

# Week 1 – Nature and Role of Accounting

## CONTENT

### Accounting and Types of Accounting

- Accounting the process of “identifying, measuring, recording & communicating economic information to assist users to make decisions”

1. **Financial Accounting** — Preparing structured financial information for **external decision makers** or users. They **do not influence day to day decisions**. Receive 3 main reports: Income Statement; Balance Sheet; Cash Flow Statement
2. **Management Accounting** — Preparing financial information, usually more in detail about a specific area, for **internal decision makers**. It is related to **costs, budgets, pricing**, etc.

Features	Financial Accounting	Management Accounting
<b>Nature</b>	General purpose reports for a wide range of users	Specific purpose reports for managers in making decision
<b>Level of Detail</b>	Broad overview of position, performance and cash flow. As a result not a lot of detail	A lot of detail for managers in a specific section to help them make decisions
<b>Restrictions</b>	Legal and accounting regulation where they need to be presented in a standard form	No restrictions on the form or content of the reports
<b>Reporting Interval</b>	Usually on annual basis, however also done half-yearly or quarterly	Produced whenever the manager requires
<b>Range of Information</b>	Concentrates on information that can be quantified into monetary terms	Most likely to produce additional reports on non-financial matters, such as physical quantities of inventory and output
<b>Users</b>	External: Stakeholders, e.g. Banks or Creditors to see if they want to lend you. Investors to see if they want to buy/sell shares. Government to see tax is paid	Internal: Managers and decision makers.

- In providing financial information, there are 2 crucial fundamental qualities that need to be considered:
  - **Relevance**
    - Information must be helpful in influencing decisions, and information that could alter decisions must be included
    - Must be relevant in prediction of future events or confirmation of past events
  - **Faithful representation**
    - Information must be complete, neutral and free from error
    - All information should be in it, should be included as it will influence user decision
- Further qualities after the fundamental qualities are achieved
  - **Comparability** — helps users identify similarities and differences between information
  - **Verifiability** — Different experts would confirm its faithful portrayal
  - **Timeliness** — Produced in time for users to make decisions
  - **Understandable** — Clear and concise
- **Traditionally, the objective of business is to increase the wealth of its owners**, where this is only achieved if a range of groups are satisfied. **Shareholder theory** — to act in accordance to shareholder's interest in a way still permitted by law and social values
- Need to ensure stakeholders in company are satisfied, e.g. workers happy, customers satisfied
- Accounting involves 4 stages:
  - **Identify** and capturing relevant economic information
  - **Recording** information systematically

- **Analysing** and **interpreting** information collected
- **Reporting** information in a manner that suits the need of users

### Accounting Measurement Concepts and Principles

- **Entity Concept**
  - For **accounting** purposes it is assumed that the business is separate from the owner(s). The business may be in the form of a sole proprietorship, partnership, company or other operating structure.
  - From the perspective of the **law**, most entity structures other than the company do not represent separate legal entities. That is, from the perspective of the law, there is no distinction between the business and the owners of the business. However, with the company entity structure, the business is granted the status of a 'legal person' and the rights and responsibilities that go with that status.
- **Accounting Time Period** Concept — period of time which accounting information is recorded over a financial year
- **Cost Principle** — Record the cost as the historical cost that it was valued at, at the time of purchase

### Types of Business Organisations

- **Sole proprietorship:** An individual is the sole owner of a business and it is often quite small
  - **No separate legal entity** — Business and owner is only regarded separate in accounting terms, in seeing the movement of capital between business and owner
  - **Limited life** — Business will only exist for as long as the owner lives, and will need to be renewed if its wants to continue
  - **Unlimited liability** — Owner is fully responsible for the obligations and debts of the business
  - **Limited access to funds** — Usually restricted to only the owner's own capital, and lender's are not as willing to lend to sole proprietorships
  - **Minimum reporting regulations** — Recording and reporting are minimal compared with those of large companies. All they have to do is track their taxation reports
  - **Low cost to establish**
- **Partnerships:** Relationship that two or more individuals share with aim of generating financial profit
  - **No separate legal entity** — No legal distinction between the business and the partners
  - **Limited life** — Each time partners leave, or new partners join, there is a change of partnership
  - **Unlimited liability** — Liability of partners jointly and separately is unlimited with respect to the debts of the business. Everyone has to contribute towards the debt
  - **Mutual agency** — Each partner is responsible for the business actions of all other partners
  - **Co-ownership of profits**
  - **Increased regulation** — Most states have Partnership Acts which provide direction for the activities of partnerships and the rights and responsibilities of partners
  - **Reduced decisions making authority**
  - **Greater access to capital** since there are two or more owners
  - **Different skills** brought into the business
  - **Taxation advantages** when income can be spread among partners
- **Limited company:** Owned by multiple investors where they are called shareholders
  - **Many more regulations** — Registration of ABN. Application through ASIC as well as financial reports correct, accurate and frequent
  - **Complicated structures of company** — Board directors have to split operations into different departments, and ensure all shareholders of the business are satisfied
  - **Limited liability** — individuals contributing capital to the company are liable only for debts incurred to the company up to the amount that they have agreed to invest in
  - **Unlimited life**

### Accrual and Cash Accounting

- Accrual accounting recognises transactions even if they have not been paid yet or received (accounts payable and receivable) as long as they are within the period where revenue and expenses occur
  - Revenue — Generally from sales of inventory, interests received on investments, dividends from shares, rent from owned premise
  - Expenses — Costs of resources consumed in the process of generating revenue — Labour, rent, electricity, depreciation
- Cash accounting involves recording revenue and expenses at the time cash is paid or received
- **Revenue Recognition Principle** — Revenue should be earned only when services/goods have been provided
- **Expense Recognition Principle** — All revenues are reconciled with appropriate expenses
- **Historical cost principles** — The best objective system to records the cost the goods

### **MYOB**

- “Manual accounting systems are outdated and therefore no longer in use”.
- Computerised system is not the solution for all accounting problems. For example, if there is **no backup**, you will still need manual records - for **audit** purposes, you will still need **receipts** (and these receipts **may be manual**)
- A computerised system is also limited in that it is **reliant on the inputs**. If you make a mistake in the input, it is **easy to overlook the mistake** and rely on the output. With the manual and computerised systems working together, it is easy to trace any errors using source documents
- Although it may be faster and generate organised structured documents quickly, computers can also easily be lost in fires and more prone to being stolen, so need back up