ACCOUNTING REVISION

FINANCIAL ACCOUNTING

CHAPTER 1

- Accounting is the process of identifying, measuring and communicating economic information to permit informed judgements and decisions.
- Four assumptions:
    - Economic entity
        - The financial activities of a business can be separated from the financial activities of the business owners and from other business activities
    - Accounting period
        - Economic information can be meaningfully captured and communicated over short periods of time
    - Monetary unit
        - The dollar is the most effective means to communicate economic activity
    - Going concern
        - A company will continue to operate into the foreseeable future
- Income statement or profit loss statement
    - Reports a company's revenues and expenses and the resulting profit or loss
- Revenues
    - An increase in resources resulting from the sale of goods
    - Recorded according to the revenue recognition principle. States that revenue should be recorded when a resource has been earned, regardless of when the cash is received.
- Expenses
    - A decrease in resources resulting from the operation of a business.
    - Recorded in the period they are incurred.
    - The matching principle states that expenses should be recorded in the period resources are used to generate revenues.
    - Supplies used up
    - Equipment ongoing
- Income Statement
    - Reports revenues and expenses over a specific period of time
    - Revenues – Expenses = net profit or net loss
- Balance Sheet
    - Reports a business' assets, liabilities and equity at a specific point in time
    - Assets = liabilities + equity
- Assets
    - A resource of a business, that is objectively measurable, results from a prior transaction and will provide future economic benefit.
    - The cost principle states that assets should be recorded and reported at the cost paid to acquire them
- Liabilities
    - An obligation of a business that results from a past transaction and will require the sacrifice of economic resources at a future date.
- Equity
    - The difference between a business' assets and liabilities, representing the share of assets that is claimed by the business owners

    - Contributed capital are the resources that investors contribute to a business in exchange for ownership interest
    - Dividends are profits that are distribute to owners (or drawings)
    - Retained earnings are profits that are kept by the business
    - Statement of changes in equity reports the change in a business' equity over a specific period of time
- Order of preparation:
    - 1. Income statement
    - 2. Statement of Changes in Equity
    - 3. Balance Sheet
- Activities:
    - Financial- borrowing, receiving, generating and repaying cash
    - Investing- buying and selling of assets
    - Operating- purchase of supplies, payment of employees and sale of products
- The Cash Flow statement
    - A financial statement that reports a business' sources and uses of cash over a specific period of time
    - Cash flow provided by operating activities +/- Cash flow provided by investing activities +/- Cash flow provided by financing activities = Net increase/ decrease in cash + cash at the beginning = cash at the end
- Objectives of Financial Reporting:
    - Relevance: The capacity of accounting information to make a difference in decisions
    - Materiality: the threshold at which a financial item begins to affect decision- making
    - Faithful Representation: financial information that is presented in a way that is complete, neutral and free from error
    - Comparability: the ability to use accounting information to be weighed against or contrasted to the financial activities of different businesses
    - Verifiability: When information allows different independent observers to arrive at the same or similar outcomes
    - Timeliness: When information is provided quickly enough that the user can take action
    - Understandability: The ability of accounting information to be comprehensible to those who have a 'reasonable understanding of business and economic activities and accounting and a willingness to study the information with reasonable diligence'.
- Conceptual Framework for financial Reporting
    - The objectives, characteristics and concepts that guide the manner in which accounting is practised.

CHAPTER 2

- Business forms
    - Sole proprietorship- one owner
    - Partnership- two or more owners
    - Company- a separate legal entity that is established by registering the company with ASIC. Sells shares to individuals.
- Private and public companies- public companies are a separate legal entity in which ownership is available to the general public
- Generally Accepted Accounting Principles
    - The accounting rules, standards, principles and procedures that comprise authoritative practice for financial accounting
- Australian Accounting Standards Board
    - The standard setting body whose mission is to develop and maintain high quality financial reporting standards

- International Financial Reporting Standards
    - Standards issues by the international accounting standards board
- International Accounting Standards Board
    - A board, similar to the AASB, whose mission is to develop a single set of high-quality standards requiring transparent and comparable information
- Consolidated Balance Sheet: a type of balance sheet that groups together the parent company and its subsidiaries as one reporting entity
- Assets:
    - Current- any asset that is reasonably expected to be converted to cash or consumed within one year of the balance sheet date
    - Non-current- a resource that is used in a company's operations or more than one year is not intended for resale
    - Intangible- a resource that is used in operation for more than one year, is not intended for resale and has no physical substance
- Liabilities:
    - Current- an obligation that is reasonably expected to be satisfied within one year
    - Non-current- an obligation that is not expected to be satisfied within one year
- Equity: generated from retained earnings and contributed equity
    - Contributed- the amount of equity a company generates through the sale of shares to investors
- Income statement:
    - Multi step income statement calculates income by grouping certain revenues and expenses together and calculating several subtotals of income
    - Total revenue, cost of sales, gross profit, expenses, profits before income tax, profits after income tax, other comprehensive income, total comprehensive income
- Gross profit:
    - Sales revenue- the resources that a company generates during a period from selling its inventory
    - Cost of sales- the cost of the inventory sold during a period
    - Gross profit- the profit that a company generates when considering only the sales price and the cost of the product sold
- Operating expenses- recurring expenses that a company incurs during normal operations
- Profit before income tax expense:
    - The profit that a company generates when considering both the cost of the inventory and the normal expenses incurred to operate the business
    - Income tax expense- the amount of income tax expense for a given period
- Horizontal & Vertical analysis
    - Horizontal analysis:
        - A method of analysing a company's account balances over time by calculating absolute and percentage changes in each account
        - Dollar change in account balance = current year balance – prior year balance
        - Percentage change in account balance = dollar change / prior year balance
    - Vertical Analysis:
        - A method of comparing a company's account balances within one year by dividing each account balance by a base amount to yield a percentage
        - Balance Sheet: Account balance / Total Assets
        - Income Statement: Account balance / Net sales or revenue
        - Common size financial statement: a statement in which all accounts have ben standardised by the overall size of the company
- Notes to financial statements- the additional textual and numerical information immediately following the financial statements

- Auditors report- a report, prepared by a registered company auditor for the shareholders, stating an opinion on whether the financial statements present fairly, in conformity with Australian Accounting Standards, the company's financial condition and results of operations and cash flows
- Director's report- forms part of the financial report and covers matters which are the board of director's responsibility.

CHAPTER 3

- Accounting information system- the system that identifies, records, summarises and communicates the various transactions of a business
- Accounting transaction- any economic event that affects a business's assets, liabilities and/ or equity at the time of event
- Account- An accounting record that accumulates the activity of a specific item and yields the item's balance
- Chart of accounts- the list of accounts that a business uses to capture its business activities
- Dual nature of accounting- every transaction must affect at least two accounts
- Debit- a use of funds, recorded on left side of a T-account
- Credit- a source of funds, recorded on the right side of a T-account
- Journal- a chronological record of transactions
- Ledger- a collection of accounts and their balances
- Trial Balance- A listing of accounts and their balances at a specific point of time. Prepared from ledger entries
- Asset accounts- normal debit balances
- Liability and equity accounts- normal credit balances
- Revenue accounts- normal credit balances
- Expense and dividend accounts- normal debit balances

CHAPTER 8

- Recording non-current assets include:
    - Purchase price
    - Taxes paid on the purchase
    - Fees such as legal costs
    - Delivery costs
    - Insurance
    - Installation
- Depreciation- the process of systematically and rationally allocating the cost of a non-current asset over its useful life
- Depreciation expense- the portion of a non-current asset's cost that is recognised as an expense in the current period
- Accumulated depreciation- the cumulative amount of depreciation expense recognised to date on a non-current asset
- Carrying amount- the unexpired cost of a non-current asset, calculated by subtracting accumulated depreciation from the cost of the non-current asset
- Residual value- an estimate of the value of a non-current asset at the end of its useful life
- Useful life- the length of time a non-current asset is expected to be used in operations
- Depreciable amount- the difference between an asset's cost and its residual value
- Depreciation method- the method used to calculate depreciation expense :
    - The straight-line method:
        - Results in same amount of deprecition expense in each year of the asset's useful life
        - = (cost- salvage life)/Useful life
    - Reducing balance method: