Which business has limited liability?

Companies (Public and Private)
Public - Listed on the ASX, accounts must be public, can sell shares on the open market
Private - Family-owned for example, can keep their financial records private, aren't audited, but can only have a maximum of 50 shareholders

What are the qualitative characteristics and why are they important

- **Relevance**
  - The information is capable of making a difference to the decision made by users, info needs to have a predictive value
- **Verifiability**
  - Done through the auditing process, Enables knowledgeable and independent observers to reach a consensus if a particular event or transaction is a faithful representation
- **Faithful representation**
  - Information is complete, neutral and free from error
- **Reliability**
- **Timeliness**
- **Comparability**
  - Users can identify similarities and differences between different period within a set of financial statements and across different reporting entities
- **Understandability**
- **Constraint**
  - Cost preparation versus benefits

Accounting Terms:

Assets = Liabilities + Owners' Equity

Asset

- A resource **controlled** by the entity as a result of past events, and from which economic benefits are expected to flow to the entity
- Characteristics
  - Expected future economic benefit
  - Business has exclusive right to control the benefit
  - Benefit must arise from some past transaction or event
  - The asset must be capable of reliable measurement in monetary terms
- Tangible Assets
  - Physical Things (E.g Buildings, Computer), Inventories - stuff you plan to sell

- Intangible Assets
    - Not-Physical things (E.g Goodwill - the users of the product, brandname, Accounts Receivable - Money Owed (Fixed date and number), Bills Receivable - (When you negotiate a set date to repay a debt, variable date) Investments)
- **Assets becomes an expense when the benefits have been used**
    - E.g Fuel for use in a company car
- Includes “cash equivalents” such as credit cards
- Two types of claims against the assets of an entity (someone owns the asset)
    - External claims - known as liabilities
    - Internal claims - labelled owners’ equity, equity or capital
    - Owner’s equity - The claim of the owner on the assets of the business
- Land is a non-current asset that doesn’t depreciate

Liability

- A present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits
    - E.g Money, Accounts Payable, Legal retainers (E.g Bonuses to be paid), Accrued liabilities (Liabilities that a company has, but hasn’t paid yet - E.g Bills)
- Contingent liabilities
    - A potential liability that **hasn’t happened** but the probability of happening is high
    - Under “provisions”
    - Not directly shown on the financial statement, but in the notes of the financial statement
- Current Liability - Less than 12 months
    - E.g Accounts Payable
- Non-Current Liability - More than 12 months
    - E.g Mortgage

Owner’s Equity

- Consists of Revenues (Positive), Expenses (Negative), Drawings (Negative), Dividends (Negative), Capital (Positive)
    - E.g When expenses go up, Owner’s Equity goes down
    - **Revenues** - amounts received or to be received from customers for sales of products or services (E.g Unearned Revenue - Revenue received in advance)
        - The gross inflow of economic benefits during the accounting period arising in the course of the ordinary activities of an entity when those inflows result in increases in equity, other than contributions from equity participants
            - E.g Increases in assets or reductions of liabilities
    - **Expenses** - used-up assets
        - A decrease in equity

                - Decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in equity, other than distributions to equity participants.
            - Amounts that have or will be paid for costs that have been incurred to earn revenue
            - E.g Salaries and wages, electricity and gas, supplies used
    - **Capital** - owner's contribution to the business (Share-capitals relevant for large companies)
    - **Drawings** - when the owner takes money out of the business (more relevant for sole-traders)
    - **Dividends** - money paid to shareholders by the company out of its profits
- What's left of the assets after liabilities have been deducted
- Same as net assets
- Owner's claim on the entity's assets
- Reserves (accounting for these will not be examined)
    - Special accounts that the business creates
    - Money set aside for later use - there must be a specified reason approved by shareholders and auditors
    - Another example
        - If the price of land (asset) goes up from 300,000 to 500,000
        - Dr Land 200,000
        - Cr Asset Revaluation Reserve 200,000
            - You credit "asset revaluation reserve" because you can't record it as profit as you haven't sold it yet and if this was allowed, companies would keep reevaluating assets to create "false profits"
        - If the price of the land then goes down to 100,000
        - Dr Asset Revaluation Reserve 200,000
        - Dr Loss 200,000
        - Cr Land 400,000
    - Hence, the purpose of the reserve is to minimise the risk of losses, which in this case will look like 200,000 rather than 400,000

Concept of Duality

- Total debits must equal total credits
    - Debits is your own money
    - Credit is the money you have to pay back
- Owner's Equity is Credit, as eventually, the business is required to pay it back to the owner since the business and the owner are separate (Entity Principle)
- Every transaction must have a credit and a debit

Cash Management and Internal Control

Internal Control

- Organisational plan and all the related measures that an entity adopts to
    - Safeguard assets
    - Ensure accurate and reliable accounting records
    - Encourage adherence of personal to company policies
    - Promote operational efficiency
    - Consists of General Controls and Accounting Controls
    - Part of corporate governance mechanism that operates within a business
- Characteristics of an effective internal control system
    - Competent, ethical
        - Member of ICAA and CPA
        - Paying good salaries to attract top-quality employees
    - Assignment of responsibilities
        - Inform staff what they can and can't do
        - Each employee given certain responsibilities
    - Proper authorisation
        - Organisation has a written set of rules outlining approved procedures
    - Separation of duties
        - Limits chances of fraud and promotes the accuracy of accounting records
        - 4 parts:
            - Separation of operations from accounting
                - Personal should be different
            - Separation of the custody of assets from accounting
                - Accounts don't handle cash and cashiers don't have access to accounting records
            - Separation of the authorisation of transactions from the custody of related assets
                - People who authorise transactions should not handle the related asset
            - Separation of duties within the accounting function
                - Different people should perform different phases of accounting to ensure accuracy and opportunities for fraud
    - Performing internal and external audits
- MICER
    - Monitoring of controls
        - Hiring of external auditors
        - Ensure adhering to company policies and operations are efficient
    - Information systems

        - Only authorised users have access to various parts of the accounting information system
    - Control procedures
    - Control Environment
        - Heads of organisations need to establish good images and procedures
    - Risk Assessment
        - Company must identify its risks
- Internal Controls for e-Commerce
    - Encryption
        - Primary method of achieving confidentiality in e-commerce
        - Messages are rearranged by a mathematical process
        - Https - s stands for secure
    - Firewalls
        - Limit access to a local network to keep out intruders
        - Enable members of the local network to access the Internet while keeping non-members out of the network
- Limitations
    - Cost vs Benefits
        - Cost of implementation of internal controls should not exceed benefits
    - Human element
        - Collusion
    - Size of business to implement such internal control

Bank Reconciliation

- Form of internal control over cash
    - The person who reconciles should not have access to cash or record cash journal transactions
        - Otherwise theft is easy
- **The total on the right hand side is a running total**
- Cheques are Credits
- Deposits are Debits
- On the bank statement, the balance is a credit as it is from the bank's perspective - it owes the company money
- Possible reasons balance on bank statement doesn't match balance on bank rec
    - Bank Side
        - Deposit in Transit **(ADD)**
            - The money is still in transit - a cheque has been recorded in the business but not deposited into the bank
        - Outstanding Cheques **(LESS)**
            - Business has issued cheques but bank has not paid them
    - Book Side

            - Bank Collections **(ADD)**
                - Bank collects money direct from customers
            - Direct Debit **(ADD)**
                - When the customer directly deposits the cheque to the bank
            - Interest Revenue **(ADD)**
            - Clearing the cheque
                - When the bank where the cheque is deposited contacts the bank of the customer to request a transfer of the money
            - Dishonoured Cheque/Cheque Bounceback **(LESS)**
                - When the customer has no money and the cheque is bounced back
            - Bank Charges **(LESS)**
            - Theft **(LESS)**
                - Someone has stolen the money
- Bank Rec involves making adjusting entries for for transactions on the book side

Measuring and Reporting Financial Performance

- Statement of Financial Performance/Position show movements and the net change in wealth for the period (focus on **accrual accounting**)
    - Balance Sheet
        - Static Report given at a specific point
    - Income Statement
        - Measures the financial performance over a period of time
    - Cash flow statement
        - Identifies all cash receipts and payments for the period
        - Analysis of the business' cash movements over the period concerned
        - All payments of a particular type are added together to give just one figure
        - Net total of the statement is the net increase or decrease in cash of the business over the period
    - Thus, Cash Flow report is essential to reveal the liquidity of a company
- Statement of Financial Performance = income statement/profit and loss
    - Based on Profit/loss of a period = Total Income - Total Expenses incurred in generating income
    - Accounts for most operating activities except
        - Increases in the value of non-current assets
    - In Simple Reports, just have two titles **Income and Expenses** and make a list
    - In Classified Reports, need to group expenses in categories
        - Cost of Sales
        - Selling and Distribution
            - E.g Advertising, Delivery, Display
        - Administration and General