LECTURE 1 – FINANCIAL ACCOUNTING

- **Accounting** is the process of identifying, measuring and communicating economic information to permit informed judgements and decisions. I.e. ''language of business''

Learning Objectives

Describe the four assumptions made when communicating accounting information.

- The **economic entity assumption** states that the financial activities of a business can be accounted for separately from the business's owners.
- We do not have to worry that the financial information of the owner is mixed with the financial information of the business.
- The **time period assumption** states that accounting information can be captured and communicated effectively over short periods of time.
- Most businesses prepare quarterly, half-yearly or annual financial statements. Publicly traded companies like BHP Billiton are required to file statements to the ASX twice a year.
- The **monetary unit assumption** assumes that the dollar, unadjusted for inflation, is the best means of communicating accounting information.
- Accountants do not adjust for inflation/deflation – $1 earned in 1980 is same as $1 in 2014.
- All transactions in foreign currencies are converted to dollars.
- The **going concern assumption** states that the company for which we are accounting will continue its operations indefinitely.
- Most companies are assumed to be going concerns but those that are not going concerns are often in the process of liquidation (so selling their resources + paying off obligations). If an entity is not selling its assets, then the cost principle is appropriate.

Describe the purpose and structure of a statement of comprehensive income and the terms and principles used to create it.

- The **statement of comprehensive income** (or an income statement) shows a company's revenues and expenses over a specific period of time.
  - Its <u>purpose</u> is to demonstrate the financial success or failure of the company over that specific period of time.
  - Its <u>structure</u> is as follows:
  - **Revenue** is an increase in assets resulting from selling a good or providing a service.
- The **revenue recognition principle** states that revenues are recorded when they are earned.
- A resource (revenue) is earned when either the sale of the good or the provision of the service is substantially complete and collection is reasonably assured.

Therefore, the receipt of cash is not required to record revenue.
  - **Expense** is a decrease in assets resulting from selling a good or providing a service.
- The **matching principle** states that expenses are recorded in the time period when they are incurred to generate revenue.
- For many assets, the cost of the asset must be spread over the periods when it is used.

Describe the purpose and structure of a statement of financial position and the terms and principles used to create it.

- The **statement of financial position** (or the balance sheet) shows a company's assets, liabilities and equity at a specific point in time.
  - Its <u>purpose</u> is to show, at a given point in time, a company's resources and its claims against those resources. It is often referred to as a ''snapshot of a business''.
  - Its <u>structure</u> is shown by the accounting equation: