

Week 1: The nature & purpose of accounting regulatory and conceptual frameworks

- ❖ **Accounting:** The process of identifying, measuring and communicating economic information about an entity to a variety of users for decision making.
- ❖ **Stewardship function of management:** Shareholders evaluate how effectively management has invested assets and made appropriate decisions, based on FS
- ❖ **Triple bottom line reporting**(environmental, social and governance reporting): Assess how an entity makes sustainable decisions that are beneficial for environment and society instead of for profit maximization.
 - Includes analysis of risk and return on each decision
 - Typically concerned by special interest group

The process of accounting

Identifying	Measuring	Communicating	Decision making
Transactions that affect the entity's financial position are taken into consideration. They must be able to be reliably measured and recorded.	This stage includes the analysis, recording and classifying of business transactions.	Accounting information is communicated through various reports such as statements of profit or loss, balance sheets and statements of cash flows.	Accounting information is used for a range of decisions by external and internal users.

Who uses accounting information?

- ❖ Resource providers
 - **Investors - risk and return (ability to pay dividends, potential capital growth)
 - **Lenders - ability to pay debt and interest
 - Suppliers - ability to pay debt
 - Employees - ability to provide benefits, ongoing employment
 - ❖ Recipients of goods and services
 - Customers - reasonability of prices/taxes, capacity for ongoing supply
 - ❖ Parties supervising an entity's performance
 - Agencies - ensure it complies with reporting regulations
 - Advisors & analysts - analyze financial information
 - Community groups - its impact on society/environment
 - ❖ Management bodies
- ** Primary users of financial reports

Main usage of accounting info to check:

Financial status

- ❖ **Profitability:** An entity's ability to generate profits
- ❖ **Efficiency:** Ability to generate cash flow from available resources
- ❖ **Liquidity:** Ability to meet its financial obligations
- ❖ **Gearing** - Measures financial stability and firm's ability to meet long-term obligations 资本负债比率 (funded by lenders vs shareholders)
- ❖ Market performance

Non-financial status

- ❖ Corporate governance
- ❖ Social and environmental impact
ie. **Corporate Social Responsibility (CSR reporting)** - A company's initiatives to assess and take responsibility for its effects on environmental and social well-beings

Types of company structures

	Sole trader	Partnership	Company
Set up & administration	Simple	Relatively easy	Complex
Life of entity	Limited to life or desire of owner	Limited to life or desire of individual partners	Indefinite
Legal status relative to owners	Not separate	Not separate	Separate
Extent of owners' liability	Unlimited	Unlimited	Limited (with some exceptions)
Tax implications	Owner declares profit as income	Partner declares share of profit as income	Entity taxed on profit, shareholders declare dividends as income

- ❖ **Sole trader:** A person provides permanent finance. Fully control the business and keep all the profits, but has unlimited liabilities.
- ❖ **Partnership:**
 - ** Income tax expense won't be included in the entity's income statement because the income is based on his/her share of profit
 - A written partnership agreement includes:
 - Arrangements on a partner's death/retirement
 - Contribution of cash and assets made by each partner
 - Profit and loss sharing ratio
 - If a partner dies/retires, the partnership will be automatically **dissolved**(when a business legal entity is withdrawn by law)
- ❖ **Company:** Characterised by owners holding shares
 - Rights to vote and dividends
 - Indefinite life
- ❖ **Wound up:** 1st stage of dissolution; Selling all assets of an entity, paying off liabilities, distributing remaining assets to partners/shareholders, and lastly dissolving the business