ACCT 1501

2019

Contents

CHAPTER 1+2: INTRODUCTION TO FINANCIAL ACCOUNTING

What is accounting?
Accounting: the process of identifying, measuring, recording and communicating economic information to assist users to make decisions

Two types of accounting:
- Financial Accounting: provision of information to users external to the enterprise
- Management Accounting: provision of information to users within the enterprise

Financial Statements: describes financial performance and financial position
Financial Performance: generation of new resources from day-to-day operations over a period of time
Financial Position: organisation's set of financial resources and obligations at a point in time

Who uses financial accounting information?
- Stock market investors decided whether to buy, sell or hold shares of companies
- Banks and other lenders decide whether or not to lend
- Government in monitoring the actions of organisations and in assessing taxes i.e. GST
- Managers run organisations on behalf of owners, members or citizens

The people involved in financial accounting
Users: someone who makes decisions on the basis of the financial statements on his or her own behalf, or on behalf of a company, bank or other organisations
- Demand credible periodic reporting of an organisation's financial position and performance
- Credible means to be sufficiently trustworthy and competently prepared
- Periodic means that users can expect reports on some regular basis

E.g. owners, potential owners, creditors, manager, employees, regulators, analyst, competitors…

Preparers (decision facilitators)
- Managers are responsible for running an organisation, including issuing accounting and other information and controlling its financial affairs
- Accountant have the job of shaping the financial statements by applying the principles of accounting to the organisation's records

Auditors (credibility enhancers)
- Report on the credibility of the organisation's financial statements, on behalf of owners
- Assist the users by verifying the financial statements have been prepared fairly, competently and with accepted accounting principles

People and Ethics
E.g. External auditor leans that the organisation may be cheating one of its customers, but bound by rules of conduct it protect confidentiality, if he reveals information, it will result in a lawsuit. Should he keep quiet, or report it?

Accrual Accounting
Cash Accounting: recording revenues and expenses at the time the cash is received or paid
- Reasonably precise, but often the timing of cash flow is in a different accounting period

Accrual accounting: recording revenue and expense at the time they occur
- Gives a truer picture of the financial position of the organisation as it includes all asset and liabilities (such as accounts receivable and payable)

- Takes into account depreciation and amortisation

Using accrual accounting:
- include future cash payments that need to be paid
- measure the value of incomplete transactions
- estimate figure such as interest revenue

relies on many judgements and hence is far more imprecise than most people realise

Characteristics of financial accounting information

Fundamental qualities:
- Relevance: contain information that is useful for decision-making
- Faithful Representation: free from bias

Enhancing qualities:
- Comparability: contains similar information from another organisation and is comparable over time within the same organisation
- Verifiability: numbers in the financial statements can be verified
- Timeliness: in time for the user to incorporate the information in their decisions
- Understandability: understandable to informed decision-makers

#Materiality: material if its omission or misstatement could influence the economic decisions of users made on the basis of the financial statements
E.g. Woolworths write statements in $million as the exact value is NOT material

Financial Statement Assumption
- Accrual basis: revenue and expenses are recognised at the time they occur rather when the cash is received or paid
- Accounting entity assumption: activities of the entity are separate form those of its owners
- Accounting period assumption: life of business is divided into discrete time period of equal length to determine financial performance and position
- Monetary assumption: measure economic activity by a common denominator
- Historical cost assumption: transactions are initially recorded at their original cost
- Going concern assumption: continued operation of accounting entity into foreseeable future

Balance Sheet
- measures the financial position of an enterprise at a particular point in time
- used to access financial structure and ability pay debt

Asset: resources that will give future economic benefits and are controlled by an organisation as a result of past transactions
- Not all assets are recognised, it must meet the definition and the cost must be measured reliably, if not it will be in the notes to the financial statement

Liabilities: present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits

#Differentiate between current and non-current to help finical statement users access short-term financial position
Shareholders' Equity
- Share Capital: amount that the owners have directly invested in the company

- Retained Profit: the total cumulative amounts of profits that the company has retained in the business rather than distributed as dividends

##Assets=Liability + Equity##

Format:
- Name of the reporting entity
- Type of finical statement
- Date, i.e. as at 31th December 2019
- Currency used: $million AUD

Equations:
Working Capital = current asset – current liability
Current ratio = current asset/current liability
Debt to equity ratio = total liability/total shareholder's equity
Retained Profit = Opening retained profit + Net profit – Dividends declared

Note: manager's salaries, promotions are somewhat related to the balance sheet information as it shows how well the company is performing under their management

Income Statement
- provides information on an organisation's profitability for a period of time

Revenue: increase in the company's wealth arising from the provision of services or the sale of goods to customers
- cash receipts are not always revenue in the accrual system

E.g. Sakes revenue, Interest revenue etc.

Expense: decrease in the company's wealth incurred in order to earn revenue
- operating cost that have to paid
- long term wear cost such as depreciation or amortisation

Statements of Cash Flow
- records the receipt and payment of cash during an accounting period

Three sections:
- Operating activities: related to the provision of goods and services
- Investing activities: related to the acquisition and disposal of certain noncurrent assets
- Financing activities: related to the changing the size and composition of the financial structure of the entity

#Note: values are not the same as income statement, as this is cash accounting, whereas the other uses the accrual system