Accounting A – Financial Accounting

Chapter 1 – Financial Accounting

Accounting refers to the process of identifying, measuring and communicating economic information about a particular business to interested users

Accountants must make assumptions when communicating economic information

1. Economic entity – accountants must assume that the financial activities of a business can be accounted for separately from the business's owners

2. Monetary unit – accountants must assume that the dollar is the best way to communicate economic information in Australia and New Zealand

3. Time period – accountants must assume that accounting information can be communicated effectively over short periods of time

4. Going concern – accounts must assume that a company will continue its operations indefinitely

Income statement (statement of comprehensive income)

An income statement reports a businesses revenue and expenses, and the resultant profit or loss, over a specific period of time

Revenue – COGS = Gross Profit – all other expenses = Net Profit or Net Loss

Key terms

1. Revenue - refers to an increase in resources resulting from the sale of a good, or the provision of a service

2. Cost of goods sold – refers to the cost of inventory

3. Gross Profit – refers to the profit that a company generates when considering only the sales price and the cost of the products sold

4. Expense – refers to a decrease in resources resulting from the sale of a good, or the provision of a service

5. Profits before income tax – refers to the profit that a business generates before paying tax to the government

6. Profits after income tax – refers to the profit that a business generates after paying tax to the government

7. Matching principal – the principal that expenses are recorded in the time period when they are incurred to generate revenues

Balance sheet (statement of financial position)

A balance sheet represents a business's assets, liabilities and equity at a specific point in time

Assets = Liabilities + Owners Equity

Key terms

1. Assets – refers to a resource of a business
2. Current assets – refers to any resources that are cash, or are expected to be concerted into cash within 12 months
3. Non-current assets – refers to any resources that are expected to be converted to cash in a period longer than 12 months
4. Intangible assets – refers to assets that have no physical form such as trademarks, copyright or goodwill
5. Liabilities – refers to an obligation of a business
6. Current liabilities – refers to a debts of a business that are expected to be paid within 12 months
7. Non-current liabilities – refers to debts of a business that are expected to be paid in longer than 12 months
8. Equity – refers to the difference between a businesses assets and it's liabilities, representing contributed capital and retained profits
9. Cost principle – the principle that assets should be recorded and reported at the cost paid to acquire them
10. Contributed capital – refers to the funds contributed by investors of a business in exchange for ownership
11. Retained profits/earnings – refers to profits that are not distributed to owners, but are instead kept within the business
12. Dividends – a distribution of profits to owners

Statement of changes in equity

A statement of changes in equity reports the change in a company's retained profits (contributed capital + retained profits from new period) over time

Retained Profit (Beginning Balance – from previous period)
+/- Net Profit/Loss
- Dividends
= Retained Profit (Closing Balance – for current period)

Statement of changes in equity – links

1. Profit on statement of changes in equity = net profit/loss on the income statement

2. Retained earnings (closing balance) on the statement of changes in equity = retained earnings under the equity component of the balance sheet

Cash flow statement

A cash flow statement reports a business's cash inflows and outflows from its operating, investing and financing activities over a period of time

Cash Flows Provided (Used) by Operating Activities
+/- Cash Flows Provided (Used) by Investing Activities
+/- Cash Flows Provided (Used) by Financing Activities
= Net Increase/Decrease in Cash

Qualitative characteristics of accounting information

Qualitative – refers to descriptions, rather than numerical characteristics

Even though accounting is a very quantitative process and financial statements are full of numbers, accounting information must possess certain qualitative characteristics to be considered useful:

Qualitative Characteristics	
Understandability	Accounting information should be comprehensible by those willing to spend a reasonable amount of time studying it
Relevance	Accounting information should have the capacity to affect decisions
Reliability	Accounting information should be dependable to represent what it purports to represent
Comparability	Accounting information should be comparable across different businesses
Consistency	

	Accounting information should be comparable across different time periods within a business
Materiality	The threshold over which an item could begin to affect decisions
Conservatism	When uncertainty exists, accounting information should be conservative