Topic One:

The Conceptual Framework:

Qualitative Characteristics: relevance, reliability, comparability, understandability

Constraints: timeliness, cost benefit, trade-offs between qualitative characteristics

Definition and Recognition of Elements of Financial Statements: assets, liabilities, income (revenue), expenses

Must follow the principles leading to a 'true and fair' understanding of the underlying economic reality of a firm

- *Reliability:* information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully that which it purports to represent or could reasonably be expected to purport to represent – related to 'faithful representation', substance over form, neutrality, materiality and completeness
- *Comparability:* enables comparisons between entities and for the same entity over a period of time
- *Relevance:* information has the quality of relevance when it influences the economic decisions of users by helping them evaluate past, present or future events or confirming, or correcting their past evaluations – relevance is related to decision usefulness and materiality
- *Understandability:* assuming a reasonable knowledge of business, economics and accounting, diligence in studying the information, it should be readily understandable (but not excluding reporting on complex situations)

Topic Two:

Accrual Accounting vs Cash Accounting

- Accrual: the stock and flow of 'economic benefits'
- Cash: the stock and flow of 'cash'

Assets are resources controlled by the entity as a result of past events from which future economic benefits are expected to flow to the entity – they must also be probable, and capable of being reliably measured

Liabilities are present obligations 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 – the must also be probable and capable of being reliably measured

Types of liability:

- *Payables:* present obligations that are known and invoiced e.g. accounts payable
- *Accruals:* present obligations that are known but have not be been invoiced e.g. accrued wages
- *Provisions:* present obligations with some uncertainty as to timing or amount, e.g. provision for long service leave

Equity: residual interest in the assets of the entity after deducting all liabilities

Parts of equity:

- *Contributed equity/Share capital:* shares issued in exchange for part ownership of the company
- *Reserves:* amounts set aside for future use
- *Retained profits (and accumulated losses):* have not been distributed to owners

Accounting Equation:

Assets = Liabilities + Equity

Assets = Liabilities + Capital contributed + Revenue – Expenses – Dividends

Duality: the duality in economic exchanges and events is the dual effect on the accounting equation which ensures it is always balanced

Income: increases economic benefits during the accounting period in the form of inflows or enhancements of assets, or decreases of liabilities that results in an increase in equity other than contributions by equity participants – they must be earned and capable of being reliably measured Income includes *revenue* which is income earned from ordinary activities

Expenses: decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or increases in liabilities that result in decreases to equity other than reductions in equity brought about by equity participants – must follow the matching principle: expenses are recognised on the basis of a direct association with earning income, and also much be capable of being reliably measured

Ledgers: record financial transactions of a firm organised by accounts

Journals: chronological record of difference types of activities (e.g. sales)

Source Documents: operational records (e.g. invoices)

Topic Three: The Balance Sheet

Advantages for setting up a company:

- Separate Legal Entity
- Helps limit losses when each business is a separate company
- i.e. if one Woolworths goes bankrupt, losses are limited to the one store

Total Assets: The current minimum future economic benefit as estimated by management, considering estimations of (net) market value (both today and in the future), future cash flows, assets usage, stock flows and can be reliably measured

Measuring assets/liabilities:

The dollar value assigned to assets and liabilities is called the *carrying amount* or *book value*.

Measurement systems:

- Historical cost – reliable, but less relevant