Accounting Questions

CHAPTER 1

1.7 What is a business transaction and how does it relate to the accounting process?

A business transaction is an external exchanges of resources between the entity and another entity or individual that affects the assets, liabilities and owners' equity items in an entity.
The accounting process is the;

1. Identifying
2. measuring
3. communicating
   of economic information about an entity to a variety of users for decision-making purposes.

1.8 Differentiate between financial and management accounting. Give an example of how management accounting reports would be incorporated into financial accounting reports.

Financial accountants prepare and report information for external users (for example prospective investors or the tax office)
Management accountants are concerned with the effective use of an entity's resources, and in so doing assist the manager/s (i.e. internal users) of the entity in achieving their goal of enhancing customer and shareholder value. Ultimately there will be interaction between the financing accounting and management accounting areas. The information provided by management accountants will provide information for internal users that will be reflected in the financial reports used by the external users.

	Financial accounting	**Management accounting**
Regulations	Bound by GAAP, Corp Act, ASX, etc	Less formal and without prescribed rules
Timeliness	Historical picture of past operations	Can be both a historical record and a projection
Level of detail	Quantitative in nature, concern the whole entity	Both quantitative and qualitative, more detailed
Main users	External: ATO, investors suppliers, consumers, banks, employees, interested groups	Internal: managers in the entity

1.9 Describe how accounting information helps shareholders and lenders to make decisions concerning the operations and performance of the entity.

Users of accounting information (both internal and external) require accounting information to assist them in the decision making process. External users such as investors, employees, banks, suppliers, government agencies (e.g. ATO) all have their own specific information needs. A potential investor will require past profits and future profit projections, as well as future growth prospects, to determine if the entity is a good investment proposition or not. Lenders will be seeking details of the level of risk it is exposing itself to by lending money to the entity plus the prospects of the entity repaying its' debt.

1.12 List six stakeholders of accounting information. Describe the information requirements for each one;

STAKEHOLDERS:	INFORMATION NEEDS:
Internal Stakeholders:	
Managers	require information to determine make or buy decisions or whether to expand or close down or whether to change banks.
External Stakeholders:	
Investor	seek information on capital growth prospects and future dividend payments.
Lenders	need information on the ability of the entity to repay its loans.
Suppliers	want to know can the entity pay for its supply purchasers.
Consumers	are interested in the life expectancy of the entity and the entity's ability to provide appropriate goods and services.
Government agencies	for example, ATO — require information to determine the amount of tax liability of the entity.
Regulatory bodies	for example, ASX and ASIC need to know whether the entity is following the ASX listing rules and the rules and regulations of the Corporations Act.

1.14 Discuss three important issues that would need to talk over with her accountant before she purchases the sushi bar.

1. **Evaluate the purchase** — from the accountant's experience (or with assistance from his/her professional association) advice can be obtained on whether the purchase is a good buy or not e.g. through comparisons of similar recent sales; analysing past financial reports.

2. **Prepare budget forecasts** e.g. on sales — i.e. target sales of food necessary to make the purchase worthwhile or to compare whether it is better financially to remain in your present job and make passive investments with your capital. This will enable a prospective buyer to evaluate if such sales are feasible by her.

3. **Explain the personal qualities required in owning such a business** e.g. long hours; tedious work; customer relationships; impact on family life.

1.21 Describe the major purpose of the ASX. What types of information does it provide for a novice investor?

The major purpose of the ASX is to provide an orderly and fair market in listed companies' shares and securities. It also regulates companies through its Business and Listing Rules. The ASX Listing Rules govern the procedures and behaviour of all ASX listed companies and listed trusts.

1.26 Briefly describe how the AASB develops accounting standards.

The **Australian Accounting Standards Board (AASB)** is responsible for the development and maintenance of high-quality financial reporting standards in Australia, and to contribute to the ongoing development of global accounting standards.
The AASB provides input into current accounting standards issued by the IASB by contributing to the due process. The due process of an accounting standard includes identifying a technical issue through submissions and other materials from interested parties; developing a project proposal to determine if the project is worthwhile; researching the issue comprehensively; issuing an exposure draft, discussion paper or an invitation to comment; and issuing a draft interpretation.

1.27 How do accounting standards assist large companies? (AASB)
The Corporations Act stipulates that large companies must apply accounting standards in preparing their financial reports. The accounting standards assist with consistency in financial reporting and ensuring the users of financial reports (e.g. investors, consumers, employees, regulatory bodies) will have the necessary relevant and faithfully representative information to assist them in their decision making. Without accounting standards, there would be no comparability in financial accounting – firms would produce an income statement with differing amounts of information.

1.18 Compare and contrast the roles of the Financial Reporting Council (FRC) and the Australian Securities Exchange (ASX).
The FRC is a statutory body made up of key stakeholders from the business community, the professional accounting bodies, governments and regulatory agencies. The FRC's role is to oversee the accounting and auditing standard-setting process for both the public and private sectors in Australia.

The ASX contributes to company regulation in Australia as it regulates listed entities on the stock exchange through its Business Rules and Listing Rules, which are in addition to the regulations in the Corporations Act.

1.10 Provide an example of a company that would produce a GPFS (general financial statement) and a company that would produce a SPFS (special purpose financial statement). Who are the likely stakeholders of both types of entities?

An example of a company who would produce a GPFR would be Qantas Group, Qantas Group has various stakeholders such as investors, employees, customers, supplies, banks, regulatory bodies that would all require important information from the Qantas annual report.

A company that would prepare a SPFS could be an entity such as a local government association (RMIT). This type of entity would provide a set of financial statements in accordance with the local government code of accounting practice and financial reporting and relevant Australian accounting standards. The association would not have a diverse range of stakeholders and a special purpose financial statement would fit the requirement of its stakeholders such as lenders and regulatory bodies.

1.17 What are some of the opportunities and threats for the accounting profession resulting from the large number of corporate collapses in the early 2000s?

The large number of corporate collapses in the early 2000s and throughout the last decade provides many **opportunities** for the accounting profession. Such as:

- employment in areas such as forensic accounting, insolvency, taxation, auditing
- demand generally for accounting and audit services
- demand for accountants with experience working with global accounting standards
- job opportunities overseas with the Big 4 accounting firms and multinational entities

Threats

- Accounting professions' work under more scrutiny
- There has been an increase in litigation against accountants and auditors
- The demise of some accounting firms e.g. Arthur Andersen

1.28 What is an IFRS and how does it impact on standard setting in Australia?

Australia adopted Australian equivalents **to International Financial Reporting Standards, (IFRS)**, from 1 January 2005. The adoption of IFRS helps ensure compliance with internationally agreed principles, standards and codes of best practice.

The adoption of IFRS also reduces the amount of standard setting in Australia by the Australian Accounting Standards Board, (AASB), which allows the AASB to focus on providing expert advice on some of the International Accounting Standards Board future projects and interpreting issues arising out of the adoption of IFRS.

CHAPTER 3

3.27 Shannon, a sole trader operating a small landscaping business, asks you to prepare his balance sheet (showing his equity) for the year ended 30 June 2015; contributed capital $26 440; profit $5600; drawings $3600; cash $36 000; fixtures and fittings $10 800; accounts receivable $9000; accounts payable $13 500; bank loan $13 860.

SHANNON – SOLE TRADER
Balance Sheet
as at 30 June 2015

Current assets			
Cash		36 000	
Accounts receivable		9 000	
Total Current Assets			45 000
Non-current assets			
Fixtures and fittings		10 800	
Total Non-Current Assets			10 800
Total assets			$55 800
Current liabilities			
Accounts payable			13 500
Total Current Liabilities			
Non-current liabilities			
Bank loan			13 860
Total Non-Current Liabilities			13 860
Total liabilities			**$27 360**
Net assets			**$28440**
Owner's equity			
Capital – Shannon		26 440	
Profit		5 600	
		32 040	
Less drawings	3 600		
Total Owners Equity			**$28 440**

3.8 Illustrate with an example the difference in the format of the equity section of the balance sheet between a sole trader, partnership and company.

In the **sole trader's** Balance Sheet, the capital account in the equity section will reflect the capital contribution of the single owner. For example if Lenny Low commenced a business selling USB sticks, then the capital would reflect

Lenny's sole contribution. Also the profit amount will reflect all the profit for the financial period.
For a **partnership**, the capital account will reflect the multiple owners' contributions to the entity. If Tom, Cherise and Livia all contributed a variety of different assets and liabilities then the capital account would reflect each of the sum of their contributions separately. Undistributed profit will be shown in each partner's respective current accounts for each of Tom, Cherise and Livia.
For a **company**, such as JB Hi-Fi Ltd the capital account will reflect the contribution of the shareholders of JB Hi-Fi Ltd and undistributed profits for the company will be shown in the retained profits account.

3.16 What do the following terms mean?

a. Unlimited liability: is when the individual or partnership is fully liable for all the debts of the entity.
b. Mutual agency: is when a partner in a partnership is seen as being an agent for the business, having the right to enter into contracts for the business and being bound by any partnership contract.
c. Dividend: is the distribution of part of a company's profit to shareholders. It is usually expressed as a number of cents per share.
d. Preference shares: rank ahead of ordinary shares if the company goes into liquidation. Preference shares also usually have a fixed rate of dividend, which is paid out before the ordinary shareholders dividend is paid.
e. Unit trust: is a type of trust that holds a collection of assets on behalf of various parties rather than family members. Income is distributed to the parties according to their respective unit holdings in the trust. Unit trusts usually concentrate on a particular investment such as equity, property or cash management.

3.5 You are a friend of Lucy Lu who is thinking about starting a business to sell her handmade quilts. Advise Lucy on the four factors that should be considered before deciding on what form of business structure to operate under.

(i) Whether the owner will be the only contributor of capital to the entity;
(ii) The degree of risk that the owner(s) are willing to take with the entity (i.e.) whether the entity should have limited or unlimited liability;
(iii) The potential for growth of the entity in the future;
(iv) Issues of taxation i.e. sole trader/partnership forms do not pay tax on the entity's profits. The owner's will include their share of the entity profit in their individual taxation returns

3.6 Explain with examples the major differences between a company limited by shares (such as JB Hi-Fi Ltd) and a proprietary company (such as Haute Hats Pty Ltd).

JB Hi-Fi **Ltd** has the right to sell shares to the public. The two types of shares that it could issue are ordinary shares and preference shares. Limited by shares means that the liability for the shareholders is limited to the subscription price of the shares. JB Hi-Fi Ltd is listed on the Australian

Securities Exchange (ASX). Public companies such as JB Hi-Fi Ltd are normally much larger companies compared with private companies.
Haute Hats **Pty Ltd** is typical of a family owned company. They do not have the right to sell shares to the public at large. Because they are smaller in nature than public companies such as JB Hi-Fi Ltd they do not have to follow the same stringent reporting requirements that these companies must comply with.

3.7 What are two major advantages and disadvantages of a company structure? Provide an illustration with a company listed on the ASX (such as JB Hi-Fi Ltd, CSL Ltd, and BHP Billiton Ltd).

Two **major advantages** of a company structure are:
(i) access to additional capital;
(ii) limited liability for the shareholders in relation to the debts of the business.

Two **major disadvantages** of a company structure are:
(i) The time and money to establish the company form;
(ii) The more complex regulatory requirements imposed on the company.

3.11 What does the term 'mutual agency' refer to in the context of partnerships? Provide an example where 'mutual agency' could be both an advantage and disadvantage for a partnership.

Mutual agency refers to the right that each partner has in a partnership, where each partner is seen as an agent for the entity and has a right to enter into contracts for the entity which bind the other partners.
An example of where this would be an **advantage i**s that each partner can operate as an agent so there can be an allocation of tasks and more than one partner can make decisions so the decision making can be spread over several different partners.
An example where this would be a **disadvantage** is if Cerise a partner in the partnership of "Tom, Cerise and Livia" decides to enter into a contract with a friend "Martha" who is in a related industry. Cerise was acting as an agent for the partnership and had a right to enter into a contract with Martha on behalf of the other partners. The contract is binding and if Martha cannot provide the goods, then the partnership must face the consequences of Cerise's actions.

	Sole Trader	Partnership	Companies
No. Of Owners	1	2 – 50	As many as per articles of association
Liability of Owners	Unlimited	Unlimited	Limited
Asset Ownership	Belongs to owner	Partners Co ownership	Company ownership
Regulations	Minimal	Moderate	Significant
Set up costs	Minimal, can be completed by the owner	Moderate, may involve expert opinion	Extensive, if considering publically listed organisation
Transfer of Ownership	Business structure ceases (closes down)	Partnership ceases (closes down)	Simple market sale of equity (business structure continues)
Separation of Ownership and Management	No	Not normally	Normally
Access to Capital	Contributed by the owner	Contributed by the partners	Many owners can contribute, can also raise capital in the market place
Profit	Belongs to owner	Distributed to partners as per agreement	Distributed to shareholders in form of dividends, at discretion of board.