BUSS1030 – Accounting, Business and Society

1. Introduction to Accounting

1. <u>The Accounting Process (LO1)</u>

Accounting – encompasses the information system that measures business activity, processes the data into reports and communicates the results to decision makers.

- Product of accounting – financial statements.
- Information is used by managers, directors, investors, customers, govt. agencies, unions etc.
- Accounting decisions in everyday life:
  - Resources are limited – what to buy? Is it good value?
  - Need for positive cash flow (inflow > outflow).
  - Surplus cash → invest, buy equipment, save etc.
  - Do the right thing? Donations, invest in sustainable companies etc. (ethical decisions).

2. <u>The New Conceptual Framework (CF)</u>

- Defines the nature, purpose and content of financial reporting (rules that will be in line with needs of **external users**).
- Universal framework/international harmonisation – **consistency** amongst companies; accountability.
- Currently in process of modification – redesigned etc.
- CF and SAC 1 (Statement of Accounting Concepts) consists of:
  a. Objective of GPFR (General Purpose Financial Reports) – communicate with users (internal and external).
  b. The reporting entity – any entity that has users that require the financial information e.g. a company.
  c. Qualitative characteristics.
  d. Definition of elements of financial statement.
- Does not talk about internal/external users; instead it talks about **PRIMARY USERS**.

3. <u>Users of Accounting (LO2)</u>

- CF – Primary users are resource providers e.g. shareholders (give funds), banks (give money), customers (buy products).
  - Resources = cash, supplies, equipment.
- Equity investors – e.g. shareholders.
- Lenders – e.g. banks.
- Other creditors – e.g. employees, suppliers, customers etc.
- CF does not make explicit mention of internal and external user classification.

4. <u>Differences between Financial Accounting and Management Accounting (LO1)</u>

Financial Accounting (external)	**Management Accounting (internal)**
- Provides information for external decision makers e.g. investors and lenders. - Preparation and presentation of financial information to allow users to make economic decisions about the entity. - External user focus. - Includes: 'Statement of Comprehensive Income' (Income Statement), 'Statement of Financial Position'	- Focuses on information for internal decision makers e.g. business managers. - Core activities include formulating plans and budgets. - Information used in monitoring and control within the entity.

(Balance Sheet), 'Statement of Changes in Equity', 'Statement of Cash Flows' (Cash Flow Statement).	

5. <u>Ethics in accounting and business (LO5)</u>

- Ethical behaviour in accounting ultimately relates to the standard of moral behaviour expected of accountants – they are responsible for deciding what goes into and what is left out of financial reports.
- The CPA, ICAA and other professional accounting organisations and many large firms have Codes of Professional Conduct:
  - Integrity.
  - Objectivity.
  - Professional competence and due care.
  - Confidentiality.
  - Professional behaviour.

6. Accounting profession in Australia (LO4)

- Accounting principles, standards, ethics and disciplinary procedures of accounting professional bodies:
  - ICAA – Chartered Accountants (CA).
  - CPA Australia.
  - NIA (National Institute of Accountants – no tertiary qualification required).
- ASIC, ASX, ACCC, RBA, APRA, ATO etc.
- **AASB** (Australian Accounting Standards Board) – responsible for technical accounting standards; governs measurement rules and level of disclosure.
  - Australia has adopted International Accounting Standards.
    - *Private sector* – professional accountants apply Australian Accounting Standards; AASB sets IFRSs, which are used as a basis for equivalent Australian Accounting Standards.
    - *Public sector* – federal government through the Financial Council (FRC) and the AASB regulates accounting standards.

7. Types of business organisations (LO6)

- Sole Proprietorship/Sole Trader – single owner.
  - ADV: total undivided authority, no restrictions on type of business (must be legal), easy to setup.
  - DISADV: unlimited liability, limitation on size (fundraising power).
- Partnership – joins 2+ individuals together as co-owners of a business.
  - ADV: pooling in different resources of partners, more brainpower, simple to form.
  - DISADV: unlimited liability for general partners, potential for conflict amongst partners.
- Company – a business owned by shareholders.
  - ADV: separate legal entity = limited liability of shareholders, transferability of ownership relatively easy.
  - DISADV: separation of ownership and control, extensive government regulation.

8. Accounting measurement concepts and principles (LO7)

- **Primary objective of financial reporting** – to provide information useful for making investment and lending decisions.
- ***Entity Concept** – the business activities and the personal affairs of the owner are separate; only information about transactions relating to the entity is included in its financial statements.
  - From an accounting point of view, sole traders, partnerships and companies are all separate accounting entities to their owners.
  - (From a legal point of view, sole traders and partnerships are the same legal entity as their owners = unlimited liability; companies are a separate legal entity to their owners = limited liability).
- ***Accounting Time Period Concept** – unit of time for which accounting data is collected and the financial statements prepared.
  - Australia: financial year from July 1 to June 30 the following year.
  - Allows for comparison in the financial performance of firms in a set and standard time frame.
- ***The Cost Principle** – assets and services acquired should be recorded at their actual cost (reliable and objective).
  - Historical Cost – the cost that you first pay when you purchase an item (proof from sources e.g. receipts = objective).
  - Other cost systems:
    - Market value – what the market is willing to pay (value at the point in time).
    - Replacement cost – cost to replace that exact item.

9. Qualitative characteristics of accounting information (LO7)

- Faithful representation – information is complete, neutral and free from error.

b. Enhancing Qualitative Characteristics.

- Comparability – users can identify similarities/differences between different periods within a set of financial statements and across different reporting entities.
- Verifiability – enables observes to reach a consensus if an event/transaction is a faithful representation.
- Timeliness – the older the information, the less useful it is.
- Understandability – classified and presented in a *clear*, concise way.
- Constraint – cost of preparation vs benefits.

2. Key Accounting Concepts

1. Nature of assets, liabilities, equity, income and expenses (LO8)
2. Concepts of duality, proportionality and balance (LO8)
3. Development of double entry bookkeeping and the accounting equation (LO9)
4. Accounting processes (LO9)

A = L + OE

This equation must always balance

Asset – something that a company owns/controls which has future economic value.

- Includes cash, inventory (things that you sell), furniture (lasts > 12 months), land, equipment, goodwill, accounts receivable (money owed to the business), bills receivable (variable), prepaid expenses, supplies (things that you buy to use, must physically diminish e.g. stationery).
- Goodwill – an intangible asset (conceptual); it is the cost of the name/brand which gives the business future economic value.
- When you consume up the benefits of an asset, it becomes an expense.

Liability – something that a company owes.

- Includes money, service – legal retainers, accounts payable (money that the business owes, fixed), bills payable (variable), accrued liabilities (expenses that you haven't paid yet e.g. salary payable, rent payable), mortgages, debentures.
- Current liabilities – must be paid within 12 months e.g. a/c payable, rent payable, bills payable.
- Non-current liabilities - > 12 months e.g. mortgages.

Owners Equity – the owner's claim on the entity's assets; what is left after liabilities have been deducted (net assets).

- A – L = OE
- OE Accounts:
    - + capital (whatever the owner contributes to the business e.g. cash, equipment etc.)
    - + revenues
    - – expenses
    - – drawings
    - – dividends
- Revenues – money generated from the provision of goods/performance of services.
    - Includes sales revenue, service revenue, rent received, interest revenue.
- Expenses – costs incurred (including assets consumed) in generating revenue during the accounting period.
    - Includes salaries and wages, electricity and gas, supplies used, advertising.
- OE increases due to: owner's investments in the business, revenues.
- OE decreases due to: owner's drawings from the business, expenses.

- Each transaction is recorded with at least:
  - One debit AND one credit – total debits must equal total credits.
  - Assets are on the left side – DEBIT.
  - Liabilities and equity are on the right side – CREDIT.
  - A = L + OE ∴ debits = credits.

Account title e.g. CASH

Debit	**Credit**

Assets

Increases are recorded on the left (debit) side.	**Decreases** are recorded on the right (credit) side.

Liabilities and owner's equity

Decreases are recorded on the left (debit) side.	**Increases** are recorded on the right (credit) side.

3. Business Transactions (W3/4)

1. <u>Business transactions (LO1/2/3)</u>
2. <u>Source documents (LO1)</u>
3. <u>Analysing business transactions (LO2/3)</u>

Need to know:

- Has a transaction occurred?
  - Check source documents – provide documentary evidence that a transaction has occurred (proof).
    - E.g. cash receipts, invoices, credit card receipts, customer invoices, supplier invoices, purchase orders, deposit slips, bank statements, notes for loans, payment stubs etc.
- If so, is the transaction a business transaction?
  - External business transactions.
  - Internal business transactions.
  - Non-business transactions.
- How does the transaction affect the accounting equation?
- What specific accounts are affected by the transaction?