

Introductory Financial Accounting Notes ACC710002

Topic 1: Introduction to Financial Reporting

Accounting

- Process of identifying, measuring, recording and communicating the economic transactions and events of a business to improve decision making

Internal Users

- Comprised of:
 - Managers who plan, organise and run the business
- Use management accounting: do not rely on GPFs as they obtain information externally and have access to information not available to the public

External Users

- Comprised of:
 - Resource providers
 - Investors, employees, creditors and lenders
 - Recipients of goods and services
 - Customers and beneficiaries
 - Parties with a review or oversight function
 - Regulatory agencies, government and special interest groups
- Use financial accounting: rely on GPFs as they cannot require entities to provide information directly to them nor tailor reports to suit their needs

Conceptual Framework

- Set of concepts to be followed by preparers of financial statements and standard setters
- Provides guidance as to who is required to report and who are the likely users

Conceptual Framework Components

- Definition of reporting entity
- Objectives of GPFs
- Elements of financial statements
- Qualitative characteristics

Reporting Entity

- All entities in which it is reasonable to expect the existence of users dependent on general purpose financial reports for information to improve decision making
- Must prepare GPFs in accordance with accounting standards
 - Non-reporting entities have significantly lower financial reporting obligations
 - Lower report preparation costs and less release of competitive information

Characteristics of Reporting Entities

- Separation of management from economic interest
- Economic or political significance
- Significant financial characteristics
 - Such as sales, employees, assets and borrowings

General Purpose Financial Reports

- Not intended to show the value of an entity
 - Information within GPFs can be used to estimate the value of the entity however
- Designed to meet the needs of a wide range of financial information users
- Largely based on estimates, judgements and models rather than exact amounts

Lecture 4: Inventory

Inventory

- Assets held either for sale in the ordinary course of business, in the process of production or in the form of materials to be consumed in the production process

Inventory Classifications

- Raw materials: Materials that will be consumed in the production process
- Works in progress: Manufactured inventory that has been started but not yet completed in the production process
- Finished goods: Completed manufactured items that are ready for sale

Inventories OR Fixed Asset?

- Inventory if the firm is intending to sell it to generate profits
- Fixed asset if the firm is intending to use it to help generate revenues

Cost of Inventory

- All costs incurred in bringing inventory into a condition and location ready to sell

Capitalised Costs

- Costs that are allocated to inventory
 - Must reasonably be able to allocate it to one or more identifiable inventory lines
 - Increases profit for the current period as it is included as part of inventory but decreases profit for future periods as cost of sales is higher
- If costs cannot be reasonably allocated, they may be written off as an expense in the period in which the inventory was bought as part of cost of sales
 - Decreases profit for the current period as all of the cost is expensed in the current period but increases profit for future periods as cost of sales is lower

Service Business

- Perform the service -> Send invoice -> Receive cash

Merchandising Business

- Buy inventory -> Sell inventory -> Send invoice -> Receive cash
 - Longer cash cycle compared to a service business as they must purchase inventory and wait for it to be sold

Gross Profit Margin

- $\frac{\text{Gross Profit}}{\text{Net Sales}}$
- Indication of mark-up
- Gross profit as a percentage of sales

Inventory Systems

- Periodic
- Perpetual

Periodic Inventory System

- Revenues are recorded when the sale is made
- Quantity and cost of sales is determined only at the end of the accounting period by a stocktake
- Assumes that everything that has not been counted has been sold, representing cost of sales
 - No identification of stock loss/gain

Lecture 6: Non-Current Assets

Property Plant and Equipment

- Tangible items expected to be used for more than 12 months that are either held for use in production or supply of goods and services, for rental to others or for administrative purposes

PPE Recognition

- Probable inflow of future economic benefits
- Reliable measurement

Classes of PPE

- Property
 - Includes land, land improvements and buildings
- Plant and Equipment
 - Includes computers, office furniture and motor vehicles

Capitalised Cost

- Included in the purchase price of stock or PPE

Non-Capitalised Cost

- Not included in the purchase price of stock of PPE and is written off as an expense as it is recurring and does not add to the asset's value

Cost of PPE

- All costs incurred in bringing PPE into a condition and location ready for use
 - Includes purchase price, freight, insurance during transit and installation
 - Excludes training operators and electricity as they are either expensed immediately or recurring
- Initially recorded at historical cost
 - Amount of cash or cash equivalents paid or the fair value of any other consideration given to acquire the asset

Cost of Land

- All costs incurred in getting land into a condition ready for use
 - Includes purchase price, settlement costs, stamp duty, accrued property taxes (unpaid rates to councils) assumed by the purchaser and costs to demolish old buildings (less proceeds received from the sale of salvaged materials)

Cost of Land Improvements

- Non-current asset that identifies improvements to land
 - Separate to land as this includes items that are subject to depreciation
 - Includes paving, landscaping, car park construction and fences

PPE Judgements in Valuation

- Cost
- Depreciation
- Fair value

Fair Value

- Estimated market value
- Can also be determined based on the NPV of future cash flows of the asset

Topic 9: Statement of Cash Flows

Uses for Cash

- Pay dividends
- Expand operations
- Replace assets

Statement of Cash Flows

- Financial statement that provides a reconciliation of opening and closing cash, including cash on hand and cash equivalents

Significant Non-cash Activities

- Significant financing and investing activities that do not affect cash are not reported in the statement of cash flows but are included in the notes
- Examples:
 - Issue of shares to purchase assets
 - Issue of debt to purchase assets
 - Conversion of debt into ordinary shares
 - Exchanges of property, plant and equipment

Objective of the Cash Flow Statement

- Provide additional information to assess business performance and liquidity
 - Meet financial commitments as they fall due involving the servicing of borrowings and the payment of dividends
 - Obtain external financing
- Assess the ability of the entity to generate cash and cash equivalents and the timing and certainty of their generation
 - Fund changes in scope or nature of its activities

Cash

- Cash on hand and demand deposits

Cash Equivalents

- Short term, highly liquid investments that are readily convertible to cash and without significant change in value

Cash Flows

- Inflows and outflows of cash and cash equivalents

Categories of the Cash Flow Statement

- Operating Activities
 - Primary revenue producing activities of the entity and other activities that are not investing or financing activities
- Investing Activities
 - Acquisition and disposal of long-term assets and other investments not included in cash equivalents
- Financing Activities
 - Activities that result in changes in ownership structure (size and composition of contributed equity and borrowings)