Assets, Owner’s Equity, Liabilities, Revenues, Expenses

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Havings of Company

Funds = Sources of Funds
Accounting Objects:

Havings of Company

Assets = Liabilities + Owner’s Equity
Basic Accounting Equation

Assets = Liabilities

Assets (A) = Liabilities (L) + Owner’s Equity (OE)
Definition of Asset:

A resource:

- Controlled by an entity as a result of past events;  
  and
- from which future economic benefits are expected to flow to the entity.

Future economic benefit -

The potential to contribute, directly or indirectly, to the flow of cash and cash equivalents to the entity.
Depending on the period in which the enterprise will receive economic benefits, the assets can be divided into:

- **Non-current Assets** if the period is more than 1 year
- **Current Assets** if the period is less than 1 year
Assets

Non-current assets

Tangible
- Property and plant equipment
- Machines
- Vehicles etc.

Intangible
- Patents
- Licenses
- Trademarks
- Software
- Goodwill

Financial
**Tangible Assets**

Useful life is more than one year.

Have a material form

Used to produce revenue rather than being held for resale.

Can be used separately from other assets
Acquisition Cost of Assets

**General Rule**

The amount of cash or cash equivalents given up to acquire and place the asset in service. Also includes cost incurred to get the asset into the position and condition to start earning revenue.
Acquisition Cost - Buildings /examples/
Acquisition Cost - Equipment

- Net purchase price
- Testing costs
- Transportation costs
- Installation costs
- Other payments
Acquisition Cost
Self-Constructed Assets

The cost should include all materials used and labor directly traceable to the construction as well as indirect costs such as interest, utilities, and supervision.
Depreciation is the process of allocating the cost of non-current assets to the periods that will benefit from its use.

Asset Cost $150,000

Depreciable base $145,000

Salvage value $5,000

Depreciate over useful life. (Depreciation expense)

Not depreciable.
Factors Affecting Depreciation

- Asset cost
- Estimated salvage value
- Estimated useful life
- Depreciation method used
How to present non-current assets in Statement of Financial positions:

We present all non-current tangible assets in their **Carrying amount**/book value/- is the amount at which an asset is recognised in the statement of financial position after deducting any accumulated amortisation and accumulated impairment losses thereon.

\[ \text{CA (BV)} = \text{Acquisition Costs} - \text{Depreciation} \]
Intangible Assets

• An identifiable non-monetary asset without physical substance.
• An asset is identifiable if it either:
  ▫ is separable, i.e. capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, identifiable asset or liability, regardless of whether the entity intends to do so; or
  ▫ arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.
Examples:

- scientific or technical knowledge;
- design and implementation of new processes or systems;
- licences, intellectual property, market knowledge and trademarks
- computer software, patents, copyrights, motion picture films, customer lists, mortgage servicing rights, fishing licences, import quotas, franchises, customer or supplier relationships, customer loyalty, market share and marketing rights;
- purchased goodwill etc.
Financial Assets

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

Financial Asset is any asset that is:

(a) cash;
(b) an equity instrument of another entity;
(c) a contractual right:
   ▫ (i) to receive cash or another financial asset from another entity; or
   ▫ (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity; or
(d) a contract that will or may be settled in the entity’s own equity instruments and is:
   ▫ (i) a non-derivative for which the entity is or may be obliged to receive a variable number of the entity’s own equity instruments; or
   ▫ (ii) a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity’s own equity instruments. For this purpose the entity’s own equity instruments do not IAS 32.11

Examples: Stocks and bonds that were purchased to receive economic benefits from for a period greater than 1 year;
A financial asset or financial liability is classified as held for trading if:

- it is acquired or incurred principally for the purpose of selling or repurchasing it in the near term;

- on initial recognition it is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking; or

- it is a derivative (except for a derivative that is a financial guarantee contract or a designated and effective hedging instrument).
Current Assets

An entity shall classify an asset as current when:

- it expects to realise the asset, or intends to sell or consume it, in its normal operating cycle;
- it holds the asset primarily for the purpose of trading;
- it expects to realise the asset within twelve months after the reporting period; or
- the asset is cash or a cash equivalent unless the asset is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting period.

- An entity shall classify all other assets as non-current.
Current Assets

Inventory:
- Materials
- Work in process
- Finished goods for sale

Accounts receivable:
- From enterprises
- From other customers
- From the State
- Legal claims etc.

Cash:
- Cash on hand
- Bank accounts
- Cash equivalents
Owner’s Equity

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

\[
\text{OEq} = \text{Assets} - \text{Liabilities}
\]

Includes:

- Invested capital; Share capital /by owners/
- Reserves
- Net Income $\rightarrow$ Profit or Loss (Revenues − Expenses)
Liabilities

**Liability** - is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

Depending **on the period for repayment** liabilities can be divided into:

- **Current Liabilities**
- **Non – current liabilities**
What is a Current Liability

**Current liability** is debt with two key features:

1. Company expects to pay the debt from *existing current assets* or through the *creation of other current liabilities*.

2. Company will pay the debt within one year or the operating cycle, whichever is longer.

Current liabilities include *notes payable*, *accounts payable*, *unearned revenues*, and *accrued liabilities* such as *taxes*, *salaries and wages*, and *interest payable*. 
Liabilities

- **Current liabilities:**
  - Accounts payable
    - to suppliers, tax liabilities, from short-term bank and trade loans etc.
  - Accrued liabilities
  - **Payroll and payroll taxes**

- **Non-current (Long-term) liabilities:**
  - Bank loans
  - Notes payable
  - Bonds payable
Revenues and Expenses

• Revenue - increase in economic benefit during the reporting period in the form of acquisition of assets or reduce liabilities, leading to an increase in equity, except that which be distributed to owners of capital and revaluation, reflected in equity.
Expense - reducing the economic benefit during the reporting period in the form of removal or reduction of company assets or increasing liabilities, leading to a reduction in equity, separately from what is be distributed to owners of capital and revaluation reflected in equity.
Revenues and Expenses

• **Accrual basis**
  In order to meet their objectives, financial statements are prepared on the accrual basis of accounting. Under the basis, the effects of transactions and other events are recognised when they occur (and not as cash or cash equivalent is received or paid) and they are recorded in the accounting records and reported in the financial statements of the periods to which they relate.
  Financial statements prepared on the accrual basis contain information not only of past transactions involving the payment and receipt of cash but also of obligations to pay cash for the future and of resources that represent cash to be received in the future. So they provide the information about past transactions and other events that is most useful to users in making future economic decisions.
Example:

- Company “Z” sells services to a client for €1000, which will pay after 1 month. Although he will not pay now, the company should account for income at the time of the transaction and another object called an account receivable.

\[
\begin{align*}
\text{Assets} & \quad 1000 \quad = \quad 1000 \quad \text{Owners’ Equity}
\end{align*}
\]
An entity receives monthly invoice for GSM on 29/01/2011. The company will pay this invoice in February.

In what month the enterprise will recognize an expense?

However, the cost will be reflected for January.
Tests and Problems
To be classified as a current liability, a debt must be expected to be paid:

a. out of existing current assets.
b. by creating other current liabilities.
c. within 2 years.
d. both (a) and (b).
1: Tick the correct Answer:

- Capital refer to equity of owner in a firm  
  T/F
- Liabilities are claim of outsiders in a business.  
  T/F
- Inventories are current assets.  
  T/F
- Revenue means income.  
  T/F
- Commission receive is an income.  
  T/F
- Building purchase for office will be included in fixed assets.  
  T/F
2. Fill in the blanks:

• Any action undertaken for purpose of earning profit is called ____________________
• Art of measuring, communicating, interpreting financial activities is called ______________
• Any dealing between two persons in term of money is called____________________
• Goods sold in course of trading is called ____________
• Any documentary evidence in support of business transaction is called as ________________
• Amount of cash and goods which owner of business invest is called ________________
3: Classify following as Assets, liabilities and Owners equity.

- Account Receivable
- Account Payable
- Loan from Bank
- Capital
- Building
- Machinery
- Expenses Payable
- Net Income
4: Classify as Current asset, Non current asset, Fixed asset, Intangible asset:

- Cash,
- Account receivable,
- Building,
- Investments,
- Goodwill,
- Inventories,
- Copyright,
- Prize bonds,
- Furniture,
- Electric fans,
There are listed assets, liabilities and owner’s equity of “KML Ltd.“ Please define them:

- Shared capital - 29 050
- Materials - 12 000
- Accounts payable – 8 300
- Buildings - 5000 and accumulated depreciation(amortization) of buildings 2 700
- Office equipment – 2300 and accumulated depreciation(amortization) of office equipment 800
- Software – 1000 and accumulated depreciation(amortization) of software 200
- Current income tax liabilities – 1 220
- Investments in other companies (52% ot stocks) – 4 600
- Cash on deposit – 8 900
- Profit – 780
- Cash on hand – 2 400
- Reserves – 2 000
- Land – 2 000
- Loans payable for the period of 3 years – 2 850
- Accounts receivable – 3 000
- Inventories – 2 200
- Investments held for trading (stocks on other firms) – 1 200
- Trademarks – 2 500
- Goodwill - 2000
- Production - 1 300
- Losses – 1 500