MAA103 – ACCOUNTING FOR DECISION MAKING

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WEEK 1: THE ACCOUNTING ENVIRONMENT

Concept 1: What is accounting?

It is the language of 'business'. While it does include the recording, and reporting of 'transactions', accounting is much more.

Accounting is an information system that:
- Identifies (select economic events (transactions));
- Records (records, classify and summarise); and
- Communicates (prepare accounting reports and analyse and interpret for users).
  The economic events of an organisation to interested users.

*Verification is not part of the accounting process.

<u>The role of accounting</u>

- Accounting provides the financial information required for making decisions with regards to money and business issues
- Accounting is a means of communication
- Accounting is a means of measuring business activity

<u>Who uses accounting data?</u>

Internal users
- **Managers** who plan, organise and run the business (e.g. – marketing managers, production supervisors, chief financial officers and other employees)

External users
- **Investors** to make decisions to buy, hold or sell shares;
- **Creditors** to evaluate risks of giving credit and lending money (e.g. – suppliers, bankers);
- **Government** and regulatory bodies (e.g. – ATO, ASIC).

<u>What is the difference between bookkeeping and accounting?</u>

- Bookkeeping usually involves only the recording of economic events (transactions) which is only one part of the accounting process
- Accounting involves the entire process of 'identifying, recording and communicating' economic events plus it involves the use of considerable judgment

Concept 2: The 5 Elements

<u>Assets (definition criteria)</u>
Resources controlled by a business which are a result of past transactions or events and have the capacity to provide future economic benefit.

  - used in carrying out such activities as production, consumption and exchange;
  - usually physical in nature, such as land, buildings, supplies to be used, and inventory that the business expects to sell to its customers;
  - sometimes intangible, like trademarks

<u>Liabilities (definition criteria)</u>
Present obligations claimed against assets which are a result of past transactions or events and lead to an economic scarifies.

  - examples include outstanding accounts payable, bank loans, wages payable, etc.

Owner’s Equity
Represents the ownership claim to total assets net of any liabilities.

- Owners’ Equity is **increased** by:
  - Capital (Investment by the owner/s)
  - Revenue
- Owners’ Equity is **decreased** by
  - Drawings/Dividends
  - Expenses

ASSETS – LIABILITIES = OWNERS EQUITY

Increases in Owner’s Equity
- **Capital**
  - Are the assets the owner puts in the business
- **Revenues**
  - Gross increases in the owner’s equity from business activities entered into for the purpose of earning income
  - May result from a sale of merchandise, services, rental of property or lending of money
  - Usually result in an increase of an asset

Decreases in Owner’s Equity
- **Drawings/Dividends**
  - Are withdrawals of cash or other assets by the owner for personal use
- **Expenses**
  - Decreases in owner’s equity that result from operating the business
  - Cost of assets consumed or services used in the process of earning revenue (e.g. – utility expense, rent expense, supplies expense and tax expense)

Revenue

Expenses

ALORE – acronym for Assets, Liabilities, Owner’s Equity, Revenue, Expenses.

Assets	**Debt** **Equities**	Stocks
Expenses	**Revenue**	Flows

Recognition of the accounting elements
Recognition is the process of incorporating items in the statement of financial position (balance sheet) if it meets the definition of an element.

In addition to meeting the definition criteria of an element, an item must meet recognition criteria:
- **Probability** (benefit will be received or sacrifice made)
- **Reliable measurement**

Q: Which one of these is an asset?
a) Income tax payable
b) Income earned from sales
c) Interest earned on investments
d) Inventory on hand

Concept 3: The Accounting Equation

The concept includes:

- The underlying framework for recording and summarising the economic events of an entity
- The essential building blocks of accounting are the categories into which the economic events are classified

The basic accounting equation:
ASSETS – LIABILITIES = OWNERS EQUITY

The accounting equation represents the relationship between assets, liabilities and owners' equity.

<u>The accounting equation and Transaction analysis</u>

A transaction

- is a record of an economic event of an entity
- may be internal or external
- affects two or more components of the basic accounting equation
- entities/businesses have many transactions every day

Transaction analysis is the process of identifying the specific effects of transactions and events on the accounting equation.

NB: not all activities represent business transactions.

Another way to present the 'basic accounting equation' to show the relationship between A, L and OE is:

OWNERS EQUITY	=	ASSETS	-	LIABILITIES
$15,000.00		**$25,000.00**		**$10,000.00**

Q: The accounting equation may be expressed as:

e) Assets – Liabilities = Owner's Equity
f) Assets = Liabilities = Owner's Equity
g) Cash = Assets
h) Assets = Owner's Equity

Q: If total liabilities decreased by $14,000 during a period of time and owner's equity increased by $6,000 during the same period, then the change in total assets is:

a) an increase of $14,000
b) an increase of $20,000
c) a decrease of $8,000
d) **an increase of $8,000**

Q: As of December, 31 2015, Anders Company has assets of $21,000 and owners' equity of $12,000.00. What is the liabilities amount?

a) $9,000
b) $6,000
c) $15,000
d) $12,000