

BUSS1030 Final Exam Notes – theory

Introduction to Accounting

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- Accounting – the information system that measures business activity, processes the data into reports and communicates the results to decision makers.
- Financial accounting – provides information for external decision makers such as investors and lenders
- Managerial accounting – focuses on information for internal decision makers such as managers

The users of accounting information

- Individuals
 - Manage bank accounts, evaluate new jobs, purchases etc
- Businesses
 - To set goals, evaluate progress and take corrective action
- Investors
 - To decide if a company is a good investment
- Creditors
 - Evaluate the businesses ability to make loan repayments
- Government regulatory agencies
 - ASIC to administer and enforce the Corporations Law
- Tax authorities
 - To determine income tax, GST etc
- Non-profit organisations
 - The same way businesses do
- Other
 - Unions to make wage demands

Accounting Regulation

- Australian approach has both private and public sector involvement in standard setting
- Australian accounting standards board (**AASB**) – prepares, interprets, revises and approves technical accounting standards
- AASB is overseen by the Financial Reporting Council (**FRC**) established under the Corporate Law Economic Reform Program
- Members of both are appointed by the federal government

International Harmonisation

- In 2001 as a move to achieve more international comparability of financial statements the FRC announced Australia would adopt the International Financial reporting Standards (IFRS) and the earlier series of International Accounting Standards (IAS) issues and amended by the International Accounting Standards Board (IASB) (composed of private sector members from various countries)

Corporate Social Responsibility

- CPAA, ICAA and other professional accounting organisations and many large businesses have codes that list CSR duties and bind their members and employees to conduct themselves in certain ways, called codes of conduct
- CPAA and ICAA have a joint code of ethics following the Handbook of the Code of Ethics for Professional Accountants
 - Contains common prescriptions and places common obligations on members with the purpose of maintaining and enhancing their credibility, professionalism, quality and confidence of the public
 - Lays down minimum standards of conduct and is not meant to be exhaustive
 - Principles
 - Integrity (to be honest, fair and sincere)
 - Objectivity (to avoid conflicts of self-interest and bias)
 - Professional competence and due care
 - Confidentiality
 - Professional behaviour (compliance with the law)
 - Some of these overlap and sometimes they have to be prioritised, which calls for subjective judgement
- Sustainability
 - When accountants estimate profit in income statements and values in balance sheets, they usually presuppose firms have the ability to produce profits in the future
 - Sustainability is therefore assumed
 - Sustainability – meets the needs of the present without compromising the ability of future generations to meet their own needs'
 - Carbon accounting system to measure and track the level of carbon emissions

Types of business organisations

- Proprietorship (sole trader)
 - Single owner, many small businesses start as this
 - Each proprietorship is distinct from its proprietor, thus the accounting records don't include the proprietor's personal financial records (even though in law they have unlimited liability)
- Partnership
 - 2 or more individuals together as co-owners
 - Accounting records are distinct from the personal affairs of each partner (despite unlimited liability)
- Companies
 - Owned by shareholders
 - Must fulfil certain legal requirements by ASIC
 - Are an incorporated legal entity, an 'artificial person' that conducts business in its own name
 - Limited liability
 - Indefinite life of organisation

Concepts and principles

- Generally accepted accounting principles (GAAP)
- Should be:

- Relevant (useful to decisions)
 - Valid (an accounting number really should represent what a user assumes it represents)
 - Reliable (number is accurate)
- Entity concept
 - An accounting entity is an organisation that stands apart from other organisations and individuals as a separate economic unit for the purpose of some decision
 - Sharp boundaries are drawn around each entity
 - Only information about transactions relating to the entity is included in its financial statements
- Account period concept
 - Defines the unit of time for which accounting data are collected
 - Usually regular recurring intervals of one year in length
- Cost principle
 - Accounting measures are based upon transaction costs
 - Goods and purchases acquired from suppliers should be recorded at their actual purchase price
 - Also called historic cost accounting
 - There are many other ways such as cash flows, market or fair values
 - Cost principle increases the objectivity
 - It is considered to be a valid and reliable measure
 - Should be based on objective evidence
 - However sometimes cost isn't considered relevant, such as market values 'now' to decision makers concerned with forecasting future events
 - Can also be misleading, such as property exchange should be based on fair value
- The matching principle
 - All businesses have inputs and outputs
 - The matching principle relates these inputs and outputs to one another
 - Costs of inputs used to produce outputs that are completed and sold are treated as expenses and subtracted from the proceeds resulting from the sale of those outputs
 - It is sometimes difficult to determine whether or not an input is used up and thus whether to write it off or capitalise its costs, this is a subjective element
 - If an activity is unfinished, the cost of the inputs are usually included as assets and carried forward to be charged against the income of later accounting periods
 - Whether capitalised or written off depends on:
 - Condition of inventories at the end of the accounting period
 - Did the business intend to continue to trade after the end of the period
- Profit recognition principle

- Profit should be recognised when the sale and any other revenues or gains relating to the relevant activity are 'earned' and can be reliably measured
- Cash vs accrual accounting
- Recognise losses immediately
- Conservatism (prudence) principle
 - Anticipate no profits, but anticipate all losses
- The going concern assumption
 - It is assumed that the business as a whole will continue operating for the foreseeable future
 - If this assumption cannot be sustained by the evidence, financial reports should make this clear and value assets and liabilities accordingly
 - In liquidation assets are sold for their current market value, therefore in a liquidation the most useful type of information to the user of financial statements is more likely to be current market value than cost

The accounting equation

- Assets – liabilities = owners equity
- Assets
 - Resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity
- Liabilities
 - Debts that are payable to outsiders called creditors. A present obligation of the entity arising from past events, the settlement of which is expected to result in the outflow from the entity of resources embodying economic benefits
- Owners equity (capital)
 - The residual interest in the assets of the entity after deducting all of its liabilities

Key Accounting Concepts

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- Revenues
 - Either increase assets or decrease liabilities
 - Sales revenue, service revenue, interest revenue, dividend revenue
- Owner withdrawals
 - Decrease OR when the owner takes assets out of the business for personal use
- Expenses
 - Decrease in owners equity by using up assets or increasing liabilities in order to deliver goods or services to customers
 - Include:
 - Office rent
 - Salaries
 - Advertising
 - Water, electricity and gas
 - Insurance
 - Interest expense on loans payable
 - Rates
 - Supplies used up
 - Have the opposite effect of revenues, they cause the business to shrink
- A transaction is an event that involves at least two parties exchanging resources, it takes place at a point in time and creates a cost that affects the financial position of the business
- For every transaction, the amount on the left side of the equation must equal the amount on the right side
- An income statement reports revenues and expenses to measure a profit or loss
- The basic summary device of accounting is the account
- An account is the detailed record of all the changes that have occurred in a particular asset, liability or owners equity during a period
- Accountants record transactions first in a **journal**, which is the chronological record of transactions
- Accountants then post the data to the accounts in a record called the **ledger**
- A list of all the ledger accounts with their balances is called a **trial balance**
- Assets
 - Cash – bank account balances, currency, coins and cheques
 - Accounts receivable – the right to receive cash in the near future when goods or services are bought on credit
 - Bills receivable – a bill of exchange is a written pledge that the customer will pay a fixed amount of money by a certain date. It offers more security for collection than an account receivable and is a right to receive cash and interest in the future
 - Inventories – stock. I they are stationary or other consumables that aren't directly used in the production of goods for resale and

are part of non-operating, overhead expenses, they can be identified as supplies

- Prepaid expenses – assets because the business avoids having to pay cash in the future for the expense. The ledger usually holds a separate asset account for each prepaid expense
- Land – record of the cost or value of land a business controls and uses in its operations. Land held for sale is accounted for separately in an investments account
- Buildings – offices, warehouses etc. Buildings held for sale are separate assets, accounted for as investments
- Plant and equipment – computers etc.
- Liabilities
 - Accounts payable – promise to pay off a purchase made on credit, it is an obligation to pay cash in the near future
 - Bills payable – amount the business must pay because it signed bills of exchange to borrow money, they are an obligation to pay cash and interest in the near future
 - Accrued liability – an expense that hasn't been paid or revenues that haven't been received but not yet earned and which have not been recorded as an accounts payable or an accounts receivable.
- Owners equity
 - Capital – owners claim to the net assets of the business, after total liabilities have been subtracted from total assets
 - Drawings – withdrawing cash or other assets from the business for personal use, it shows a decrease in OE
- Income
 - Income increases owners equity and is recorded in the revenue accounts
- Expenses
 - Expenses use up assets or create liabilities, they have the opposite effect of revenues and decrease OE
- Chart of accounts – to list all the accounts they use along with their account numbers, used as posting references
 - 1 – usually assets
 - 2 – usually liabilities
 - 3 – usually owners equity
 - 4 – usually revenues
 - 5 – usually expenses
- Double-entry system records the dual effects of a business transaction
 - Each transaction affects at least two accounts
- T-account
 - The left side is the debit side
 - The right side is the credit side

Assets

Increases are recorded
on the left (debit) side.

Decreases are recorded
on the right (credit) side.

Liabilities and owners' equity

Decreases are recorded
on the left (debit) side.

Increases are recorded
on the right (credit) side.

Format of a Statement of Cash Flows

TO BE PROVIDED AFTER PURCHASE

Format of a Statement of Financial Performance

Hi-Price Stores		
Statement of financial performance		
For the year ended 30 June 2012		
	\$	\$
<i>Sales</i>		432,000
<i>Less cost of sales</i>		<u>254,000</u>
Gross profit		178,000
Other revenue		
Interest from investments	2,000	
Rent from properties	<u>5,000</u>	<u>7,000</u>
		185,000
<i>Less expenses</i>		
<i>Selling and distribution</i>		
Advertising	5,000	
Commissions	4,000	
Delivery	3,000	
Display	2,000	
Salary and wages	<u>37,000</u>	<u>51,000</u>
<i>Administration and general</i>		
Salary and wages	41,000	
Rates	2,000	
Heat and light	3,000	
Telephone and postage	2,000	
Insurance	1,000	
Repairs and maintenance	5,000	
Motor vehicle running expenses	4,000	
Depreciation plant and equipment	1,000	
Depreciation motor vehicles	2,000	
Depreciation buildings	<u>3,000</u>	<u>64,000</u>
<i>Financial</i>		
Interest	3,000	
Bad debts	<u>7,000</u>	<u>10,000</u>
Total expenses		<u>125,000</u>
Net profit		<u><u>60,000</u></u>

- If the company provides a service, there will be no gross profit figure
- The categories for expenses are generally
 1. Cost of sales
 2. Selling and distribution
 3. Administration and general
 4. Financial

But not always, there may be no cost of sales for service companies.

- Income is also generally broken up into categories such as sales, other revenue, service revenue etc
- Business name, 'Statement of financial performance' and 'For the year ended (date)' are critical

Format of a Statement of Financial Position

Horizontal Format

TO BE PROVIDED AFTER PURCHASE

Vertical Format

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