Chapter 1: Introducing Financial Accounting

Links between financial statements:

1. Balance Sheet Explained by Cash Flow Statement: The difference between opening and closing balance of cash in the balance sheet is explained by statement of cash flows.
2. Income Statement Explains Change in Retained Profit: The profit for the period, minus any dividends contributes to the change in the profit noted on the balance sheet.

Explain the basic principles and assumptions of accounting:

1. Accrual Basis: The effect of transactions are recorded as they occur, regardless of whether the cash is received or paid at that time.
2. Accounting Entity: The financial activities of a business are separate from activities of the owner.
3. Accounting Period: The life of the business is divided into discrete time periods for the purposes of measuring performance.
4. Monetary Unit: Transactions are measured using a common denominator.
5. Historical Cost: Assets are initially recorded at cost that is determined at the time the transaction takes place.
6. Going Concern: The company intends to stay in business for the foreseeable future.

Quantitative Characteristics of Accounting (further discussed in Chapter 6):

1. Understandability: Reports should be prepared having regard to the interest of the users.
2. Relevance: If information is to assist users in making decisions about the allocation of scare resources, we need:
   1. Timelines: The need to provide relevant information in enough time for decisions to be made;
   2. Materiality: Assessing whether an omission, misstatement or non-disclosure of a piece of information would affect the decision of users of the accounting reports.
3. Reliability: The financial statements should report the economic substance of events happening to the company, and the numbers should measure the events neutrally.
4. Compatibility: Users should be able to compare financial statements from similar companies.