Define Accounting

Accounting is the process of identifying, recording, measuring and communicating economic information to assist users with their decisions.

Users

- Management
- Creditors
- Shareholders
- Banks
- Corporate board
- Unions and management (to decide wages etc.)
- Consumers
- Community
- Employees

The People Involved

- the information users (the decision-makers)
- the information preparers, who put together the information to facilitate the users' decision-making
    - managers
    - accountants
- the auditors, who assist the users by enhancing the credibility of the information, providing a professional opinion about the fairness and appropriateness of the information.

Accrual Accounting

Accrual accounting is where the transaction, whether or not it is paid yet, is written down. For example, if I had something that's going to be paid in a month of $40 000, but was bought this month, and this month's already bought goods are worth $50 000, the accrual way of accounting will say that I have had a revenue of $90 000.

Examples include: Wages, electricity, rent etc.

So why is accrual accounting important?
It's important to show estimates of the *total* cost of the year/ time period, thus making revenue more correct.

Cash Accounting
Unlike accrual accounting, cash accounting involves recording things only as they are paid.

Consolidated Financial Statements
Basically grouping the mama company and its babies together and making one big financial statement for them altogether.

The Key Financial Statements
Balance Sheet
The balance sheet contains three major components.
1) Assets
   Things we have.
2) Liabilities
   Things we owe.
3) Equity
   Things that belong to the owners.

<u>Assets</u>
The things that we have. Assets are not necessarily fully owned yet. E.g. Buying a house but using the bank's money.

There are different components/accounts to assets which include:
- Cash at Bank
  This is where deposits and withdrawals from the bank are recorded.
- Accounts Receivable (debtors)
  This represents the amounts owing from customers for goods and services e.g. Credit. It is shown in net, which shows the amount that management expects to get from its customers after unlikely to be collected amounts are taken away.
- Inventory
  This is the stock on hand (unsold products).
- Property, Plant and Equipment
  e.g. land, buildings, equipment, computers, furniture etc.

<u>How do we finance assets?</u>
Through liabilities (borrow from a bank etc.) or/and shareholders' equity, which is essentially selling new shares.

<u>Liabilities</u>
What we owe.

Terminology:

- Accounts payable (often called trade creditors)
  This is the amount owed to various suppliers for goods or services that they provide.
- Wages payable (also called accrued wages)
- Provision for employee entitlements
  What employees can get because they've worked e.g. long service leave payments etc.
- Long-term loans are loans that are not repayable within a year.

Share Holder's Equity

This is what we actually own. (Assets – Liabilities)

There are two main components:

- Share capital
  This is the amount that has been directly invested into the company.
- Retained profits
  This is the total amount of profits that the company itself still has (after giving away dividends etc.) Revenue is part of it.

To write the perfect balance sheet, the heading must have the following:

- The name of the accounting entity
- The time at which the financial position was recorded

A balance sheet looks like a T.

EXHIBIT 1.1

XYZ LTD

BALANCE SHEET AS AT 30 JUNE 2016

	2016 $000	2015 $000
Assets		
Cash at bank	2 000	1 400
Accounts receivable	16 000	13 000
Inventory	12 000	10 000
Property, plant and equipment	90 000	91 000
Total assets	120 000	115 400
Liabilities and shareholders' equity		
Liabilities		
Accounts payable	17 000	16 800
Wages payable	2 000	2 000
Provision for employee entitlements	4 000	3 000
Long-term loans	30 000	33 600
Total liabilities	53 000	55 400
Shareholders' equity		
Share capital	40 000	36 000
Retained profits	27 000	24 000
Total shareholders' equity	67 000	60 000
Total liabilities and shareholders' equity	120 000	115 400

Income Statement

It was previously known as the profit and loss statement. It shows the profit or loss of an enterprise through it's pairing of revenue and expenses over a time period.

The components:

- Cost of goods sold (COGS)
- Sales revenue
- Gross profit
  Sales revenue – COGS
- Profit before tax = sales revenue – cost of operation
- Profit after tax = Profit before tax – tax

XYZ LTD

INCOME STATEMENT FOR THE YEAR ENDED 30 JUNE 2016

	$000	$000
Sales revenue		21 000
Less Cost of goods sold		8 000
Gross profit		13 000
Less Operating expenses		
Salaries	2 500	
Depreciation	500	
Electricity	300	
Travel	300	
Other	400	4 000
Operating profit before tax		9 000
Less Income tax expense		3 000
Operating profit after tax		6 000

How does the income statement link with the balance sheet?
The income statement links to the balance sheet through the *Statement of Retained Earnings* and then through *retained profits* section of the Balance Sheet under Equity.

Statement of Cash Flows

The statement of Cash Flows shows the changes in an entity's cash balance over a given period of time. Not Accrual!!

The three types of transactions are:

1. Operating activities
   These are related to the provision of goods and services e.g. buying from a producer, selling to a customer
2. Investing Activities
   Related to the buying and selling of Property, Plant and Equipment.
3. Financing Activities
   Borrowing from a bank, or paying it back. Equity, capital and borrowing.

EXHIBIT 1.3

XYZ LTD

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 30 JUNE 2016

	$000
Cash flows from operating activities	
Receipts from customers	17 000
Payments to suppliers	(7 700)
Payments to employees	(2 500)
Cash operating costs	(4 300)
	2 500
Cash flows from investing activities	
Purchase of machinery	(2 300)
Cash flows from financing activities	
Issue of shares	4 000
Bank loan	(3 600)
	400
Total net cash flows	600
Cash: 1 July 2015 (opening balance)	1 400
Cash: 30 June 2016 (closing balance)	**2 000**

The Demands on Quality of Financial Statements

1. **Relevance**: The content must be useful to aid making decisions
2. **Objective / Faithful representation**: Free from bias.
3. **Materiality**: Do the things that are left out, or wrongly written, make large impacts on the choices of consumers etc. – it's a measure.
4. **There must be a standard**: *Generally Accepted Accounting Principles (GAAP)*
5. **Principle of disclosure**: This is usually in the form of notes.
6. **Understandability**: Does it somewhat make sense?
7. **Verifiability**: Things should be able to be verified.
8. **Consistency**: Using the same method for the same reports (doesn't mean that you have to use the same method throughout the entire report).

Financial Statement Concepts (Assumptions)

Accrual Basis

This is where transactions are recorded as they happen, not when the money actually comes (e.g. in the form of credit, or loan payments).

Going Concern

This is where financial statements are prepared with the idea that the entity will continue to be financially liable.

Accounting Entity

That's the business and doesn't include the owner's assets, money etc.

Accounting Period

That's the time period in which the financial statement is calculated.

Financial Performance
The enterprise's ability to generate new resources from day-to-day operations over a period of time, via dealing with customers, employees and suppliers. Measured by the net profit figure in the income statement.

Financial Position
The enterprise's set of assets, liabilities and owner's equity at a given point in time (measure by a balance sheet)

Monetary Assumption
This is where all money is transferred into Australian Dollars to create a basis for comparison and calculations. If a transaction cannot be The monetary unit is also exempt from inflation.

Historical Cost
This is where the price of an asset is recorded as its original nominal cost.