Accounting for Business Decisions A Practice Examination

Theory Section

Question 1

Financial statements are prepared for a range of different business entities.

1. Identify the different entities financial statements can be prepared for.

   There are three types of business entities:

   - Sole proprietorship (sole trader): a business owned by one person.
   - Partnership: a business formed by two or more proprietors joins together to own a business.
   - Company: a separate legal entity that is established by registering with ASIC (Australian Securities and Investments Commission).

2. Identify the different financial statements and explain the type of information contained within each of the financial statements.

   There are four financial statements that accountant must prepare for a business:

   1. Income statement:

      Presents a company's financial activity over a period of time, recording revenue and expenses to provide various profit figures. Designed to monitor the performance of a company, its successes and failings over a specific period.

      ▪ The statement of comprehensive income provides crucial information to a number of stakeholders. First it allows members/managers of a business to measure company performance, make predictions concerning the future and make informed decisions. Second it provides shareholders insight into how well their shares may perform/company direction and finally it provides other business a means to gauge and compare the performance of another business entity.

2. Balance sheet:

Presents Assets, Liabilities and Equity at a given time. Displays a company's resources and its claims against those resources.
▪ Directly conveys to stakeholders, the claims held on parts of a business. No part of a business is unclaimed and thus, the statement of financial position tells stakeholders which assets a company owns and whether those assets are claimed under liabilities or held by equity holders.

3. Statement changes in equity:

Presents the changes in a business's equity that is its retained earnings over a specific period of time. Displays starting retained earnings, income, drawings and closing retained earnings.
▪ Conveys to business owners the growth or recession in their company's retained earnings, while concurrently conveying how these retained earnings are divided in terms of dividends. Due to this dual function it is known as both the statement of retained earnings and the statement of changes in equity.

4. Cash flow statement:

Reports a business's cash inflows and outflows from its operating, investing and financing activities over a specific period of time. The movement in cash is reported from operating activities (e.g: purchase of supplies, selling products and pay salary), investing activities (selling or buying of land, equipment…) and financing activities (generating or repaying cash from creditors and investors).

Provides company information concerning where its money is, where it's come from and where it's going. Allows for managerial