Management and Accounting - Modulo 2
(Accounting and Financial statement analysis)

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ACCOUNTING AND FINANCIAL STATEMENT ANALYSIS

INTRODUCTION TO FINANCIAL STATEMENT AND FINANCIAL ACCOUNTING

WHAT IS A FINANCIAL STATEMENT?

Financial statement refers to specific thing and specific period; this is the financial statements of Coca-Cola. Accounting period is the length pf time during niche the events are recorded, and financial statement is prepared. Is the same of calendar year: it begins the 1 of January and end the 31 of December. Not for all companies the accounting companies is the same of the calendar year (like football club).

INCOME STATEMENTS:

- **REVENUES – EXPENSES = NET INCOMES** (profit when revenues are higher than expensive and vice versa is negative). If net incomes < 0, it is called net loss.

Revenues increase in net incomes and expenses decrease in net incomes.
Revenues are services and good sold by the companies.
Expensive are all the cost that a company need to do (selling expenses, administrative expenses).
Income statement is useful to understand how well perform a company.

The Income Statement reports the company's revenues, expenses and net earnings (or income) for the accounting period. In order to define revenues and expenses we need to first define net earnings. Net earnings represent the result of the business operations. It is the amount. Earned by income-producing activities.
Revenues are increases in net earnings deriving from sales of goods or services to customers or clients.
Expenses are decreases in net earnings. They are the cost of doing business, that is the cost of all the resources USED to perform the business' activity.

THE COMPANY AND SUBSIDIARIES – Consolidated Statements of Income

(in millions $, except per-share data)

Year ended December 31,	2024		2023	2022
Net Operating Revenues	**$47.061**	100%	**$45.754**	**$43.004**
Cost of goods sold	-18.324		-18.520	-18.000
Gross Profit	**28.737**		**27.234**	**25.004**
Selling, general and administrative expenses	-14.582		-13.972	-12.880
Other operating charges	-4.163		-1.951	-1.215
Operating Income	**9.992**		**11.311**	**10.909**
Interest income	988		907	449
Interest expense	-1.656		-1.527	-882
Equity income	1.770		1.691	1.472
Other income	1.995		570	-338
Income Before Income Taxes	**13.086**		**12.952**	**11.686**
Income taxes	-2.437		-2.249	-2.115
Consolidated Net Income	**10.649**	23%	**10.703**	**9.571**

THE COCA-COLA COMPANY AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In millions except par value)

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December 31,	**2024**
ASSETS	
Cash and cash equivalents	$10,828
Short-term investments	2,020
Total Cash, Cash Equivalents and Short-Term Investments	*12,848*
Marketable securities	1,723
Trade accounts receivable	3,569
Inventories	4,728
Prepaid expenses and other current assets	3,129
Total Current Assets	**25,997**
Equity method investments	18,087
Deferred income taxes	1,319
Property, plant and equipment — net	23,300
Trademarks and indefinite lives	13,301
Goodwill	18,139
Other non-current assets	13,403
Total Non Current Assets	**74,552**
TOTAL ASSETS	100,549
TOTAL ASSETS	100,549

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December 31,	**2024**
LIABILITIES AND EQUITY	
Accounts payable and accrued expenses	$21,715
Loans and notes payable	1,499
Current maturities of long-term debt	648
Accrued income taxes	2,469
Long-term debt	42,375
Other non-current liabilities	4,084
Total Non Current Liabilities	**42,969**
TOTAL CIABILITIES	**74,717**
TOTAL LIABILITIES	
The Coca-Cola Company Shareowners' Equity:	41,659
Common stock	1,760
Capital surplus	19,801
Retained earnings	-76,054
Accumulated other comprehensive income	-16,843
Tresury stock — at cost:	1,158
Equit (ɘttibɩıteʂ to concntrolling interests	**26,378**
TOTAL, LABILTIES	26,372
TOTAL LIABILITIES AND EQUITY	100,549

BALANCE SHEETS:
Picture of the financial position at the end of the accounting period. It reports three main categories of items:

- **Asset:** what the company own to do a its business, are useful to do the business, economic resources of a business that are expected to be a benefit in the future. Like cash or trade accounts receivable, inventories.
- **Liability:** both are who has aim on the asset, a company holds something, are outsider claims, economic obligation payable to creditors. Are something that a company must pay in the future. Liability is obligation.
- **Equity**: insider claim asset for owner of the companies, what put the owner of the company. Risk capital = a company haven't an obligation to pay, if the business runs well the company pays the owner (dividendo). What remains to the owner after all liabilities are paid. Owner claims in the asset of a business.

Asset is financed by liabilities or equity.
ASSET = LIABILITIES + EQUITY
The balance is useful because you can read how many assets need the company to do her business and what kind of asset, and who claims that asset.

Assets are the economic resources of a business that are expected to be of benefit in the future (examples: cash, merchandise, buildings, furniture…). Liabilities are "outsider claims", that is economic obligations (debts) payable to outsiders (creditors) (example: a loan). Shareholders' (or Owners') Equity represents the "insider claims" to the business resources. These are the assets held by the owners who invested money in the firm.

THE COMPANY AND SUBSIDIARIES CONSOLIDATED
STATEMENTS OF CASH FLOWS
(In millions)

Year ended December 31,	2024	2023	2022
Operating Activities	$10,649	$10,703	9,571
Consolidated net income	1,075	1,128	1,260
Adjustments to reconcile consolidated net income to net cash provided by operating activities:			
Depreciation and amortization	1,075	1,128	1,260
Stock-based compensation expense	286	254	356
Deferred income taxes	-11	-2	-182
Equity (income) loss — net of dividends	-802	-1,019	-838
Foreign currency adjustments	311	-43	299
Significant (gains) losses — net	-111	-226	11
Other operating charges	6,807	1,599	1,783
Net Cash Provided by Operating Activities	6,805	11,599	11,108
Investing Activities			
Purchases of investments	-5,640	-6,698	-3,751
Proceeds from disposals of investments	2,689	6,454	4,771
Acquisitions of businesses, equity method investments and non marketable securities	-415	-150	-900
Purchases of property, plant and equipment	-3,485	-3,830	-3,240
Proceeds from disposals of property, plant and equipment	235	366	765
Collateral (paid) received associated with hedging activities — net	-25	-1,862	-1,484
Net Cash Provided by (Used in) Investing Activities	-6,641	932	-3,839
Financing Activities			
Issuances of loans, notes payable and long-term debt	12,061	6,891	8,972
Payments of loans, notes payable and long-term debt	-9,533	-1,504	-490
Dividends	-4,638	-4,431	-1,109
NET INCREASE (DECREASE) IN CASH DURING THE YEAR	1,796	-133	-200

CASH FLOW STATEMENTS:

Is similar to the income statement because here they have to move cash in the accounting period (increasing or decreasing cash). Is useful to read the increasing or decreasing of cash but also for know how it does it; the cash flow can increase or decrease for:

- Operating activities
- Investing activities: cash that the company need to buy things.
- Financial activities

The basic set of financial statements is composed of the following (italian translation in brackets):

- Income Statement (Conto Economico).
- Balance Sheet (Stato Patrimoniale).
- Statement of Cash Flow (Rendiconto Finanziario).
- Notes to the accounts (nota integrativa): provide details about the numbers reported.
- Directors' Report (relazione sulla gestione): provide comments from the Directors on the activity and the performance of the Company.
- Audit Report (relazione del revisore): is a sort of «certification» provided by an independent professional (the auditor) that provide assurance on the reliability of the financial statement and its compliance with relevant regulation.

Financial statements tell us how well a business entity is performing in terms of profits and losses and where it stands in financial terms.
The most basic concept in accounting is the entity concept. An accounting entity is an organization that stands apart as a separate economic unit. From an accounting point of view, we need to clearly separate each entity in order not to confuse its affairs with those of other entities. In other words, when we prepare a set of financial statements, we do it with reference to a specific entity, whose name is reported on the top of each statement.
There are several legal forms of organizations (we'll see them later).

For our purposes, we'll refer to a generic "company". When necessary, we'll distinguish among the different forms of business.

ACCOUNTING PERIOD:
For each statement we talk about a "period". This is the accounting period, that is the period of time depicted by financial statements. Usually, this period corresponds to the calendar year (01.01-12.31). When the accounting year is different from the calendar year, we talk about fiscal year. The accounting year chosen by each entity is reported on the top of each statement. Now let's have a closer look at each of the statements we mentioned.

WHY FINANCIAL STATEMENT IS SO USEFUL?

To manage and evaluate the performance of a company.
The **Income Statement** is useful to understand how well the company performs during a period.
The **Balance Sheet** is useful to understand how many assets and what kind of assets the company owns for its business at the end of a period and who has claims on them. How much liabilities and how much equity has a company. Liabilities must be paid on the scheduled due dates; equity is risk capital...
The **Cash Flow Statement** show how much cash a company generate and spend during the period.
The Financial statement is useful:

- **To manage business**: every business decision has impact on revenues, expenses, net income, assets, liabilities and cash flow. Financial statement and accounting are useful to take the best decision to manage a company.
- **To evaluate business decision**: managers and investors need Financial Statement and accounting information to evaluate if the company is able to reach its goals or if it's a profitable investment (in comparison to other investments).
- **For internal users**: Managers who plan, organize and run a business. These include marketing managers, production supervisors, finance directors and company officers.
- **For external users**: Investors (owners) that use accounting information to make decision to buy, hold or sell stocks; creditors (such as bankers and suppliers) that use the accounting information to evaluate the risk of lending money or risk of selling on credit; but also, customers, consultants, government, Tax Authorities, employees… lawyers

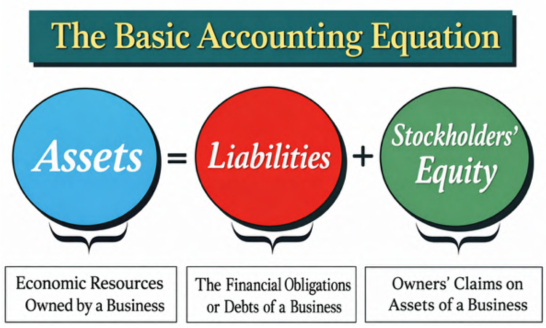
HOW IS A FINANCIAL STATEMENT PREPARED?

The financial statement is the result of the financial accounting.
The accounting is the information system that measures business activities, processes that information into reports and communicates the results to decision makers. In a company we can have two types of accounting: financial accounting and management accounting.

- **Financial accounting** is regulated and provides information mostly to external users.
- **Management accounting** is not regulated and give detailed information to the manager (internal users), this gives more detail for run the business. It is not regulated because companies are different.

However, there are very strong links between financial and management accounting. Financial accounting uses much information coming from the management accounting.

The financial accounting records any event that has effects on the financial position (that is balance sheet) of the company.



ASSET = LIABILITIES + OWNERS'EQUITY
ASSET – LIABILITIES = OWNERS' EQUITY

OWNERS' EQUITY (called stockholders' equity for corporation) is composed of two main items:

- Paid-in capital or share capital: that is the amount invested in the company by the owners. Resources, cash that the owner put in the company.
- Earnings: that is the amount earned by the company and kept for use in the business. Result of the investments.

The total amount of earnings accumulated in different periods and kept in the business (not distributed to owners) is called **retained earnings**.

Net earnings (net profit or net loss) are part of the owners' equity, since it represents the remuneration for the investment they made in the firm. At the same time the Income Statement reports net earnings (net profit or net loss) as difference between revenues and expenses. We can say that the Income Statement gives details about the increase (in case of net profit) or decrease (in case of net loss) in the owners' equity due to the operations performed by the company during the accounting period.

A transaction, in accounting terms, is any events that both affects the financial position of the company and can be reliability recorded. In order to understand how a financial statement is prepared, we need to start analysing how such transactions affect the financial position of the company.

For this purpose, we use the accounting equation:
ASSETS = LIABILITIES + OWNERS' EQUITY (composed by paid-in capital and earnings)

Since we already know that stockholders' equity is composed by paid-in capital and earnings, we can rewrite our equation as follows:
ASSETS = LIABILITIES + PAIED-IN CAPITAL + EARNINGS (revenues – expenses)**.**
→Revenues and expenses are read in income statement, and it is where we calculate the earnings, that instead we trove the latter in balance sheets.

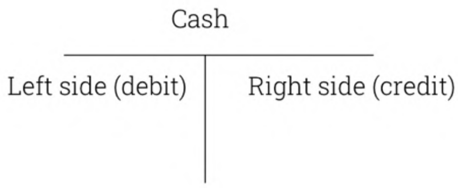
DOUBLE ENTRY SYSTEM

Double-entry system means that each transaction affects at least two items. This comes from the basic rule that we have always to verify the accounting equation, so, if we change something on one side, we have to change something on the other side too or we have to change something on the same side but with an opposite sign.

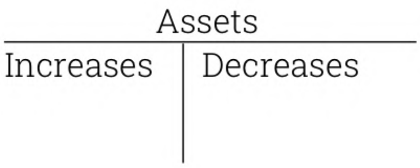
INTRODUCTION TO THE LEDGER AND THE JOURNAL

T-ACCOUNT

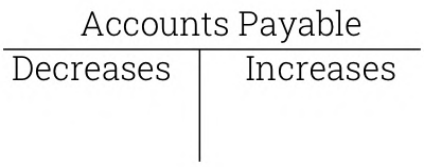
One of the basic tools used by accountants is the so-called "T-account". It is represented as follows:



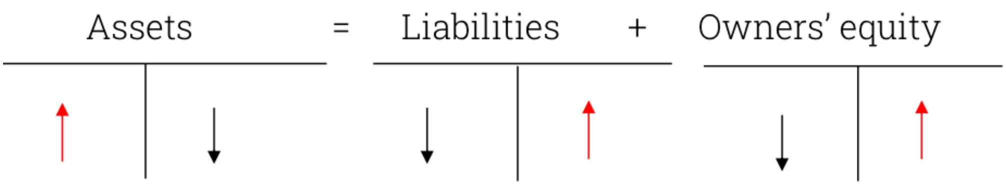
The name of the account is reported on the top. According to the double-entry system, every transaction involves both a credit (right) and a debit (left) side.
Increases in assets are recorded on the left (debit) side and **decreases on the right** (credit) side, for example:



Increases in liabilities and owners' equity are recorded on the right (credit) side and decreases on the left (debit) side, for example:



If we consider the accounting equation, we can understand why each transaction always involves both a credit and a debit entry.



The chart of accounts (piano dei conti in Italian) is the list of all the accounts (name and code-number) of the company.
The Ledger (libro mastro in Italian) is a book containing all the accounts used by the company with their balances.

THE BALANCE OF AN ACCOUNT

The amount remaining in an account (the difference between the total debits and the total credits) is called its **balance**.

- An account has a debit balance when debits (left) > credits (right).
- An account has a credit balance when credits (right) > debits (left).
- An account's normal balance is on the side where increases are recorded.

Therefore:

Assets		=	Liabilities		+	Owners' equity	
Normal balance				Normal balance			Normal balance

THE RECORDING PROCESS

In order to leave a clearer record of all transactions, accountants do not record them directly in the T-accounts.
Accountants record transactions in the **journal**, which is another book containing a chronological description of all transactions occurred.
This process is called "to make the journal entries" or "to journalize the transactions". After journalizing, the transactions are copied to the ledger. This process is called posting. Posting is normally performed by computers.

THE JURNAL

- A typical journal entry looks as follows:

Date	Account moved on the left	amount	
	Account moved on the right		amount

Description of the transaction

In short, a complete entry in the journal consists of:

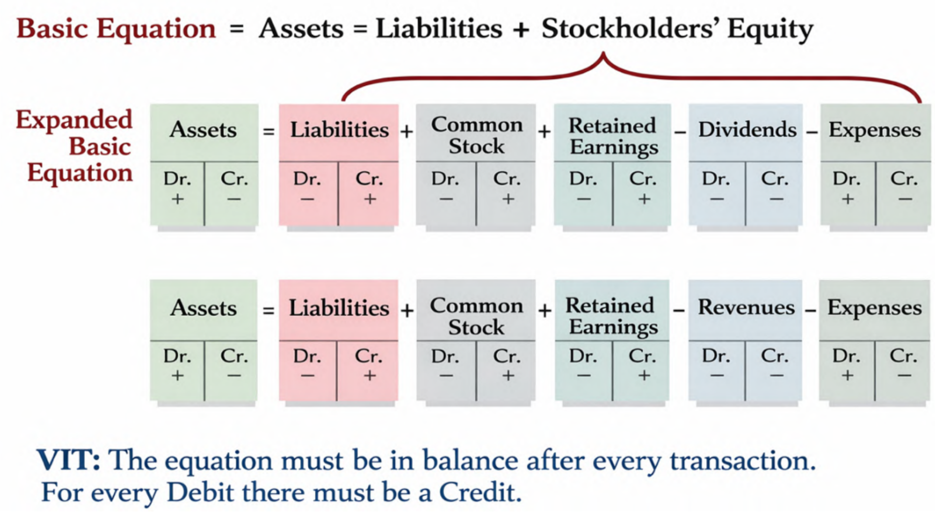
- Date of the transaction.
- The accounts and amounts to be debited or credited.
- A brief explanation of the transaction.

To simplify:
• (A) if the account is an asset.
• (L) if it is a liability.
• (OE) if it is an owners' equity item, different from revenues and expenses.

• (R) if it is a revenue.
• (E) if it is an expense.

SUMMARY OF DEBIT AND CREDIT RULES

Remember that the relationship among the asset, liabilities and stockholders' equity of a business works ad follows:



RECORDING COMPANY START UP

THE CORPORATION

To run a business, it is not necessary to have a corporation, it is possible to operate as a sole proprietorship or a partnership.
However these types of business structures can have some limitation because they cannot easily raise the capital, and the owners are personally liable.

Let's focus our attention on corporation. A corporation is created by law, and its owners are called shareholders (stockholders).
A corporation operates its business, owns assets and cash, and is responsible for its liabilities.
The shareholders have limited liability to the amount they have invested in the shares. Company's creditors have no legal claim on the personal assets of the shareholders unless fraud occurs. Thus, even in the event of bankruptcy of corporation, stockholder's losses are generally limited to the amount of capital they have invested in corporation.
The shareholders hold shares in capital stock which are transferable units.
The shareholders may dispose a part of or all their interest in a corporation simply by selling their stocks. The transfer of the shares has no effect on the operating activity of the corporation.
It is a transaction between individual owners. The company does not participate in the transfer of these ownership rights.
It is relatively easy for a corporation to obtain capital through the issuance of a stock. Buying stock in a corporation is often attractive to an investor because a stockholder has limited liability and shares of stock are readily transferable.

The rules to form a corporation are set at the national or state level and can vary from country to country.

For example, in the United States a corporation is formed by a state charter. The charter describes the name and purpose of the corporation, the types and number of shares that can be issued, and the names of the founders and their shareholdings. A similar process exists in Italy, where a company is formed by a notarial deed with similar content that must be filed with the business register.

RECORDING COMPANY START-UP

In order to start a business, owners have to contribute some assets (resources) to the company. Therefore, **owners' initial contribution** is the first transaction a company has to record. Without such a contribution the business cannot even start operating.

Journal entry is the following:

Cash (A)	1.000	
Common Stock (OE)		1.000

Stockholders' initial contribution in cash € 1.000

DEFERRED CONTRINUTION RECORDING

In some cases, the stockholders **pay for the stocks after the purchase**. In this case, we first record the receivable:

Owners' contribution receivable (A)	1.000	
Common Stock (OE)		1.000

Issued and subscribed 1.000 euros of new shares

…And then the collection of money from the stockholders.

Cash (A)	*1.000*	
Owners' contribution receivable (A)		*1.000*

Collection from the stockholders

If shareholders contribute other kinds of assets we make a different journal entry, such as for. example:

Land (A)	1.000	
Building (A)	5.000	
Furniture (A)	2.000	
Common Stock (OE)		8.000

Issued 10.000 euros of shares. Contributed Land for 1.000 euros, Buildings for 5.000 euros and Furniture for 2.000 euros

RECORDING PURCHASES AND SALES

RECORDING PURCHASE

The company purchase goods and services for its business.
The company records purchases when it receives goods and services from seller. Every purchase should be supported by business documents that provide written evidence of the transaction. Typically, the most important document is **the invoice**.
The invoice is a bill issued by a seller when that product has been delivered or the service has been completed. The invoice is now usually on a digital format (e-invoice). E-invoicing has been mandatory for all B2B invoices in Italy since 1st January 2019.

RECORDING PURCHASE: CASH VS. ACCOUNTS PAYABLE

When we buy goods paying cash we make the following entry:

Inventory (A)		3.500	
	Cash (A)		3.500

Purchase for cash of inventory, cost 3.500,

If we buy something "on account" we first record the debt and later the payment. Journal entries are the following:

Inventory (A)		6.000	
	Accounts payable (L)		6.000

Purchase of inventory, cost 6.000, to be paid in one month

Accounts payable (L)		6.000	
	Cash (A)		6.000

Payment of the liability related to the purchase of inventory

RECORDING PURCHASES: NOTES PAYABLE

Although rarely nowadays, the seller might ask to issue a “note payable”, that is a formal promise to pay a definite sum at a specific date in the future, including also the promise that the creditor may claim certain assets (collateral) if the debtor fails to pay the amount due. In this case we record, for example:

Plants (A)	3.500	
Note payable (L)		3.500

Purchase of a plant - issued a note payable

At maturity we'll record:

Note payable (L)	3.500	
Cash (A)		3.500

Payment of the note payable

RECORDING PURCHASES: INTERESTS ON NOTES PAYABLE

The seller may also ask for interests in case of delayed payment. These interests are paid at maturity. Using the same example:

Note payable (L)	3.500	
Interest expense (E)	350	
Cash (A)		3.850

Payment of the note payable + interest for 350 euros

RECORDING PURCHASES: RETURNS, ALLOWANCES AND DISCOUNTS

If we return part of the goods purchased or ask for an allowance (reduction in price) we record:

Accounts payable (L)	300	
Inventory (A)		300

Returned (or received an allowance of) 300 euros of goods previously bought

Sometimes, if we pay before the agreed deadline, we benefit from a cash discount:

Accounts payable (L)	2.700	
Cash (A)		2.600
Cash discounts on purchase (R)		100

Paid 2,700 euros to our supplier in advance, received a cash discount of 100

RECORDING PURCHASES: ADVANCE PAYMENT

If we pay our supplier in advance, that is before receiving the goods or services purchased, we have to record an asset (a receivable), representing the right to receive something in the future:

Advance to supplier receivable (A)	1.500	
Cash (A)		1.500

Paid 1.500 in advance to the supplier for the purchase of inventory

When we receive the goods or services we pay for what is left:

Inventory (A)	3.500	3.500
Cash (A)		2.000
Advance to supplier received. (A)		1.500

Received the inventory total cost 3.500, paid cash the remaining amount

RECORDING PURCHASES: VAT

In some countries (like Italy) there are taxes on purchases (e.g. VAT, Value Added Tax). In most cases, if we are a business and we are buying goods or services for our business activity, we pay for the taxes to our supplier, but we are reimbursed for such taxes by the government.

Inventory (A)	1.500	
VAT receivable (A)	330	
Accounts payable (L)		1.830

Purchase of goods, cost 1.500+VAT 22%. Payment postponed

Note that who bears the cost of sales taxes like VAT is only the “final consumer” of the goods or services sold, that is the person who uses them for their own consumption and not to produce any other good or service!

VAT RATES IN ITALY

Value-added taxation is based on taxpayers' consumption rather than their income.
In contrast to a progressive income tax, which levies greater taxes on higher-level earners, VAT applies equally to every purchase.
Standard VAT rate in Italy is 22% and applies to all taxable goods and services that are not listed as subject to higher or lower VAT rates.

RECORDING SALES

In accordance with the revenue recognition principle, companies record sales revenue, like service revenue, when the performance obligation is satisfied.
Typically, that performance obligation is satisfied when the ownership of the goods is transferred from the seller to the buyer or when the service is provided.

Every sales transaction should be supported by a business document that provides written evidence of the sale. Typically, the most important document is the invoice. Sales may be made for cash or on credit.
The seller makes one or two entries for each sale, depending on whether the sale is related to services or goods.
In both cases, (1) It increases (debits) Accounts Receivable or Cash, as well as (credits) Sales Revenue. In case of sale of goods, (2) it increases (debits) Cost of Goods Sold and decreases (credit) Inventory.
As a result, the Inventory account will show at all times the amount of inventory that should be on hand. This is the so-called "perpetual inventory system", which is updated at each sale.

RECORDING SALES: VASH V.S. ACCOUNTS RECEIVABLE

When we sell services collecting cash we make the following entry:

Cash (A) 3.500
Services revenue (R) 3.500

Sold Services for 3.500 euros, collected cash

If we sell something "on account" we first record the credit and later the collection:

Accounts receivable (A) 3.500
Service revenue (R) 3.500

Sold Services for 3.500 euros, collection postponed

Cash (A) 3.500
Accounts receivable (A) 3.500

Collected the accounts receivable related to the sale of services

RECORDING SALES: NOTES RECEIVABLE

Like for purchases, we may ask our customer to issue a "note receivable", that is a formal promise to pay a definite sum at a specific date in the future, including also the promise that we may claim certain assets (collateral) if the debtor fails to pay the amount due. In this case we record:

Note receivable (A) 2.200
Service revenue (R) 2.200

At the maturity we'll record:

Cash(A) 2.200
Note receivable (A) 2.200
Collected the note receivable

We may also ask for interests in case of delay payment. Such interests are collected at maturity. Using the example:

Cash (A) 2.300
Note receivable (A) 2.200
Interest Revenue (R) 100

Collected the note receivable + interest for 100 euros

RECORDING SALES OF MERCHANDISE

If we sell goods instead of services, we record:

Cash (A) 3.500
Sales revenue (R) 3.500
Sold goods for 3.500 collected cash

But when we sell goods, we are actually losing an asset (inventory). Therefore, we should record, at the same time, the cost of the goods sold (which represent an expense, that is a decrease of owner's equity):

Cost of goods sold (E) 2.400
Inventory (A) 2.400
Recorded the cost of good sold as an expense for 2.400 euros

RECORDING SALES: ADVANCE PAYMENT FORM CUSTOMERS

If our customer pays us in advance, that is before receiving the goods or services purchased, we have to record a liability (a debt), representing the obligation to deliver something in the future:

Cash (A) 1.200
Payable for advances from customers (L) 1.200
Collected 1.200 euros as advances from customers

When we deliver the services, for example:

Cash (A) 800
Payable for advances from customers (L) 1.200
Service revenue (R) 2.000
Delivered services for 2.000 euros and collected the amount left

RECORDING SALES: DISCOUNTS

Something if our customer pays before the agreed deadline, we can allow a cash discount:

Cash (A) 1.940
Sales Discounts (E) 60
Accounts receivable (A) 2.000

Collected A/R for 2.000 and recorded a discount for 60

RECORDING SALES: RETURNS AND ALLOWANCES

If our customer returns part of the purchased goods or asks us for an allowance (reduction in price) we record:

Sales revenue (R) 300
Accounts receivable (A) 300
Returned 300 euros of goods by the customer

In case of returns (not of allowances!), we have to record also an increase in inventory (for the cost of goods returned) according to the perpetual inventory system:

Inventory (A) 140
Cost of goods sold (E) 140
Cost of goods sold (E) 140
Increased the inventory of 140 euros, that is the cost of the goods returned by the customer

RECORDING SALES: SALES TAX PAYABLE

In some countries (like Italy) there are taxes on sales, e.g. VAT. We charge on the customers the taxes in addition to the price of the sold items, but we owe to the government the collected taxes. Such taxes, therefore, represent a liability.

Cash (A) 2.440
Sales revenues (R) 2.000
VAT payable (L) 440

Sold 2.000 euros – VAT 22% of services, collected cash

RECORDING EMPLOYEE COMPENSATION

WHAT IS EMPLOYEE COMPENSATION?

Employee compensation refers to the total rewards and benefits that employees receive in exchange for their work or services provided to an organization. It is one of the most significant expenses for businesses and encompasses both monetary and non-monetary components. It may include base salary and wages, incentives and commissions.
Total compensation includes cash rewards as well as any other company benefits. Employee compensation represents a major expense for businesses. Employees receive a lower amount of money, since their compensation is subject to a number of deductions and subtractions for taxes and other items.

RECORDING EMPLOYEE COMPENSATION

We record the gross amount of salary and wage expense as follows:

Wage and salary expense (E) 10.000

Employee compensation payable (L) 10.000

Accounted for wages and salaries related to May for 10.000 euros

For tax deductions we record:

Employee compensation payable (L) 2.000

Employee income tax payable (L) 2.000

Deducted taxes 2.000 from the gross salaries to be paid to the employees

For social contribution (for the part charged to the employees) we record:

Employee compensation payable (L) 1.000

Social security contribution payable (L) 1.000

Deducted SSC 1.000 from the gross salaries to be paid to the employees

For union dues we record:

Employee compensation payable (L) 200

Union dues payable (L) 200

Deducted union dues 200 from the gross salaries to be paid to the employees

Not only do employees pay (through the company) their social security contributions, but also firms pay part of the cost of the social security system. In such a case, they record:

Social security expense (E) 2.000
Social security contribution payable (L) 2.000

Recorded social security cost borne by the company 2.000

In some countries (like Italy) employees also receive family contributions from social security institutions. This reduces the total liability with the SSI and increases the amount payable to the employees:

Social security contribution payable (L) 400

Employee compensation payable (L) 400

Accounted for family contributions 400 to be paid to the employees on behalf of the SSI

The business pays the net amount to the employees:

Employee compensation payable (L) 7.200

Cash (A) 7.200

Paid the net salary to the employees

When we pay (the employer) our liabilities to the social security institutions, to the government and to the unions we just record:

Social security contribution payable (L) 2.600
Union dues payable (L) 200
Employee income tax payable (L) 2.000
Cash (A) 4.800

Paid the SSI, the unions and the taxes related to the employee compensation of May

In some countries (like Italy), employees have the right to receive a certain amount of compensation called **Severance Pay** (TFR) when they leave the company (if they retire, they quit the job or even if they are fired).
Such amount of money is proportional to what they earned during the period they spent in the company as employees; Therefore, every year, at the end of the accounting period, the companies account for the expense and for the increase in the liability related to such deferred employee compensation, technically called "severance pay".

Severance pay is granted to all employees, and it is added to the base remuneration they accrue for each month of work.

Severance pay expense (E) 500
Severance pay payable (L) 500

Recorded the share of severance pay related to this accounting period 500

RECORDING LONG-TERMS INVESTMENTS

LONG-TERMS INVESTMENTS

Long-term investments include:

- Investments in stocks and bonds of other corporations that are held for more than one year,
- long-lived assets such as land or buildings or intangible assets used in operations
- other real estate that are held as financial investments.

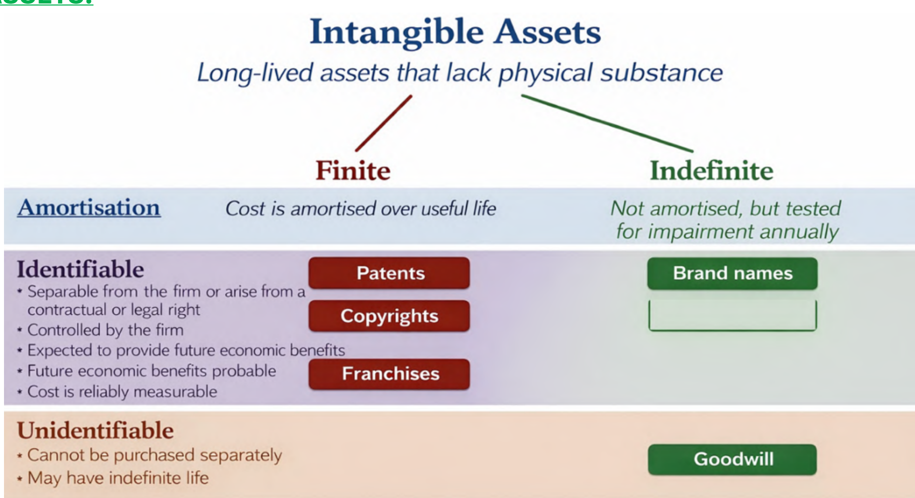
PROPERTY, PLANT AND EQUIPMENT (PP&E)

Fixed asset: land, budling, factories, furniture, equipment, delivery vehicles, and furniture.
Property, plant, and equipment (PP&E) are assets with relatively long useful lives that are currently used in operating the business.
PP&E, with the exception of land, are subject to depreciation.

TANGIBLE VS INTANGIBLE ASSETS

A tangible asset is an asset that has a finite monetary value and usually a physical form.
Many companies have assets that do not have physical substance and yet often are very valuable.
We call these intangible assets.
One common intangible is goodwill.
Others include patents, copyrights, and trademarks or trade names that give the company exclusive right of use for a specified period of time.

INTANGIBLE ASSETS:



RECORDING PURCHASE OF LONG-LIVED ASSET

When we buy a long-lived asset, we make the following entry:

Land (A)		1.000	
	Cash(A)		1.000

We record the asset at purchase cost. This cost includes purchase commissions, applicable taxes, legal fees, transportation charges, installation costs and all other amounts paid to acquire the asset and to make it ready for its intended use. So, for example, if we pay brokerage commissions for a 200 Euros related to the land acquired, we record:

Land (A)		200	
	Cash(A)		200

RECORDING SALES OF LONG-LIVED ASSET

When we sell a long-lived asset, we record a gain (loss) on the sale if the selling price is higher (lower) than the book value of the asset.
For example, if we sell the land (we had bought before at 1.000) for 1.300:

Cash (A)		1.300	
	Land(A)		1.000
	Gain on sale (R)		300

If we sell the land (we had bought before at 1000) for 900:

Cash (A)		900	
Loss on sale (E)		100	
	Land (A)		1.000

EXCHANGE OF LONG-LIVED ASSET

Businesses often trade in some of their assets for new ones. In these cases, we record both the sale of the old asset and the purchase of the new one.
For example, we exchange our land for a new building whose price is 3.000. The book value of our land is 1.500 and we settle the difference by paying 1.100. In this case we record:

Building(A)		3.000	
	Land (A)		1.500
	Gain on sale of land (R)	400	
	Cash (A)		1.100

FINANCIAL ASSET

Cash, stocks, bonds, mutual funds, and bank deposits are all are examples of financial assets. Unlike land, property, commodities, or other tangible physical assets, financial assets do not necessarily have inherent physical worth or even a physical form.
Rather, their value reflects factors of supply and demand in the marketplace in which they trade, as well as the degree of risk they carry.
A company may invest part of its cash in short-term or long-term investments in securities, in order to earn a return until the cash is needed.

There are three categories of investments:

- trading investments, expected to be sold in a short period of time.
- held-to-maturity investments, which the investor expect to hold until maturity.
- available-for-sale investments, including all other security investments.

RECORDING FINANCIAL INVESTMENTS

When we buy securities, we make the following entry:

Short (Long)-term investments (A)	1.000	
cash (A)		1.000

When we receive dividends or interests from the issuer of the securities:

Cash (A)	100	
Dividend (interest) revenue (R)		100

When we sell the securities, we may have a gain or a loss. When the selling price is higher than the book value of our investments:

Cash (A)	1.300	
Short (Long)-term investments (A)		1.000
Gain on sale of investments (R)		300

When the selling price is lower than the book value of our investments:

Cash (A)	800	
Loss on sale of investment (E)	200	
Short (Long) –term investments (A)		1.000

RECORDING FINANCIAL TRANSACTION

FINANCING TRANSACTION

Companies need money to buy assets and to pay for expenses. In most cases money contributed by owners is not enough. It's therefore necessary to look for other sources of money to finance the operating activity.
Actually, the very:

- postponing the payment of purchases.
- speeding-up the collection of sales.

RECORDING CURRENT FINANCING OPERATIONS

To speed-up their cash receipts, businesses can use the following strategies:

- credit-card sales.
- factoring.
- discount of notes receivable

When we sell a service (or a good) on credit or bank cards, we record:

Cash (A)	1.930		
Financing expense (E)	70		
		Sales revenue (R)	2.000

The company may sell its receivables to a factor. The factor immediately gives the company an amount corresponding to the amount of the receivables minus some financing expenses and waits until maturity to collect the credit from the customers:

Cash (A)	1.800		
Financing expense (E)	200		
		Accounts receivable (A)	2.000

FACTORING

→ recourse factoring.
→ non-recourse factoring.

What is the difference between ***non-recourse*** and ***recourse***?

Non-recourse factoring: the factoring company takes on all the risk of non-payment if a customer is enabled to pay.

- Higher rate
- No risk (avoid costs associated with extending credit and collecting bad debt);

Recourse factoring: the company sells its invoices with the understanding that they will buy them back if unpaid.

- Lower rate
- Costs associated with extending credit and collecting bad debt

RECORDING CURRENT FINANCING OPERATIONS

Companies may also issue promissory notes (notes payable) to get money from a bank or other financing institution. Accounting for such notes is not different from notes payable issued to suppliers, taking into account the interests paid.

Cash (A)	1.850		
Financing expense (E)	150		
		Notes payable (L)	2.000

PROMISSORY NOTE

Notes payable is a promissory note that is offered by the lender to the borrower for an agreement between these two wherein the borrower is bound to pay a certain amount to the lender within a stipulated time period along with an interest.

RECORDING LT FINANCING OPERATIONS

Companies may need to borrow large amounts of money for a long period of time to finance some of their operations (e.g. the purchase of large amounts of long-lived assets).
In such cases, companies make long-term financing operations, the most common of which are the following:

- bank loans.
- bonds.
- leasing.

TYPES OF LOANS

a) **SECURED LOANS:** This is a loan which has been secured by some asset or property. So, the borrower will pledge his assets against the loan. In case the borrower defaults on his loan, the bank will become the owner of such asset. It can sell the asset and recover the amount owed to them.
   A mortgage is one popular type of secured loan. Here some real estate is kept as collateral to borrow funds from the bank. If the borrower defaults, then the creditor will gain ownership of the property.
b) **UNSECURED LOAN:** Opposed to secured loans, an unsecured loan is one in which the borrower does not keep any of his assets as collateral. These loans are always riskier from the bank's point of view, but they are an essential tool in the business world for short-term funds. Some forms of an unsecured loan are:
   a. Line of credit
   b. Overdraft
   c. Credit Card debt
   d. Peer to peer lending

→ These are typically short-term loans.

c) **SUBSIDIZED LOAN**: In a subsidized loan the rate of interest is subsidized. Which means the borrower is given the loan at a lower rate of interest than the going rate. The government is the one that provides the said subsidy.

These subsidized loans are generally given to students when they take loans for educational purposes. Some agricultural loans are also subsidized in some countries, to help farmers with growth. There are times when the entire interest amount may be subsidized.

RECORDING BANK LOANS

If the bank grants us a loan, we make the following entry:

Cash (A)		4.000	
	Bank loan (L)		4.000

Periodically, we pay interests to the bank, recording the following entry:

Interest expense (E)		200	
	Cash (A)		200

When we repay the loan, we make the following entry:

Bank loan (L)		4.000	
	Cash (A)		4.000

BONDS

Bonds are certificates issued to a large number of lenders called bondholders. Therefore, bonds are debts of the issuing company. Purchasers of bonds receive a bond certificate carrying the following information:

- issuing company's name.
- face (or par) value of the bond, also called the principal, that is the amount that the bondholder will receive at maturity.
- maturity date, when the bondholder will be paid back.
- interest rate that the issuer will pay and the dates when the interests are due.

GREEN BONDS

A green bond is a type of fixed-income financial instrument specifically designed to raise funds for projects that have positive environmental and climate benefits.
These bonds work like traditional bonds, where investors lend money to an issuer (such as a government, corporation, or financial institution) in exchange for periodic interest payments and the return of principal at maturity.

RECORDING BONDS

When we issue bonds a par value:

Cash (A)		30.000	
	Bonds payable (L)		30.000

At due dates (for example each 6 months), we pay interests, making the following entry:

Interest expense (E) 900
Cash (A) 900

When companies retire their bonds at maturity, they pay back the face amounts of their bonds:

Bonds payable (L) 30.000
Cash (A) 30.000

RECORDING LEASE TRANSACTION

Lease may be used to finance the acquisition of some long-lived assets. It's a long-term non-cancellable agreement related to the use of an asset. Usually, the lessee becomes the legal owner of the asset at the end of the lease term, but this is not a requirement.

Under the new IFRS 16, lease transactions are recorded as follows:

- The lessee enters the asset (right-of-use) into her balance sheet; at the same time the lessee records a liability.
- Periodically, when the lease payments are made, the lessee records interest expenses and lease liability reimbursement.
- The lessee also records yearly depreciation on the right-of- use recorded among the assets,

RECORDING LEASE: AN EXAMPLE

The lessee has a total obligation of 120 for a leasing of a plant. Interest included in the total obligation is 20. Each 6 months the lessee has to pay 24 to the lessor.
At the beginning of the lease term, we record:

Right-of-use (A) 100
Lease payable (L) 100

RECORDING CAPITAL LEASE

Each 6 month we'll record:

Lease payable (L) 20
Interest expense (E) 4
Cash (A) 24

MAIN ACCOUNTING PRINCIPLES – ADJUSTING ENTRIES

FUNDAMENTAL ACCOUNTING PRINCIPLES

The fundamental accounting principles according to IAS/IFRS (and most other standards) are:

- **Going Concern**: Financial statements are prepared on the assumption that the entity will continue operating in the foreseeable future unless management intends to liquidate or cease operations.
- **Accrual Basis Accounting**: Transactions and events are recognized when they occur, not when cash is received or paid.
- **Materiality and Aggregation**: Information should be presented separately if it is material. Similar items should be aggregated unless they are significant enough to be reported separately.
- **Comparability Principle:** Financial statements should include comparative information for previous periods to help users understand changes over time.
- **Revenue Recognition Principle:** Positive income components should be recorded when the business transaction occurs (e.g., when ownership of the asset is substantially transferred to the buyer, or the service is provided to the client)
- **Matching Principle:** Expenses must be recorded in the same period as the revenues they relate to.
- **Substance Over Form Principle:** When recording a transaction, the economic substance must take precedence over its legal form.
- **Conservatism Principle:** Losses should be recognized, even if only presumed, while gains are recognized only when actually realized.

ACCRUAL-BASED VERSUS CHAS-BASED ACCOUNTING

Accountants usually:

- record revenues as they were earned.
- record expenses as they were incurred.

whether or not cash was received or paid. This method of accounting is called accrual-based accounting.
A possible alternative method is cash-based accounting, which books revenues only when cash is received and expenses only when cash is paid.
In the past, cash-based accounting was quite common. Nowadays, the majority of countries use accrual-based accounting.

ACCRUAL-BASED
Accrual-based accounting is based on two key principles:

- **revenue principle**: revenue must be recorded when earned, i.e. when a service is provided or the ownership of a good passes to the buyer, which usually coincides with the delivery.
- **matching principle**: expenses are the costs of all resources used up in the revenue earning. Therefore, expenses must be recorded in the same period when the related revenues are recorded. In different words, expenses must be matched against the revenues they contribute to.

ACCOUNTING CYCLE
Some issues in the application of these principles come from the fact that businesses need periodic reports of their financial and economic situation.
In order to provide such reports, accountants slice the business life into small segments and prepare financial statements for each segment.
Each segment is an accounting period and it usually coincide with the calendar year. During each accounting period, a number of accounting operations are performed. They are the following:

- journalizing and posting transactions, as they occur
- issuing an unadjusted trial balance
- recording and posting adjusting entries
- issuing an adjusted trial balance
- recording and posting closing entries
- preparing Income Statement and Balance Sheet
- back to journalizing and posting transactions

ADJUSTING ENTRIES
The unadjusted trial balance is a list of all the accounts and their balance before the adjusting entries. It's the starting point for the adjustment process. Adjusting entries accomplish two purposes:

- to assign revenues to the period in which they are earned and expenses to the period in which they are incurred, on the basis of the matching principle.
- to update asset and liability accounts.

It is necessary to post adjusting entries because not all transactions are recorded immediately as they occur, or some of them need adjustments to meet the matching principles and other general accounting principles.
At the end of each period all the accounts must be updated to record all revenues which were already earned but not recorded yet and all related expenses.
Moreover, the value of some assets and liabilities may need to be updated since it may be different from what recorded during the period.
The first three categories of adjusting entries are:

- Deferrals.
- Depreciation.
- Accruals.

DEFERRALS

Deferrals are adjustments to revenues or expenses related to time and for which the business paid or received cash in advance. There are both deferrals of expenses and of revenues.

DEFERRALS OF EXPENSE

If we pay for a time-related expense in advance, we'll benefit of service acquired in the future, therefore we have to record an asset.
Suppose that on Sept. 30 we pay 1,600 in advance for the rent of 8 months. At the payment we record:

Prepaid (or deferred) rent (A)	1,600		
		Cash (A)	1,600

Advanced payment of a rent by 1,600

If our accounting period ends on Dec. 31, before preparing the financial statements we have to post an adjusting entry in order to record the rent expense for the period Sept. 30 – Dec. 31:

Rent expense (E)	600		
		Prepaid (or deferred) rent (A)	600

Recording portion of the rent expense related to the current financial year

The amount of 600 is calculated as follows:
→ 1,600 (8 month's rent) / 8 months = 200 (monthly rent)
→ 200 (monthly rent) * 3 months (Oct/Nov/Dec) = 600 (expense referred, in terms of accruals, to the current year).

DEFERRALS OF REVENUES

There are also cases of time-related revenue collected in advance, e.g. newspaper subscriptions, which are typically collected in advance.
For example, if we collect on June 1st 240 cash for a subscription covering the period from June 1 to May 31 of the following year, on June 1 we record:

Cash (A)	240		
		Unearned (or deferred) revenue (L)	240

Increase of cash by 240 and increase of liabilities due to unearned or deferred revenues

On Dec. 31 we have to record the revenues already earned (from June 1 to Dec. 31):

Unearned (or deferred) revenue (L) 140
Subscription revenue (R) 140

Recording revenues related to the current financial year by 140 and reducing by the same amount the initial liability

The amount of 140 is calculated as follows:
→ 240 (12 months subscription revenue) / 12 months = 20 (monthly revenue)
→ 20 (monthly rent) * 7 months (June/July/Aug/Sept/Oct/Nov/Dec) = 140 (revenues related, in terms of accruals, to the current year).

DEPRECIATION

The depreciation is the process through which the cost of long- term tangible and intangible assets is allocated over the time that they are used and contribute to the firm's activities. Only land is not depreciated as it is considered to have an unlimited life.
In other words, depreciation is the process of allocating the cost of a long-lived asset over the years of its useful life.
At the end of the accounting period, it is necessary to book an expense related to the fact that during the same period we used those assets, therefore they contributed to the revenue earned.
Assuming that company A bought a plant for 10,000 and it is expected to use it for 10 years, at the end of each year, company A records:

Depreciation expense – plant (E) 1,000
Accumulated depreciation – plants (-A) 1,000

Recorded depreciation expense on plants

We put (-A) for the accumulated depreciation since it represents a decrease in the value of the assets. Accumulated depreciation is a contra-account, i.e. it corrects (reduces) the value of the plants recorded in the account "plants and equipment".
The net amount of the plants (original cost minus accumulated depreciation) is called the asset's book value, or net book value, or carrying amount.

• In our example, the book value of the plants at the end of the first accounting period is = 10,000 – 1,000 = 9,000

SALE OF LONG-LIVED DEPRECIABLE ASSETS

Considering that now we know what depreciation is, we can see how to book a sale of a depreciated long-lived asset. This transaction is different from the sale of goods and/or services, due to the depreciation process and its effects.
Let's suppose that company A bought a plant three years ago and paid for it 20,000 Euros. Let's also suppose that company A depreciated it 5,000 each year, for a total amount of 15,000, since

we expected it would be used for 4 years. After the end of the third period company A sells it for 7,000 Euros.
The accounting entries are the following:

Accumulated depreciation – plants (-A)	15,000		
Cash (A)	7.000		
		Plants and equipment (A)	20,000
		Gain on sale of plants (R)	2,000

Recorded sale of plant, with gain and cash collection

In case we sell an asset for a value smaller than its net book value, we record a "loss on sale of the asset", which is classified as an expense in the income statement.

ADJUSTING AND CLOSING ENTRIES

END – OF YEAR ACCRUALS

End-of-year accruals refer to time-related expenses and revenues, which the business has already incurred or earned but not recorded yet.
This happens for expenses and revenues incurred or earned during the period, that will be paid or collected after the end of the accounting period.
There are both accrued expenses and accrued revenues. Such accruals typically refer to interests, rents, income taxes, salaries and wages.

ACCRUED EXPENSES

On Sept. 1 company B issues a payable bond, related to which it pays interests for 1.200 at the end of each semester. The due dates for interest payment are March 1 and Aug. 31. On Dec. 31 (the end of our first accounting period) we must record the interests already incurred but not paid (therefore not recorded) yet (from Sept. 1 to Dec. 31).

Interest expense (E)	800		
		Interest payable (L)	800

Recorded accrued interest expense by 800 and of the related liability by the same amount.

The amount of 800 is calculated as follows:
- 1,200 (6 months interest) / 6 months = 200 (monthly interest).
- 200 (monthly interest) * 4 months (Sept/Oct/Nov/Dec) = 800 (interest expense referred to the current financial year).

An additional typical adjusting entry is related to **severance pay or pension and other post-retirement liabilities**. These are expenses that mature over time, in relation to employees' compensation, but that will be paid only when the employees retire or leave. The amount and the type of such additional components of the compensation is regulated differently in each country. Imagine that company C recognizes 10,000 Euros to its employees, who are going to receive it when they retire.
For such expenses we have to record at the end of the accounting period as follows:

Employee post-retirement expense (E) 10,000
    Employee post-retirement liabilities (L) 10,000
Increase of the post-retirement expense by 10,000 and of the related liability by the same amount.

Another typical accrued expense is **income taxes expense**. This is typically the last adjusting entry of the period, as taxes are calculated on income before taxes, which has to include every revenue and expense of the year, but taxes.
After calculating the taxes on income of the closing accounting period (suppose that the final amount of taxes is equal to 5,000 Euros), we make the following adjusting entry:

Income tax expense (E) 5,000
    Income tax payable (L) 5,000

Increase of tax expenses by 5,000 and of the related liabiiity by the same amount.

ACCRUED REVENUES
Suppose company D has marketable securities, related to which it collects interests for 1,200 at the end of each quarter. The due dates for interest payment are 2/28, 5/31, 8/31, 11/30. On Dec. 31 (at the end of the accounting period) we must record the interests already earned but not collected (therefore not booked yet) related to the period 11/30-12/31:

Interest receivable (A) 400
    Interest revenue (R) 400
Accrued interest revenues by 400 and recorded the related receivable by the same amount.

The amount of 400 is calculated as follows:
- 1,200 (3 months interest) / 3 months = 400 (monthly interest)
- 400 (monthly interest) * 1 month (from Nov 30 to Dec 31) = 400 (interest revenue referred to the current financial year).

PERIODIC INVENTORY SYSTEM

If there are a lot of small sales during the accounting period, companies may prefer to record the cost of goods sold only at the end of the accounting period for the whole amount. This is called the "periodic inventory system".
Let's assume that company E has – at the end of the period – total inventories equal to 4,000 Euros. If it uses the periodic system, among the adjusting entries it books:

Cost of goods sold (E) 4,000

Inventories (A) 4,000

Reduction of the value of inventories and increase of the cost of goods sold

ADJUSTED TRIAL BALANCE

The adjusted trial balance lists all the accounts and their balances after the adjusting entries. This is a very useful step in preparing the Income Statement and the Balance Sheet.
Before making the closing entries and preparing the financial statements we need to identify all the "revenue" and "expense" accounts, whose balance will be reported in the Income Statement, and all the "asset", "liability" and "owners' equity" accounts, whose balance will be reported in the Balance Sheet.
After all the adjustments have been made and the adjusted trial balance has been prepared, the balances of the different T-accounts are reported in the right statement.

1. First, revenues and expenses T-accounts are reported in the income statement.
2. Second, the net income (or earnings) is calculated as the resulting balance of the income statement.
3. Third, the assets, liabilities and owners' equity T-accounts are reported in the balance sheet.

At the end of the closing procedure, total assets must equal total liabilities + owners' equity in the Balance Sheet, based on the basic accounting equation.

RETAINED EARNINGS AND DIVIDENDS

In most countries, like Italy, earnings of the last period are reported separately from retained earnings coming from previous periods. Differently, in other countries, after earnings are determined and recorded at the end of each accounting period, they are directly accumulated into the account retained earnings.
If we use a separate account like 'earnings of the period' or 'net income' in the Income Statement, during the following period we need to move its balance to the retained earnings account:

Earnings (or Net Income) (OE) 50,000

Retained Earnings (OE) 50,000

Transferring net income of the previous year to retained earnings as a part of the owners' equity (OE)

Companies may decide to pay dividends to stockholders instead of retaining earnings inside. Dividends are first declared by the Board of Directors and then paid. When declared, we record:

Retained Earnings (OE)	2,000	
Dividends payable (L)		2,000

Reduction of retained earnings by 2,000 and increase of the liability (for dividends payment) by the same amount

When we pay, the accounting entry is the following:

Dividends payable (L)	2,000	
Cash (A)		2,000

Dividends payment for the amount of 2,000 euros.