zero balance
* **The Capital (Retained Earnings) accounts has either been increased by the profit, or decreased by the loss and decreased by the drawings (dividends)**

Table

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* **ONLY PERMANENT (REAL) ACCOUNTS LEFT**
* **Cr AND Dr MUST BE IN BALANCE!**

# Week 8

## Information needed by stakeholders

1. **Financial performance**

Information about the ability of the entity to utilise its assets effectively and efficiently (Profitable? High volume of sales?)

1. **Financial position**

Information about the financial resources controlled by the entity information about the entity’s financial structure (What is the total liability?)

1. **Cash movements**

Information about the entity’s ability to generate cash flows (Cash inflows vs Cash outflows)

## Income Statement (Statement of Financial Performance OR Profit or Loss Statement)

* Shows **financial performance** for a **specific time period**
* Shows income and expenses
* Income > Expenses = Profit
* Income < Expenses = Loss

**Example**

Table

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## Balance Sheet (Statement of Financial Position)

* Reports **financial position** at a **specific point in time**
* Shows assets, liabilities, and equity
* Represents the accounting equation (Assets = Liabilities + Equities)
* Two alternative presentation formats
  + Narrative format (vertical) **PREFERRED IN ACCG1000**
* Income > Expenses = Profit
  + Account format (horizontal)

**Example**

Table

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## Statement of Changes in Equity

* Reports the changes that took place in equity during the period
* **Shows the opening balance, the movement, and the ending balance of equity**
* Opening balance should match closing balance of previous period
* **Both Balance Sheet and Statement of Financial Position show ending balance of equity**

**Example**

Table

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**Capital is on both Balance Sheet and Statement of Changes in Equity**

**Income Statement**

# Week 9

## Ratio Analysis

* Mathematical relationship between two different quantities
* Used to show relationships among items of financial statement data
* Expressed in terms of percentages, rates, or proportions

1. Profitability Ratio
   1. Return on assets
   2. Profit margin
2. Liquidity Ratio
   1. Current ratio
3. Solvency ratio
   1. Debt to total assets ratio

## Profitability Ratio

* Measure operating success of a company for a given period
* **Profit/Loss** = Revenue – Expenses
* Profit margin – indicated % of profit for EACH DOLLAR of revenue
* Return on assets – indicates % of profit for EACH DOLLAR invested in assets
* **Profit margin = Profit / Revenue (% margin)**
* **Return on Assets = Profit / Average Total Assets**
  + *Average Total Assets is calculated by taking the average of the current and previous periods total assets from the respective balance sheets*

## Liquidity Ratio

* **Identify risk for company’s ability to pay short-term debt**
* Measures short-term ability of entity to pay its maturing obligations and to meet unexpected needs for cash
* Current ratio – indicated how much current assets EXCEED current liability on a dollar-for-dollar basis (rule of thumb is normally 1.5 : 1)
* **Current ratio = Current assets / Current liabilities**

## Solvency Ratios

* **Identify risk for company’s ability to pay long-term debt**
* Measures the ability of entity to survive over a long period of time
* Debt to total assets ratio
  + Measures percentage of assets financed by creditors rather than shareholders
  + The higher the ratio, the greater the risk that entity may be unable to pay its debts as they become due
  + **Debt to total assets ratio = Total liabilities / Total assets**

# Week 10

## What is Management Accounting?

“Refers to the process and techniques that focus on the **effective and efficient use of organisational** **resources\*\*** to support managers in their tasks of enhancing both customer value and shareholder value”

**Resources\*\*** - Can be financial or non-financial, including information, work processes, employees, loyal customers, and committed suppliers

## Management Functions

1. **Planning** – Looking ahead and establishing short-term and long-term objectives
2. **Directing and Motivating** – Implementation of plans by coordinating diverse activities and human resources
3. **Controlling** – The process of keeping the entity’s activities on track

## Management Cost Concepts

“Cost information is crucial for the planning, control, and evaluating functions performed by management. Having accurate and timely information relating to costs enables an assessment to be made of the **efficiency and effectiveness** with which the entity’s scarce economic resources have been managed.”

What are costs?

* Resources given up to achieve a particular objective
* Measured in monetary terms $$$

Important questions?

* What costs are involved in making a product?
* If production volume is decreased, how much will costs decrease?
* What impact will automation have on total costs?
* How can costs be best controlled?

## Manufacturing Costs

Associated with converting raw materials into finished goods

Major classifications:

* Direct materials
* Direct labour
* Manufacturing overheads

## Direct Materials

* Cost of raw materials directly traceable to the finished products
* E.G., flour for bread, timber for furniture

## Direct Labour

* Wages and salaries paid to employees whose time and costs can be traced directly to products
* E.G., bakers in a bakery, labour in a furniture factory

## Manufacturing Overhead

Indirectly associated with the manufacture of finished product, it includes:

* Indirect materials
  + Do not physically become part of the finished product
  + E.G., oil for lubricating machines, small parts used in production
* Indirect labour
  + Cannot be directly traced to specific goods
  + E.G., maintenance crew and supervisors
* Depreciation on factory, buildings and machinery, insurance, and maintenance on factory facilities

## Some Terminologies for Costs

*All Costs = Product Costs + Period Costs*

**Product Costs:**

* Costs that are a necessary and integral part of producing the finished product
* E.G., direct materials, direct labour, manufacturing overhead

**Period Costs:**

* Costs that are identified with a specific period rather than with a saleable product 🡪 non-manufacturing costs
* E.G., selling expenses, administrative expenses, financial expenses

**Conversion Costs:**

* Direct labour and manufacturing overhead are incurred in converting direct materials into finished goods
* Conversion Costs = Direct Labour Costs + Manufacturing Overhead

**Prime Costs:**

* The major costs associated with producing a product
* Prime Costs = Direct Labour Costs + Direct Material Costs

Diagram

Description automatically generated

# Week 11

## Variable Costs (AKA PRODUCT COSTS – WK10)

* Costs that vary in total directly and proportionately with changes in the activity level
* E.G., materials used to produce goods
* **Cost per unit is constant, total cost increases with volume increase**
* **INCLUDES DIRECT MATERIAL, DIRECT LABOUR, AND OVERHEAD**

Chart, histogram

Description automatically generated

## Fixed Costs (AKA PERIOD COSTS – WK10)

* Costs which remain relatively constant regardless of the activity level
* E.G., rent and insurance paid for factory
* Fixed cost per unit = total cost divided by units of activity level
* **Total cost is constant, cost per unit decreases with volume increase**

Chart

Description automatically generated

## CVP Analysis

CVP (**Cost-volume-profit**) analysis can answer the following questions:

1. Entity’s breakeven point
2. Impact on sales volume and profit of increased costs
3. Sales level needed to make a profit
4. Impact of changes in selling price
5. Most profitable sales mix (NOT COVERED IN ACCG1000)

### Five Basic Assumptions of CVP

1. Costs and revenues are **linear** within the **relevant range**
2. All costs are identifiable as **variable or fixed**
3. Costs are affected only by changes in **activity level**
4. All units produced are sold
5. Sales mix is **constant** if there is more than one product (NOT COVERED IN ACCG1000)

### CVP “Master Formula”

* Revenue – Variable Costs – Fixed Costs = Profit

### Contribution Margin (CM)

* CM = the amount of revenue remaining after deducting variable costs  
  **CM = Revenue – variable costs**
* Can be expressed as a total amount, or on a per-unit basis  
  **CM/unit = Unit selling price – unit variable cost**
* Can be expressed as a ratio (Contributing Margin Ratio)
  + This indicates the proportion of each sales dollar available to cover fixed costs and earn a profit

### Break-Even Point (BEP)

* BEP is the point at which the level of activity will result in **ZERO** profit
* Can be expressed in terms of sales dollars or sales units
* Can be determined using:
  + Mathematical equation
  + Contribution margin approach

### Contribution Margin Approach

* Break-even point can be defined in terms of sales units
  + **BEP (# of units) = Fixed costs / Contribution Margin per unit**
* Break-even point can be defined in terms of sales dollars
  + **BEP ($$$) = Fixed costs / Contribution Margin Ratio**

### Margin of Safety

* The difference between actual (or expected) sales and break-even sales
* Can be expressed in dollars or as a ratio
* Gives a feel for how close projected operations are to the break-even point 🡪 indicates the amount by which sales can drop before a loss is incurred

### Target Profit

* A profit objective for the product line
* Break-even analysis is expanded by adding target net profit to total costs
* Can be determined using:
  + Mathematical equation
  + Contribution margin approach
* **Required Sales = (Fixed Costs + Target Profit) / Contribution Margin Ratio**

# Week 12

## What is Sustainability?

“Development that meets the needs of the present without compromising the ability of future generations to meet their own needs”

## Key Drivers of Sustainability

* Competition for resources
* Climate change
* Economic globalisation
* Connectivity and communication

## Three Pillars of Sustainable Development

1. **Environmental** protection
2. **Social** equity
3. **Economic** performance

Diagram, venn diagram

Description automatically generated

## Limitations of Traditional Accounting (ONLY FOCUSSED ON THE ECONOMY PILLAR)

* Focus on economic performance
* Remain silent on social and environmental issues
* How is success calculated?

## What we try to do now?

* Explore the unmarked and unreported voices in social and environmental issues, and the attributing consequences

## Environmental Accounting

*Carbon Emissions*

* Emissions trading schemes (ETS) are designed to control emissions aby allowing participants to trade excess emissions permits
* Carbon tax where a levy is paid based on the amount of emissions of greenhouse gases (GHGs)

*Water Accounting*

* Australian Water Accounting Standards – provide guidance and explanatory material to assist in preparing, presenting, and assuring general purpose water accounting reports

## Social Accounting

* Acts as a mechanism to offer greater corporate accountability and transparency
* “Involves the preparation and publication of an account about an organisation’s **social, environmental, employee, community, customer, and other stakeholder interactions and activities**, and where possible, the consequences of those interactions and activities”

*Objectives of Social Accounting:*

* Challenges traditional (financial) accounting
* Challenges the absences of traditional accounting
* Gives accountability beyond the shareholders
* Ensures the corporation acknowledges the responsibility it has towards the ethical, social, and environmental performance

## Integrated Reporting <IR> ???

* A holistic approach that shows stakeholders how an organisation creates value over time
* Shows the links between an organisation’s strategy, governance, and business model
* Integrated reporting is voluntary in Australia and New Zealand

## Do Stakeholders Care?

* Shareholders – can improve entity value
* Customers – some are interested in the source of products and actively seek ‘green’ or ‘fair trade’ products
* Creditor or banks – financial institutions need to consider the environmental impacts of projects they fund
* Media – can voice concerns of other stakeholders as well as set the public agenda relating to corporate sustainability issues
* Government – in some jurisdictions, governments are required to monitor mandatory reporting of sustainability or environmental issues

## Roles of Accounting in Sustainability

* Reporting
* Cost Analysis
* Audit and Assurance Services

## Limitations of Environmental and Social Accounting

* Criticised for lack of completeness
* Subjectivity in recording social and environmental issues
* Lack of ‘numbers’ – difficult to measure
* Who should prepare a corporations social account?
* Can a corporation adequately take responsibility for that which is external?