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Changes in corporate resources

CHANGES IN CORPORATE RESOURCES

- How can we process the changes??
- We record ALL these changes in **accounts**.
  - We set up accounts for all A, Eq, L, I & E
  - These accounts always **reflect the resource and the changes in the resource they were built on**
    - Example: Petty cash (or cash in hand) account
  - As the **functioning (behavior) of the accounts** is concerned, we may have:
    - Active or asset accounts
    - Passive or liability accounts, and
    - Bifunctional accounts

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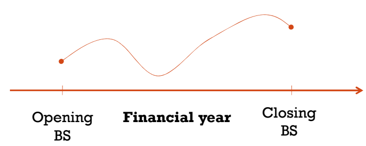
FUNCTIONING RULE OF ACCOUNTS

Active accounts

D	C
Opening balance	
Increases in the resource	**Decreases** in the resource
	Closing balance

Passive accounts

D	C
	Opening balance
Decreases in the resource	**Increases** in the resource
Closing balance	



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There should be a separate account in the general ledger for each type of asset, liability, equity, revenue, gain, expense and loss

- Example
  - Assets:
    - Cash
    - Accounts receivable
    - Inventory
    - Prepaid expenses
    - Land
    - Building
    - Equipment
    - Furniture
    - Goodwill

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- Liabilities
  - Demand loan payable
  - Accounts payable
  - Salaries payable
  - Interest payable
  - Income tax payable
  - Current portion of long term debt
  - Loans payable
  - Bonds payable

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- Revenues
  - Sales revenue
  - Service revenue
  - Interest revenue
- Gains (Losses)
  - Gain (Loss) on sale of fixed assets
  - Gain (Loss) on sale of investments
  - Gain (Loss) on repurchase of bonds

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- Expenses
  - Cost of goods sold
  - Salaries expense
  - Rent expense
  - Repairs and maintenance
  - Interest expense
  - Income tax expense

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DOUBLE-ENTRY BOOKKEEPING

- Newton' Third Law of Motion
  For every action there is an equal and opposite reaction
- Accounting rules
  For every Debit there is an equal and opposite Credit recorded in the accounting records

DOUBLE-ENTRY BOOKKEEPING

- Double-entry bookkeeping is *the* accepted accounting mechanism for recording and classifying the monetary events of a business entity
- The T-account format:

Title and Account

+ Debit side	+ Credit side

- For every monetary event there is at least one entry on the debit side of at least one account and the credit side of another account.

DOUBLE-ENTRY BOOKKEEPING

A = L + OE

Asset (+ | -) = **Liabilities** (- | +) + **Owners' Equity** (- | +)

Account Type
Assets
Liabilities
Owners' Equity

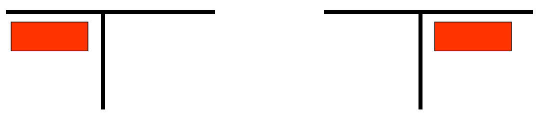
+ Debit Effect	+ Credit Effect
Increase	Decrease
Decrease	Increase
Decrease	Increase

RELATION BETWEEN ACCOUNTS

General journal entries

- method of recording transactions in the accounting records
- two columns needed for amounts
  - left column for debit entries
  - right column for credit entries

D (....) account – C (....) account



•Example

Heather contributes $10,000 cash to her business, Heather's Shoes, Ltd. and receives 1,000 shares

	Debit	Credit
Cash	10,000	
Share Capital		10,000

Cash	
10,000	

Share Capital	
	10,000

DOUBLE ENTRY ACCOUNTING

Every entry into a double entry accounting system must balance

- If cash is received, the source must be recorded
- If cash is paid out, the use must be recorded
- If a sale is made on account, the receivable must be recorded
- If a purchase is made on account, the debt must be recorded

Transaction analysis

1. determine whether an event should be recorded in the accounting records at this time
2. if yes, determine which accounts are affected
3. determine whether each account affected is increased or decreased by this transaction
4. requires significant professional judgement in the real world

BOOKKEEPING

- We can keep the books in two ways:
  - Chronologically, as the events appear in time
    - We use the General journal for this purpose

Or

  - Systematically, as the events affect resource items
    - We use the General ledger to reflect these operations.

STANDARD CHART OF ACCOUNTS

Section 1 of the accounts	Accounts for Assets	Balance sheet Accounts	
Section 2 of the accounts			
Section 3 of the accounts			
Section 4 of the accounts	Accounts for Equity and liabilities		
Section 5 of the accounts	Accounts for costs	Acts like active accounts	
Section 8 of the accounts	Accounts for expenses	Acts like active accounts	
Section 9 of the accounts	Accounts for incomes	Acts like passive accounts	
Section 0 of the accounts	Account for registry		

THE PURPOSE OF THE STANDARD CHART OF ACCOUNTS:

to facilitate the organization of the accounting of the economic entity by incorporating into a standard system the assets and liabilities of the economic entity and the effect of business operations on its profits and losses, and to provide the basic information necessary for the annual account to be prepared.

- **Section 1 of the accounts** includes the accounts used for the registration of intangible assets, tangible assets (including also assets not put into operation and assets in course of construction), and financial investments.
- **Section 2 of the accounts** includes purchased and self-manufactured stocks.
- **Section 3 of the accounts** includes current assets other than inventories (liquid assets, securities, trade debtors, debtors, employees and members, the central budget and other organizations), and deferred expenses and accrued income.
- **Section 4 of the accounts** contains the sources of assets. It includes own funds, reserves, long-term and short-term liabilities, and accrued expenses and deferred income.
- **Section 5 of the accounts** contains the expenses, itemized by costs, broken down per the following categories: raw materials, contracted services, other services, wages and salaries, other employee benefits, contributions on wages and salaries, and depreciation.
- **Section 8 of the accounts** contains material costs [including raw materials and consumables, contracted services, other services, the cost value of goods sold, and the value of services sold (intermediated)] staff costs (including wages and salaries, other employee benefits, contributions on wages and salaries), depreciation write-off and other expenses, expenses on financial transactions and the amount of tax payable for the profit and loss account prepared by the total cost method.
- Sales revenues, other income, income from financial transactions shall be shown under **section 9 of the accounts**.
- **Section 0 of the accounts** contains the records of accounts, items of which do not affect the balance sheet profit or loss figure of the financial year in question nor the amount of own funds on the balance sheet date.

SYSTEM OF ACCOUNTS

- the economic entity keeping double-entry books shall establish a system of accounts, according to which the keeping of books fully ensures the preparation of the annual account.

The system of accounts shall contain the following:

- a) number and description of all accounts designated for use,
- b) content of the account, should it not follow clearly from the description of the account, and the titles of any increase or decrease in the amount under the account, the economic events that affect the account and their relation with other accounts,
- c) connection between the general ledger account and the analytic registers,
- d) the system of documentation in support of the system of accounts.

EXAMPLES OF OPERATIONS

- We have an initial inventory of commodities of 500€, financed from equity.

1. We purchase commodities on credit for 1.000€.
2. We sell half of the inventory for 1.400€ on credit.
3. We receive 1000€ in cash.
4. We pay our supplier 800€ in cash.

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1. WE PURCHASE COMMODITIES ON CREDIT FOR 1.000 €

D 261. Commodities C
Opening balance/ 500
1/454/ 1.000

D 454. Trade payables C
Opening balance / ....
1/261/ 1.000

A ↑ L ↑

Number of event	Transaction	Debit account	Credit account	Sum
1.	purchasing commodities	261. Commodities	454. Trade payable	1.000

2. WE SELL HALF OF THE INVENTORY FOR 1.400 € ON CREDIT.

D 261. Commodities C
Opening balance/ 500
1/454/ 1.000
2.a/814/ 750

D 814. Cost of goods sold C
2.a/261/ 750

A ↓ E ↑

Number of event	Transaction	Debit account	Credit account	Sum
2. a	Selling commodities	814. Cost of goods sold	261. Commodities	750

2. WE SELL HALF OF THE INVENTORY FOR 1.400 € ON CREDIT.

D 311. Receivables C
Opening balance/ ....
2.b./91/ 1.400

D 91. Sales (turnover) C
2.b./381/1.400

A ↑ I ↑

Number of event	Transaction	Debit account	Credit account	Sum
2. b	Selling commodities	311. Receivables	91. Sales (turnover)	1.400

3. WE RECEIVE 1000€ IN CASH.

D 381. Cash C
Opening balance/ ....
3./311/ 1.000

D 311. Receivables C
Opening balance / ....
2.b./91/ 1.400
3/31/ 1.000
Closing balance/ ....

A ↑ A ↓

Number of event	Transaction	Debit account	Credit account	Sum
3.	Receiving cash	381. Cash	311. Receivables	1.000

4. WE PAY OUR SUPPLIER 800 € IN CASH.

D 381. Cash C

Opening balance/ ……… 3/311/ 1.000 | 4./454/ 800

A ↓

Closing balance/ ………

D 454. Trade payables C

L ↓

4./381/ 800 | Opening balance / ……. 1/261/ 1.000

Closing balance/ …….

Number of event	Transaction	Debit account	Credit account	Sum
4.	Paying for supplier	454. Trade payables	381. Cash	800

BALANCE SHEET

Assets	Owners' equity
A. Non-current assets I. Intangible assets II. Tangible assets III. Financial assets B. Current assets I. Inventories a. Commodities 500 € 1.000 - 750 II. Receivables 1.400 -1000 III. Securities IV. Cash 1000 - 800 C. Prepayments	A. Owners' equity I. Share capital II. Share premiums III. Reserves IV. Retained earnings (Net income) - 750 1.400 **Liabilities** B. Provisions C. Long term liabilities I. Long term bank loans II. Debentures D. Short term liabilities I. Trade payable 1.000 - 800 II. Salaries III. Taxes E. Accruals

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INCOME STATEMENT

Expenses	Income
A. Operating expenses I. Cost of raw materials and energy consumed II. Cost of goods sold 750 III. Wages & social contributions IV. Depreciation & impairment V. Others (taxes, charges) B. Financial expenses I. Interests paid II. Impairment of financial assets	A. Operating income I. Sales (turnover) 1.400 II. Change in internally generated inventories III. Capitalized value of assets B. Financial income I. Dividends received II. Income from sale of shares III. Interests received

Net income (profit or loss for the financial year) 650

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Closing Journal Entries

- journal entries prepared at the end of the fiscal year of the business
- the temporary equity accounts (revenues, expenses, gains and losses) are closed into Retained Earnings
  - they accumulate the transactions for the year only, and then their balances are closed to Retained Earnings to allow the next year's transactions to be accumulated
  - temporary account balances are reduced to zero
  - retained earnings increased by net income amount, or reduced by amount of loss
  - if dividends declared are recorded in a temporary account, it is closed to Retained Earnings, reducing the retained earnings balance
- ASSETS, LIABILITIES, SHARE CAPITAL and RETAINED EARNINGS (or OWNER'S CAPITAL) are referred to as permanent accounts because they carry forward on the Balance Sheet from one year to the next

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- Preparation of the financial statements
  1. Income Statement prepared first
  2. Statement of Retained Earnings prepared second
     - need net income from income statement
  3. Balance Sheet prepared third
     - need retained earnings balance at end of period
  4. Cash Flow Statement prepared last
     - uses information from other statements
  5. Notes prepared paralell

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THANK YOU FOR YOUR ATTENTION!

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