



Super Software for DIY Super

A Guide to Accounting for users of MySF

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1. Accounting

An Important Note

The vast majority of accounting in MySF is fully automated. While this document describes the use of debits, credits and how to build transactions from them, in reality, when you record purchases, sales and more in MySF, accounting processes run in the background without the need for you to create the entries manually. This document is intended to explain the underlying logic and why certain things happen the way they do.

1.1 Basic Principles of Accounting

Accounting is the process of keeping track of how much we own, what we owe, income that has flown in and expenses that have flown out. We record every change in an account. In other words, accounts are the places where we record increases and decreases in the levels of assets (what we own), liabilities (what we owe), equity (also known as net worth, which is what would be left over if we sold all assets and paid off all liabilities), income received and expenses paid. There is generally one account for each type of event. For example there is an account to record interest payments received and there is another account to record bank fees we have paid.

There are five different types of accounts:

- Asset
- Liability
- Equity
- Income (also called Revenue)
- Expense

Asset accounts represent things owned by the Fund. This includes items bought outright using the Fund's own money or items which were purchased using a loan. Assets are generally split into two groups: current and non-current assets.

Current assets (also called current accounts in the UK) are broadly defined as anything of value that is highly liquid or is expected to be converted into cash within a year during normal operations. Current assets therefore include cash, marketable securities such as shares (even if there is no intention of selling them) and debtors (also known as accounts receivable).

Financial assets are a subset of current assets and include cash and marketable securities only.

Non-current assets (also called fixed assets) are long term assets, which are not expected to be consumed or converted to cash in less than a year's time. Non-current assets in a typical portfolio include property and its fittings and fixtures.

Non-current assets may be tangible (such as vehicles, buildings and land) or intangible (such as goodwill, intellectual property rights, trademarks and patents).

Whenever you add a new financial asset in the software, such as shares, MySF will create the asset record and a new account in the general ledger of accounts to represent that holding. A new account is created for each batch of shares that is purchased at different times. Each holding is considered a separate asset in its own right and different holdings with the same code are grouped together by code within the software. This allows accurate processing of tax deferred income and greater precision in capital gain calculations. Please see latter sections for more information related to tax deferred income and capital gains calculations.

An important thing to note about accounts associated with a particular asset is that they contain an amount that is the cost base of the asset, not the market value (see section "Cost Base versus Market Value"). Increases in market value can be an asset themselves, but they are contained in a separate account, called "Increase in Market Value". The only time that the balance of an account representing an asset is the same as its market value is if the market value happens to be the same as the cost base, which is rare.

Liabilities accounts represent amounts owed to others by the Fund. A typical example would be a loan to the Fund or tax owed by the Fund.

Like assets, liabilities are also split into current and non-current. Current liabilities are those which we reasonably expect to discharge (settle) within a year of them being incurred. Non-current liabilities are those which we do not expect to discharge within a year's time.

Loans can also be represented as a negative asset. For example, a personal loan may be represented in your bank's internet banking as a bank account with a negative balance. This approach can also be used in MySF.

Equity accounts reflect our net worth, or put another way, they are the portion of the assets we actually own outright. These accounts are sometimes referred to as owners' equity or, in the case of investment portfolios, members' equity.

To explain what equity represents, consider the following example: if we buy a property for \$100,000 using only our own money, then we have a physical asset whose cost base is \$100,000 (this is our asset), \$0 owing to others (this is our liability) which means we own the whole \$100,000 property (this is our equity).

However, if we bought the same property using \$20,000 of our own money and take a \$80,000 loan for the rest, then we have a property whose cost base is \$100,000 (this is our asset), \$80,000 owing to the financier (this is our liability) and we are left with \$20,000 of the property that we own (this is our equity).

The **relationship between assets, liabilities and equity** is also illustrated in the above examples. In the above example we demonstrate that **Equity = Assets – Liabilities**. This is more commonly shown in a slightly different format: $Assets = Liabilities + Equity$. This equation must always hold. It is true for individual assets, just as it is true for the portfolio of assets or Fund as a whole.

The Balance Sheet (also called Statement of Financial Position) is a listing of the assets, liabilities and equity of a given Fund.

Income (also called Revenue) accounts are used to record receipts flowing into the Fund. It is important to remember that receipts into the Fund in the regular course of operations are income to the Fund. This includes contributions by members or their employers, dividends and distributions received, interest received, rent received and many more.

Please note that depending on accounting rules in your location you may be allowed or even required to record income when it falls due, even if you have not yet received the cash. This is an accrual entry. MySF is well suited to both accrual and cash accounting. To find out more about how to deal with accrual entries, please check the MySF forums or contact support.

Expense accounts are used to record payments flowing out from the Fund. Expenses include payments to third parties, such as bank fees paid or property repair costs, or a payment out of

the Fund to members of the Fund. It is important to note that a capital purchase, that is the purchase of an asset, is not considered an expense.

Please note that depending on accounting rules in your location you may be allowed or required to record expenses when they are incurred, even if you have not yet paid for them. This is an accrual entry. To find out more about how to deal with such entries, please check the MySF forums or contact support.

Income less Expenses of the Fund are its pre-tax profits for a given period. Income, expenses and the resulting profit or loss are also what is shown in the Profit and Loss report of an Fund.

The General Ledger

All accounts are organised into a hierarchical structure called the General Ledger. There is one top level account for each account type, being assets, liabilities, equity, income and expense. Under each of them are several child accounts, which can in turn have more child accounts. Each subsequent level offers a more specific categorisation for assets, liabilities, equity, income or expenses. For example, one of the child accounts of Income is Operating Income (which represents income from the normal course of operations) which has several child accounts, including Dividends. Because dividends can be received as cash or reinvested, the Dividends account has two child accounts called Dividends Received and Dividends Reinvested.

1.2 Debits, Credits and Transactions

What is a Debit and what is a Credit?

In accounting speak a debit is an accounting entry which results in an increase in the level of an account if it is an asset account or expense account, and a decrease in the level of a liability, equity or income account. Its counterpart, a credit, is an accounting entry which results in a decrease in the level of an account if it is an asset or expense account, and an increase in the level of a liability, equity or income account.

	Debit	Credit
Asset	Increase	Decrease
Liability	Decrease	Increase
Equity	Decrease	Increase
Income	Decrease	Increase
Expense	Increase	Decrease

It is important not to think of debit as plus and credit as minus, because that is not the case. As stated above, the effect of a debit or a credit depends on the type of with which we are dealing.

Note that a debit or credit by itself is not a transaction. It is a "line" or "line item" of a transaction, but a transaction is made up of at least one debit and one credit. There is no such thing as a "debit transaction" or "credit transaction".

Additionally, every transaction must balance. That is the total amount of the debits must equal the total amount of the credits.

You should steer clear of any application that allows the processing of a debit or credit by itself. Collectively these applications are known as single entry accounting applications and are inherently error prone and difficult to use.

The accounting engine of MySF belongs to a group that are referred to as double entry accounting applications because it only ever processes transactions that balance (total debits equals total credits) and never allows a debit or credit to be processed individually. This means that processing errors are minimized and everything stays in balance.

Debits, credits and transactions are best explained using examples, which are shown in the next section.

What is a Transaction?

A transaction is a group of debits and credits. For a transaction to be valid, the total debits and credits must be equal.

Consider the following examples:

Example 1) A transaction to record the purchase of a \$100,000 property using only cash already in the Fund's bank account.

In this case we need to end up with an increase in the asset account representing the property, so that its balance is \$100,000 (the cost base of the property). We also need to decrease the balance of the bank account by \$100,000 to reflect the reduction in cash we paid for the property.

The account representing the property is an asset account and the account representing our bank account is also an asset account.

To increase an asset account we debit and to decrease an asset account we credit, so the transaction will be:

Debit	Property	\$100,000	
	Credit	Bank	\$100,000

This is a valid transaction because there is at least one debit and one credit and the total amount of debits and credits are equal.

Note that the indent of the credit line in the notation above is intentional and is a standard in accounting to make transactions easier to read.

Example 2) A transaction to record \$500 rent received for an investment property.

In this case we want to increase the balance of our bank account to show that the money has been received and increase the balance of an income account ("Rent received") to categorise the income.

The bank account is an asset account, therefore to increase we debit. Rent received is an income account therefore to increase we credit.

The lines of the transaction are:

Debit Bank \$500
Credit Rent Received \$500

This is a valid transaction because there is at least one debit and one credit and the total amount of debits and credits are equal.

1.3 Bank Deposits: Asset for You, Liability for the Bank

If you look at statements you receive from a bank or speak to a customer service representative of a bank they will often refer to an increase in your bank account (which is an asset to you) as a credit. Similarly, when you look at a bank statement your deposits (increases in balance) will often appear as a credit and withdrawals (decreases in balance) appear as a debit. This is the opposite of what we would expect. A bank account with a positive balance is an asset to the member, therefore to increase we debit it and to decrease we credit. However, that same account is not an asset for the bank; it is in fact a liability for them. The reason for this is that when you put money in the bank, they have to eventually give that money back to you. For a bank the account is effectively a loan that you have given them, which you may call back at any time.

Since your bank account is a liability to the bank, they credit the account to increase its balance, and debit to decrease its balance. When you see a bank statement or speak to a customer service representative, you are being told about the debits and credits from the bank's perspective and they are looking at the account as a liability.

1.4 Cost Base versus Market Value

One of the common sources of misunderstanding of financial reports for a portfolio and the biggest source of mistakes during setup is failing to distinguish between "cost base" and "market value".

The cost base of an asset, also known as its capitalised cost, is equal to the amount paid for the asset, including any capitalised expenses associated with the purchase and delivery (such as stamp duty, legal fees or brokerage), less any amounts that have been recovered. Very few events lead to a change in the cost base of an asset. These events are discussed a little later in this section.

The market value of an asset is the value that is assigned to it in the market at any given moment in time.

The concepts of cost base and market value are largely unrelated.

Balance Sheet (Statement of Financial Position) Shows Cost Base

In the second example under the section "What is a Transaction?" we showed that when an asset is purchased, we process a transaction that contains a debit (DR) to the account associated with that asset. The amount of the DR is equal to the amount of money that was paid for the asset, including any capitalised costs associated with the purchase of the asset. Therefore the balance of the account after the purchase will be the cost base of the asset.

The Balance Sheet (Statement of Financial Position) lists the balances of asset, liability and equity accounts. Therefore, the balance shown next to an account connected to an asset should always be equal to its cost base.

Some investment management companies send their members documents which show investments with beginning values, end values and increases; or simply list assets and their current market values. While these documents are sometimes referred to as a Balance Sheet by the issuing company, they are in fact not a Balance Sheet at all. Customizable asset reports showing market values, yield and weights within a portfolio can be produced through the Report Tool of MySF.

Please note that we also provide an option to show a Balance Sheet with assets at market value, which will also add an entry under equity for "provision for increase in market value" to ensure that it remains in balance, but this is not a Balance Sheet in the accounting sense.

How Cost Base Can Change

There are a small number of specific events that can bring about a change in the cost base of an asset. These events fall into three categories.

First, the Fund may be given some form of tax deferred income from an investment. Typical examples of such income include capital returns to members by a company or tax deferred components of distributions paid by a company. Capital returns received from companies are a form of tax deferred income.

Tax deferred relates to the fact that tax is not paid at the time that this income is received. In relation to cost base, this means that tax deferred income reduces the cost base of the asset (and therefore the balance of the account associated with the asset). The impact of this reduction in cost base is that when the asset is sold the capital gain amount calculated is higher; therefore the member will be liable for a higher tax payment at that time.

The second category of events affecting cost base are those that bring about a change in the number of units of in an member's possession, without the member paying or receiving anything. Such events also result in a modification of the cost base. Examples of these events include issuance of bonus shares, splits, reverse splits or demergers. All of these events are discussed under their own headings in this document.

Finally, an member may make additional payments to continue ownership of the asset. Examples of this include instalment payments on financial assets, or additional partial payments for physical assets. These events will increase the cost base of the asset in question.

Calculating Capital Gains

Capital gains are profits or losses made from buying and selling assets. The amount of capital gain is normally calculated by subtracting the cost base from the net proceeds of the sale (also known as the sale consideration). Net proceeds of the sale are the amount received for the asset being sold less any costs of the sale (such as brokerage).

If the amount left over from net proceeds from sale minus cost base is positive it is a capital gain, if it is negative it is a capital loss. Capital gains and losses are counted as income to the Fund.

Different countries and regions have different rules and regulations for determining what portion of capital gains are taxable and non-taxable. These rules normally relate to the duration of ownership and some classes of assets may be specifically exempt from capital gains tax, meaning that any capital gains made from the sale of those assets is non-taxable (but it is still an income). MySF calculates capital gains and losses from sales as you enter the sale and allocate units to be sold. The advantage is that you can enter the combination that will give the best result for you at that time. Your aim could be maximum loss (if you can offset against gains elsewhere), or minimum taxable gain. The rules used by MySF can be changed via the Capital Gains Calculation Rules screen.

Calculating Increase in Market Value

The increase in market value for an asset in a given period is the market value of the asset at the end of the period minus the market value of the asset at the beginning of the period.; or if it was purchased in the current period then minus the cost base of the asset.

To allow accurate calculation of increases in market value, please ensure that you have revalued asset for at least the start and end date of the period in question.

In some countries an increase in the market value of the property would be recorded to the "Increase in Market Value" account, which is an asset account. Because $Assets = Liabilities + Equity$ and our loan amount does not increase with an increase in market value, such an increase will result in an increased equity amount. The process of recording an increase in market values as above is called "Mark to market" and is normally done at the end of a financial period.

2 Asset Classes

Asset classes represent the types of assets in which an Fund invests its funds. Typical examples include Equities, Fixed Interest, Managed Investments, Residential Property, Commercial Property etc. Asset classes allow the classification of assets based on their characteristics.

There are three categories of asset classes: physical, standard financial and derivative financial.

Classes of physical assets are those which will hold tangible assets that may be depreciated (but do not need to be) and where the number of units is always one. Assets in physical asset classes can never be subject to corporate actions and do not have an expiry date. Typical examples of physical asset classes include property, artwork, coins and classic cars.

Standard financial asset classes hold assets represented as some number of units, where an member may choose to buy more units in the asset or sell down their holding. Standard financial assets may be subject to corporate actions, but may never be depreciated and do not have an expiry date. Typical examples of standard financial asset classes include equities, fixed interest investments and mutual funds.

Derivative financial asset classes hold assets which are similar to standard financial assets in that there are a number of units held which may not be one, but in this case there are a number of contracts each of which cover some number of units in an underlying asset (which may not be

owned). Assets in these classes cannot be depreciated and they do have an expiry date. A typical example of a derivative financial asset class is options.

You may have up to 500 physical asset classes, with unlimited numbers of assets in each class, and 499 financial asset classes also with an unlimited number of assets in each class. Note that all of every asset class' details may be modified through the Asset Classes screen under System Setup > Asset Classes. Every asset class may also have a default asset allocation table (see next section) so you do not need to enter it every time you add an asset to that class (though you may modify it if you like).

Each asset class in MySF can have a set of user defined fields. User defined fields are used to record information that may be unique to a given asset class, but is not necessarily relevant to others, or not yet included in the software. For example if your Fund owns artwork, you may choose add Artwork as an asset class (physical assets) and add in user defined fields of "Artist", "Style" etc. These fields are then displayed on the user interface when you add or manage assets of the Artwork asset class.

3 Asset Allocation Categories

Asset allocation categories represent the categories of investments where the funds of the Fund end up when purchasing a given asset. In effect, the asset allocation categories measure the exposure of the portfolio of assets to different asset allocation categories.

When you set up a new Fund in MySF the software will load a default set of asset allocation categories. You can modify this list to suit your needs and there are no restrictions on the possible asset allocation categories.

Every asset has its own asset allocation table. The asset allocation table of each asset contains a list of the asset allocation categories available in the Fund, together with a percentage showing the amount of the funds devoted to that asset which are in that asset allocation category.

The usefulness of asset allocation categories is most apparent in the case of mutual funds of other investments which may span multiple allocation categories. Assume for a moment that you hold some units in a fund that is managed on your behalf. This fund will invest in 60% domestic equity, 30% foreign equity and 10% cash. In such a case it would be useful (and in some cases it may be a requirement) to keep track of your total exposure to a given allocation category. This means that if you purchase \$ 100,000 in domestic equities yourself and put \$ 80,000 into the mutual fund detailed above, your actual exposure to domestic equities is $\$100,000 + (\$80,000 \times 60\%) = \$148,000$.

In MySF you can define your target level of exposure to the different asset allocation categories and you can also evaluate whether or not your current investments meet that criteria.

4 Recording Purchases of Assets

To record the purchase of assets you should use the Add / Manage Assets screens in MySF. These screens are available by either by going to Manage > Add or Manage Assets > {select asset class type} > {select asset class} or through the shortcuts on the Main Menu shown in the middle of the screen when MySF is open.

4.1 Recording purchases of assets in the current financial period

When you add a current year purchase through one of the Add / Manage Assets screen in MySF, the software will automatically create the asset record, an account in the general ledger to represent the asset and a transaction to record the accounting effects of the purchase. All of this is automated and there is no need to manually calculate cost base or manually create accounts or process transactions.

When you record the purchase of an asset, MySF will automatically create the asset record and the account which will represent the asset in the general ledger. If the purchase is recorded for the current financial period, MySF will also automatically create and post the transaction to process the accounting entries for the sale.

When you add an asset in the current period MySF will create the asset record and an account to represent the asset in the general ledger. It will also create and process a transaction for the date of the purchase which will be.

DR <account of the asset> \$ cost base
CR <bank account selected> \$ cost base

If you are liable for some consumption taxes which can be reclaimed later, these will be a DR to the "paid" account of the selected tax and a CR to the bank account. For further information on cost base, please see the next section.

When you sell an asset, or part thereof, MySF will decrease the number of units in that particular holding and post a transaction to reflect the accounting effect of the sale. The transaction created is:

DR <bank account selected> \$net proceeds from sale
CR <account of the asset> \$cost base per unit * number of units sold
CR < capital gains> \$(net proceeds from sale) - (cost base per unit * number of units sold)

Note that the capital gains may be split between several capital gains accounts depending on capital gains rules defined. Some capital gains may be non taxable or taxed at a lower level. This usually depends on the amount of time for which you have held the asset being sold.

4.2 Recording purchases of assets which occurred in a past financial period

When you record a purchase of an asset through the Add / Manage Assets screen for a past financial period, please make sure that you enter "Cost Per Unit" as the cost base per unit of the asset as at the start of the current financial period (it is very important to note that this is not the same as the market value) and the "Number of Units" as the number of units remaining at the start of the current financial period.

When you record such a purchase the program will create the asset record and the account which represents the asset in the general ledger, but no transaction will be created.

The reason there is no transaction created is that no transaction may be processed outside of the current financial period. The balances of these accounts at the start of the current financial year must be entered using the Load Opening Balances screen.

4.2.2 Determining Correct Cost Base and Opening Balance

The opening balance of an account that represents an asset from the asset ledger is going to be the asset's cost base (not market value).

The cost base of an asset is the price paid plus the capitalised portion of any acquisition costs less any amounts recovered. (Note that different countries have different rules for what is considered a capitalised expense. You should speak to a suitably qualified professional before relying on this information.)

Examples

These examples below assume that you are setting up a new Fund for a financial year sometime after 2003.

If you purchased 1,000 units in XYZ in 1998 for \$15.50 each and paid \$40 as brokerage fee, then the total cost of the asset was $(\$15.50 \times 1,000) + \$40 = \$15,540$.

If you have not sold any of these units and had not received any tax deferred income for this asset and units in XYZ were not subject to any corporate actions then the cost base per unit of XYZ would be \$15.54 $(\$15,540 \div 1000 \text{ units})$ and the number of units would be 1,000. When adding this asset through the Add / Manage Asset screen you would enter \$15.54 into the "Cost per unit" field and enter 1,000 for "Number of Units Purchased". Other fields such as brokerage would stay blank. The opening balance of the asset's account should be $(\$15.54 \times 1,000=)$ \$15,540. *either cost per unit wrong or total is wrong

If you received tax deferred income, say in 1999, such as a tax deferred component of a distribution or a capital return, the cost base per unit would fall. For example if you received a distribution which included \$310.00 of tax deferred income, then the cost base of the asset would fall by the tax deferred amount. In this case the reduction in cost base per unit would be $\$310.00 \div 1,000 = \0.31 . The cost base per unit would become $\$15.54 - \$0.31 = \$15.23$. The number of units would not change, remaining at 1000 units. When adding this asset through the Add / Manage Asset screen you would enter \$15.23 into the "Cost per unit" field and enter 1,000 for "Number of Units Purchased". Other fields such as brokerage should stay blank. The opening balance of the asset's account would be $(\$15.23 \times 1,000=)$ \$15,230.

If you had then sold 100 units of XYZ from this holding, say in 2001, then the cost base would not have changed (still \$15.23 as a result of the tax deferred income above), but the number of units would have fallen to $(1,000 - 100) = 900$ units. Therefore the cost base per unit would be \$15.23 and the number of units 900. When adding this asset through the Add / Manage Asset screen you would enter \$15.23 into the "Cost per unit" field and enter 900 for "Number of Units Purchased". Other fields such as brokerage should stay blank. The opening balance of the asset's account would be $(\$15.23 \times 900=)$ \$13,707. It is also important to note here that profits or losses from a sale do not impact the cost base of the asset.

Note that any activity on the asset in the current financial period should be excluded from these calculations, as that activity would not influence the opening balance for this period.

When adding assets purchased in past financial periods, please enter the cost per unit and number of units as per the description above. This will enable MySF to automatically calculate the opening balance for the accounts of various assets.

The screen you should use to create opening balances is the Load Opening Balances screen (Menu: System Setup > Load Opening Balances). On this screen you will see all of the asset,

liability and equity accounts. Asset accounts which are associated with a physical or financial asset will have a box next to them which can be ticked. If you tick that box, the program will automatically calculate the opening balance from the information that has been entered when the asset was added. This function will incorporate any existing balances of the account so it will not double up figures if a transaction had already been posted to that account.

You will need to create opening balances for all assets that were purchased in a past financial year.

Opening Balances can be created one by one for each asset, or you can add in all assets purchased in previous financial years and create a single opening balance transaction covering all of these assets.

Please note that if you do not have any assets that were purchased in previous periods you may still need to post an opening balance to establish the balance of any bank accounts for the start date of the financial period.