ACCOUNTING

CHAPTER 1
INTRODUCTION TO ACCOUNTING AND BUSINESS DECISION MAKING

EXPLAIN THE PROCESS OF ACCOUNTING

Definition: the process of identifying, measuring and communicating economic information about an entity to a variety of users for decision-making purposes.

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 income statements, balance sheets and statements of cash flows.	Accounting information is used for a range of decisions by external and internal users.

OUTLINE THE IMPORTANCE OF ACCOUNTING AND ITS ROLE IN DECISION MAKING BY VARIOUS USERS

Accounting information is an important part of the information used by individuals and entities in decision making regarding investment and other business opportunities. The internal users (management) use accounting information to make decisions concerning sales mix, which products to make or buy, and opportunities for expansion. Stakeholders (e.g. suppliers, consumers, banks, shareholders and regulatory bodies) require accounting information to help decide whether to lend money to the entity, whether to invest in the entity and whether to purchase goods from the entity

Accounting allows the managers/owners to:

- make decisions regarding the operations of the business entity, such as planning processes (forecasting profits, determining the price of goods and appropriate sales).
- evaluate the success of the business entity in achieving its objectives, by assessing how well employees have achieved their set targets.
- weigh up various alternatives when investing the resource of the business entity.

External stakeholders have an interest in the performance of the entity.

- Current stakeholders: will seek accounting information to help them evaluate whether the entity's managers have been appropriate stewards or custodians of the entity's assets. Will look at entity reports.
- Prospective investors: will seek information from entity reports to determine whether or not a particular entity is a sound investment. Will look at the financial structure, current financial performance, future growth prospects.
- Suppliers and banks: interested in gauging the entity's ability to repay debt and the level of risk associated with lending funds to it. Will look at the statement of cash flows and the balance sheet.
- Employees: most concerned about the future prospects of the entity. Will look at particular sections in the annual report such as the chief executive officer's (CEO's) report, directors report, statement of comprehensive income and statement of cash flows.
- Government authorities (Australian Taxation Office (ATO)):Will look at reported profit of the year, associated goods and services tax (GST) paid.
- Government authorities (Australian Securities and Investments Commission (ASIC)): will seek to identify whether the business has compiled with requirements of the *Corporations Act 2001* (Cwlth)

EXPLAIN THE DIFFERENCES BETWEEN FINANCIAL ACCOUNTING AND MANAGEMENT ACCOUNTING

Stakeholder	Accounting information and decision making
Shareholders	Information to determine the future profitability of the entity, to assess the future cash flows for dividends and the possibility of capital growth of investment.
Banks	Information to determine whether the entity has the ability to repay a loan.
Suppliers	Information to determine an entity's ability to repay debt associated with purchases.
Employees	Information concerning job security, the potential to pay awards and bonuses, and promotional opportunities.
Consumers	Information regarding the continuity of the entity and the ability to provide the appropriate goods and services.
Government authorities	Information to determine the amount of tax that should be paid and any future taxation liabilities or taxation assets.
Regulatory bodies	Information to determine whether the entity is abiding by regulations such as the Corporations Act and Australian taxation law.
Community	Information to determine whether the entity is contributing positively to the general welfare and economic growth of the local community.
Special interest groups	Information to determine whether the entity has considered environmental, social and/or industrial aspects during its operations.

Financial accounting:
Definition: the preparation and presentation of financial information for all types of users to enable them to make economic decisions regarding the entity.

- Financial accounting provides information for the use of external parties so that they can make economic decisions about the entity. Financial accounting is bound by generally accepted accounting principles (GAAP). There is usually a time lag from the date of the report to when it is distributed to the various users. The financial accounting information is concise as unnecessary detail is disclosed in the notes to the financial statements. The users of financial statements include suppliers, consumers, banks, investors and regulatory bodies.

This information is presented in what is collectively known as **General purpose financial statements**. This encompasses information such as the:
- income statement
    - reflects the profit for the entity for a specified time period
- statement of changes in equity
- balance sheet
    - An entity's assets and its liabilities at a point in time
- statement of cash flows
    - an entity's cash inflows and cash outflows, which are classified into operating, investing and financing activities

Management accounting:
Definition: Field of accounting that provides economic information for use by management in internal planning and decision making

- Management accounting concerns the creation of reports for use by management in internal planning and decision making. The management accounting reports are much less formal than financial accounting reports as they are not bound by regulatory requirements. The reports can also be tailored to suit the needs of management. There is no time lag with management reports, so they are up to date. The core activities of management accounting include formulating plans and budgets and providing information to be used in the monitoring and control of different parts of the entity.

Financial Accounting		**Management Accounting**
External	Primary users of the report	Internal
Half yearly or yearly	Frequency of reports	As frequently as required
Historical focus	Tim frame focus	Current and future focus
Highly summarised	Content of reports	Very detailed

<u>**Financial Accounting**</u>		<u>**Management Accounting**</u>
Standard format	Format	Tailor made

Interaction between financial and management accounting:
Ultimately, there will be an interaction between financial accounting and management accounting, because management accounting will provide economic information for internal users that is then reflected in the financial accounting statements for external users.

	Financial Accounting	**Management accounting**
Regulations	Bound by GAAP. GAAP are represented by accounting standards (including those issued by both the AASB and the IASB), the Corporations Act, and relevant rules of the accounting association and other organisations such as the ASX.	Much less formal and without any prescribed rules. The reports are constructed to be of use to the managers.
Timeliness	Information is often outdated by the time the statements are distributed to the users. The financial statements present a historical picture of the past operations of the entity.	Management reports can be both a historical record and a projection, e.g. a budget.
Level of detail	Most financial statements are of a quantitative nature. The statements represent the entity as a whole, consolidating income and expenses from different segments of the business.	Much more detailed and can be tailored to suit the needs of management. Of both a quantitative and a qualitative nature.
Main users	Prepared to suit a variety of users including management, suppliers, consumers, employees, banks, taxation authorities, interested groups, investors and prospective investors.	Main users are the owner(s)/ managers in the entity, hence the term management accounting.

EXPLAIN THE ROLE OF ACCOUNTING INFORMATION IN THE BUSINESS PLANNING PROCESS

Accounting information assists owner(s)/managers in determining the type of business structure that would be appropriate for the business and in establishing goals for the business entity to achieve. It provides feedback for the owner(s)/managers on the daily operations of the business. It allows entities to determine the correct mix of goods to sell and the right prices at which to market the products. It also assists the business in making decisions relating to assets to purchase to help the business achieve its goals. Finally, accounting information assists the business in evaluating its business plan. Budgeted plans will be compared to actual performance. Tools such as analysis and interpretation will assist management in determining if the business entity is on track with its goals.

- Business plans provide a clear, formal statement of direction and purpose for the business entity. It allows management and employees of the entity to work towards a set of clearly defined goals in the daily operations of the business, and assists the business entity in evaluating the business.

DISCUSS THE GLOBALISATION OF FINANCIAL REPORTING

Larger entities have become bigger, more diverse and multinational as the years have passed. As entities become more multinational and diverse, they require more complex accountancy and auditing services. Accountants must ensure that they remain up to date with the local GAAP and global accounting standards. More than 120 countries worldwide prepare their financial statements following global accounting standards (known as the **International Financial Reporting Standards (IFRS)**), which improves the comparability and transparency of financial information and reduces financial statement preparation costs. When the standards are applied rigorously and consistently capital market receives higher quality information and can make better decisions. The IFRS has improved efficiency of capital market operations and promoted cross-border investment.

IDENTIFY THE SOURCES OF COMPANY REGULATION IN AUSTRALIA

The role of company regulation is to protect different stakeholders (such as investors, consumers and lenders) and help promote a strong and vibrant economy. Regulation assists in monitoring the preparation, presentation and distribution of financial statements. Company regulation also helps liquidators to obtain records from bankrupt companies, to carry out legal proceedings against directors, and to ensure that appropriate information is provided to the different stakeholders of listed companies

ASIC's role:
- uphold the law uniformly, effectively and quickly
- promote confident and informed participation in the financial system by investors and consumers
- make information about companies and other bodies available to the public
- improve the performance of the financial system and the entities within it.

The **Australian Securities exchange (ASX)** is the Australian marketplace for trading equities, government bonds and other fixed-interest securities. The ASX regulates companies through its Market and Listing Rules. The ASX Market Rules govern the operations and behaviour of participating organisations of ASX and affiliates.

EXPLAIN THE CURRENT STANDARD-SETTING FRAMEWORK AND THE ROLE OF THE PROFESSIONAL ACCOUNTING ASSOCIATIONS IN THE STANDARD-SETTING PROCESS

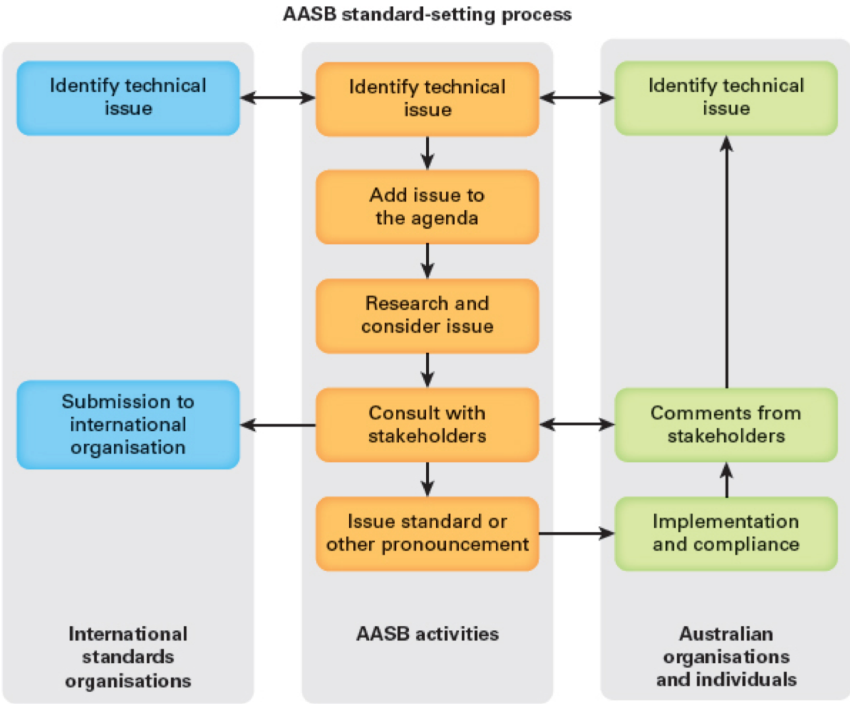
Framework objective: to provide financial information about the reporting entity that is useful to existing and potential investors, lenders, and other creditors in making decisions about providing resources to the entity.

Prior to 2005, Australian Accounting Standards were largely developed by the Australian Accounting Standards Board (AASB). However, since 1 January 2005, Australian entities have complied with International Financial Reporting Standards (IFRS) developed by the International Accounting Standards Board (IASB). The Australian Accounting Standards Board (AASB) is responsible for developing and maintaining high-quality financial reporting standards in Australia and contributing to the ongoing development of international accounting standards by the IASB. In Australia, there are two main professional associations: CPA Australia and Chartered Accountants Australia and New Zealand (CAANZ). The professional associations provide feedback on exposure drafts and forward any comments to the AASB. They also inform their members of any developments in accounting standards through newsletters and by conducting continuing professional education (CPE) sessions.

Australian Accounting Standards Board (AASB)
The AASB is an Australian body responsible for developing accounting standards for application to Australian entities. They develop high-quality financial reporting standards and contribute to the ongoing development of global accounting standards.

The functions and responsibilities of the AASB include:
- issuing Australian Accounting Standards
- significantly influencing the development of International Financial Reporting Standards (IFRS) (such as providing significant input to the development of standards relating to the global financial crisis)
- promoting globally consistent application and interpretation of accounting standards

The **Financial Reporting Council (FRC)** is responsible for overseeing the standard-setting process in Australia.



The **procedure** for due process involves the following steps: identify a technical issue; develop a project proposal; research the issue; consult with stakeholders and prepare an exposure draft; send the exposure draft for comment to interested parties; issue an exposure draft for further comment; and finalise the accounting standard, interpretation or conceptual framework document. The professional bodies provide feedback on exposure drafts and forward any comments to the AASB. They also inform their members of any developments in accounting standards through newsletters and by conducting continuing professional education (CPE) sessions

EVALUATE THE ROLE OF THE CONCEPTUAL FRAMEWORK AND ILLUSTRATE THE QUALITATIVE CHARACTERISTICS OF FINANCIAL STATEMENTS

The Conceptual Framework is designed to assist in the preparation and presentation of financial statements, to guide the standard setters in developing future accounting standards, and to help users interpret information in the financial statements. It specifies the objective of financial statements, their desirable qualitative characteristics, and the definition and recognition of elements in the financial statements. Cost is a constraint on financial reporting.

Fundamental qualitative characteristics

Relevance

The characteristic of relevance implies that the information should have predictive and confirmatory value for users in making and evaluating economic decisions. relevant

Materiality

The relevance of information is affected by its nature and materiality. Information is material if omitting it or misstating it could influence decision making. A financial report should include all information which is material to a particular entity.

Faithful representation

The characteristic of faithful representation implies that financial information faithfully represents the phenomena it purports to represent. This depiction implies that the financial information will be complete, neutral and free from error.

Enhancing qualitative characteristics

Comparability

The characteristic of comparability implies that users of financial statements must be able to compare aspects of an entity at one time and over time, and between entities at one time and over time. Therefore the measurement and display of transactions and events should be carried out in a consistent manner throughout an entity, or fully explained if they are measured or displayed differently.