ACCY 111 Accounting Fundamentals In Society Summary Notes

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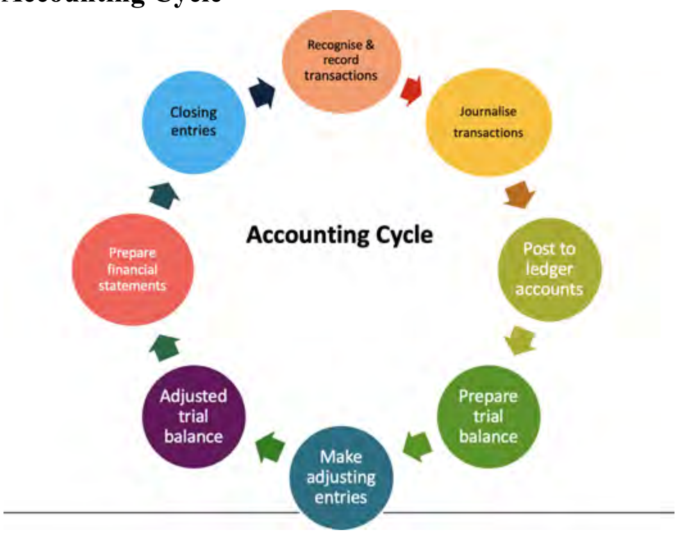
Week 3 - Recording Transactions

Accounting Cycle

What is an accounting cycle?

- Steps and procedure, ending in the preparation of financial statements, are referred to as the accounting cycle
- During each period, steps and procedures are followed within the accounting function to ensure that all transactions are properly recorded
- Basic accounting period for which financial statements are presented is 1 year (e.g 1 July 2021-30 June 2022)

Accounting Cycle



Transactions (pp 63-65)

External Transactions

- Involve an outside party
- Exchange of economic resources and/or obligations
- Example include:
    - Purchase of surfing supplies
    - Purchase of equipment
    - Borrowing money from a bank
    - The performance of services for others (e.g medical, legal, cleaning, marketing, public relations)

Internal Transactions

- Generally triggered by and are concerned with internal functions of a business
- Examples include:

Double Entry Accounting

Double entry accounting

- Transactions are recorded using the double-entry accounting system
- Debit and credit rules
- Two or more accounts are affected by each transaction
- Each transaction must be analysed to determine:
    - What type of accounts are affected
        - Assets, liabilities, equity, income and expenses
    - By how much each item must be increased or decreased

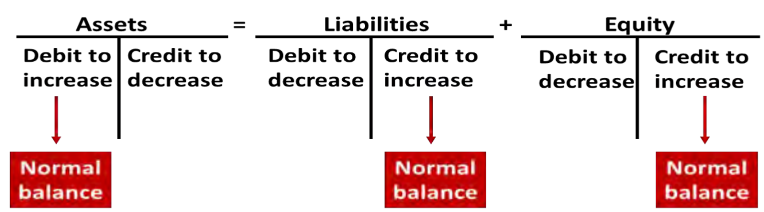
- Two equal sides, DEBIT = CREDIT
- The sum of debits equals the sum of credits
- The accounting equation must always remain in balance

Assets = Liabilities + Owners Equity

Debit and Credit Rule

- Debit and credit are an instructions we use in double-entry accounting system
    - Debit (DR) = 'on the left-hand side'
    - Credit (Cr) = 'on the right-hand side'
- Whether a debit or a credit is an increase or a decrease to the account balance depends on whether the account is an asset, a liability or an equity account

Accounts: Balance Sheet



Cash Example:

- If you receive cash = Debit
- If you spend cash = Credit

Bank loan example:

- If you borrow loan = Credit
- If you pay off loan = Debit

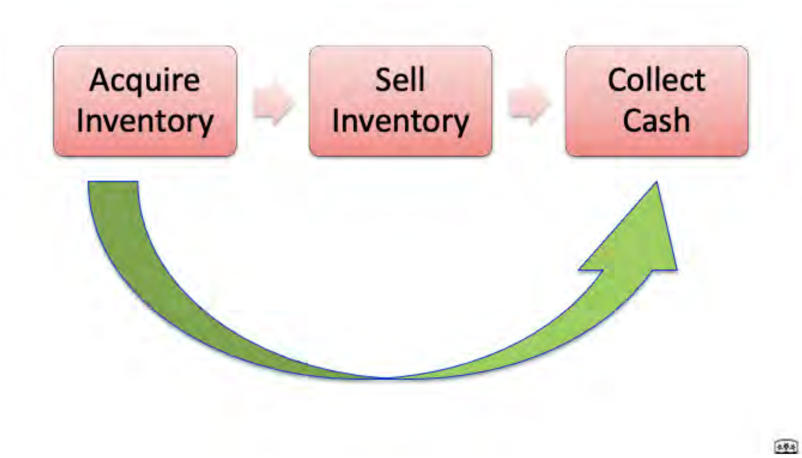
Accounts: Income Statement

Accounting for retailing

Inventory

- AASB 102 Inventories
- Inventory means goods or property purchased and held for sale
- Also known as stock or stock in trade
    - Inventory is one of the most active assets in a retail business
    - At the time of purchase, inventory is recorded at cost
    - Reported in the statement of financial position as a current statement
    - Other assets may be sold from time to time but do not constitute inventory

Operating cycle - retailer



Accounting for sale of inventory

Recording Sales Transaction:

- Recorded when inventory is transferred from the business to the customer
- To record a sale an asset account is debited and the sales account is credited.

Accounting for sales

- The entry to record a $2 000 Sale of inventory on credit and for cash:

General Journal			
Oct 1	Accounts Receivable/Cash	2 000	
	Sales		2 000
	(Sold inventory on credit and for cash)		

Cash (Settlement) Discounts

- The inventory is sold on **credit**, the terms of payment, called the **credit terms** — e.g. '2/10, n/30.
- Provide an incentive for the buyer to make payment before the end of the credit period.

- Converts inventory turnover into a measure of days for inventory to be sold

365 days = days

inventory turnover

Financial Stability Ratios

1. **Debt Ratio**
   - Indicates degree of leverage (percentage of total assets funded through debt)

total liabilities = %

total assets

2. **Asset Turnover ratio**
   - An analysis of entity's ability to use its assets during the period to generate revenue
   - Ratio measure the effectiveness with which all assets have been used
   - Expressed in TIMES, e.g assets have been turned over an average of X number of times

revenue = times

average total assets

Profitability ratios

1. **Return on assets**
   - Measures overall profitability with respect to investment in assets

= profit

average total assets

2. **Profit Margin**
   - Measures percentage of each dollar of sales that results in profit
     - High Volume firms (e.g. supermarkets) generally experience low profit margins
     - Low volume firms (e.g. white goods) have high profit margins

= profit

revenues (sales)

Limitations of Financial Statement Analysis

1. Estimates
   - Financial statements contain manny estimates

     e.g . - allowance for doubtful debts

     - Depreciation expense