LECTURE OUTLINE TOPIC 1

**Organisations and the Accounting Process**

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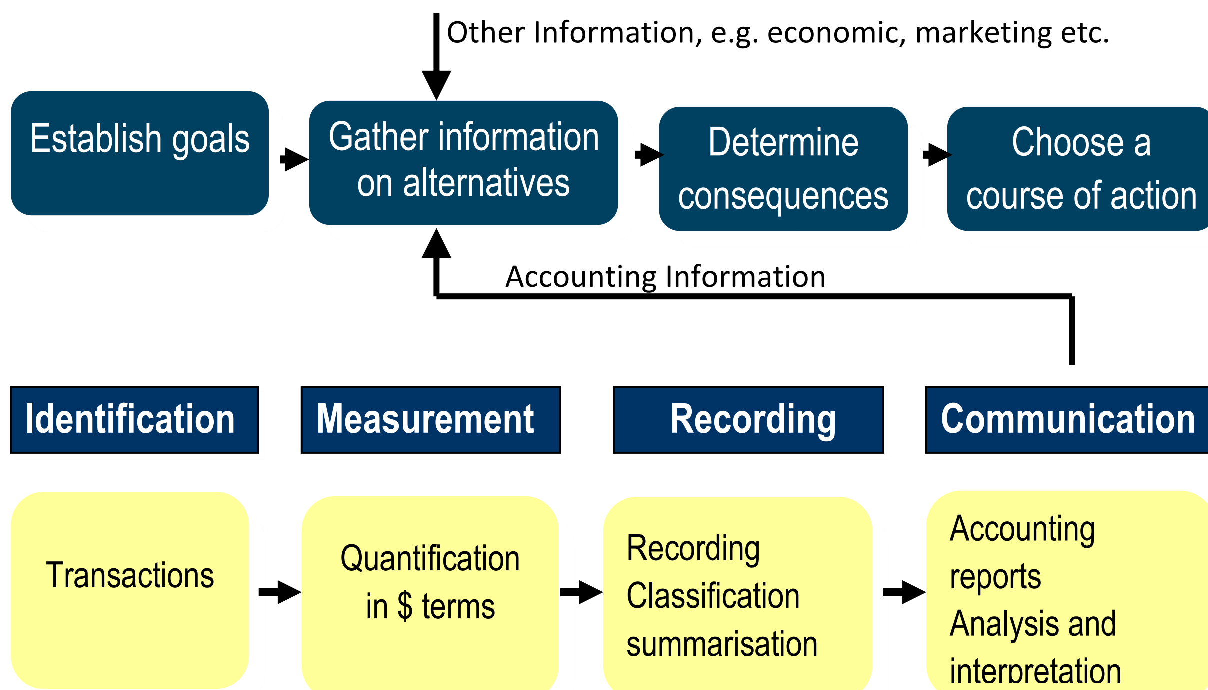
## 1. What is accounting?

"Accounting has been defined as the process of identifying, measuring, recording and communicating economic information to permit informed judgements and economic decisions by the users of the information." (H,E,M,C,H, B & M 2015, p. 8)

## 2. Introduction to the Financial Accounting Process

(Adapted from Figures 1.1 and 1.2 from Hoggett, Edwards, Medlin, Chalmers, Hellmann, Beattie & Maxfied)




## 3. Types of Organisations

- by purpose
  - commercial / "for profit"
  - non commercial / "non profit"
- by form
  - sole trader
  - partnership
  - company

## 4. Introduction to the Conceptual Framework

The framework is a guide to help regulators develop accounting standards that are consistent and logically formulated and to provide guidance to accountants in areas where no standards exist in order to prepare financial statements and reports.

## 5. The Major Financial Reports

### 5.1 The Balance Sheet (Statement of Financial Position)

*A report listing the assets, liabilities and equity of a business at a specific date.*

Assets: An asset is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.

1. …………………………………………………………………..
2. …………………………………………………………………..
3. …………………………………………………………………..

Liabilities: A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

1. ……………………………………………………………………..
2. ……………………………………………………………………
3. …………………………………………………………………….

Equity: Equity is the residual interest in the assets of the entity after deducting all its liabilities.

### 5.2 The Income Statement

*A financial report listing income, expenses and profit or loss of a business for a certain time period.*

Income: Income is increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants.

1. ………………………………………………………………………
2. ………………………………………………………………………
3. ……………………………………………………………………….

Expenses: Expenses are decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to equity participants.

1. ……………………………………………………………………….
2. ……………………………………………………………………….
3. ………………………………………………………………………..

Profit: The change in the equity in an entity during a period from all events other than direct contributions of capital, or withdrawals of capital by owners. (Rivett & Jones)

Loss: The excess of expenses over incomes.

### 5.3 Statement of Changes in Equity

*A link between the balance sheet and the income statement that explains the changes that took place in equity during the period.*

## 6. The Financial Accounting Process

Overview - Figure at point 3 above.

6.1 Identification

- select those transactions/ economic events which have consequences for the entity, i.e. will affect one of the elements within the financial statements

6.2 Measurement

- measure the quantitative effect of the event
  - measurement attribute, e.g. financial attribute
  - measurement unit, e.g. $A

6.3 Recording

- classify consequences of the event in terms of the affect on specific items
  - for all events at least TWO items are affected

6.4 Communication

## 7. The Accounting Identity (or Accounting Equation).

- Assets = Liabilities + Equity

  (A) = (L) + (Eq)
- Eq = CC - D + I – Ex

- Profit = I – Ex = ↑ Eq

Capital Contributions: *amounts contributed by the owners to the entity. These increase equity*.

Drawings (Capital Withdrawals): *The withdrawal of assets from the business by its owners. Capital withdrawals decrease equity.*

## 8. Transaction Analysis

8.1 Example 1 : Weekly Whisper

Expenses are recognised in the income statement when a decrease in future economic benefits related to a decrease in an asset or an increase of a liability has arisen that can be measured reliably. This means, in effect, that recognition of expenses occurs simultaneously with the recognition of an increase in liabilities or a decrease in assets (for example, the accrual of employee entitlements or the depreciation of equipment). (FPPFS 94)

Income is recognised in the income statement when an increase in future economic benefits related to an increase in an asset or a decrease of a liability has arisen that can be measured reliably. This means, in effect, that recognition of income occurs simultaneously with the recognition of increases in assets or decreases in liabilities (for example, the net increase in assets arising on a sale of goods or services or the decrease in liabilities arising from the waiver of a debt payable). (FPPFS 92)

Three Questions:

- which items ($\geq 2$)
- how much?
- Increase or decrease the item?

**Example 1**

(Martin, C., An Introduction to Accounting, McGraw Hill, Sydney, Question 3. 1)

The following events concern a small business, The Weekly Whisper, set up to provide a pictorial newspaper for Adelaide readers.

*Event:*

1. The proprietor, Ms J.A. List, contributed $18,000 cash as capital to start the business.
2. Bought office equipment costing $5,000 on credit from E.Z. Chair; paid a deposit of $1,000 on the furniture.
3. Paid for a delivery van, $10,000.
4. Paid week's wages to reporter/photographer, $400.
5. Sold first week's newspaper to various shops for cash, $250.
6. Sold first week's newspaper to “Corner Stall” for $600 on credit.
7. Withdrew $100 for personal use.
8. Corner Stall paid $200 of the amount owing.

(a) Analyse each event as it affects the basic accounting equation of the business.

(b) Summarise the effects in a Balance Sheet, Income Statement and Statement of Changes in Equity.

**The Weekly Whisper**

**Event Analysis Table**

| **Event #** | **Assets** | | **=** | **Liabilities** | **+** | **Equity** | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | | **Increases** | | **Decreases** | |
| | **Cash *** | **Other Assets** | | | | **Contributed Capital** | **Income** | **Expenses** | **Withdrawals of Capital (drawings)** |
| 1. | | | | | | | | | |
| 2. | | | | | | | | | |
| 3. | | | | | | | | | |
| 4. | | | | | | | | | |
| 5. | | | | | | | | | |
| 6. | | | | | | | | | |
| 7. | | | | | | | | | |
| 8. | | | | | | | | | |

* Cash is no different from any other asset. It has been separated out in this example to highlight that not all sales and expenses will affect the cash account. This shows that Profit cannot be measured using just cash transactions.

**Balance Sheet after event 3.**

The Weekly Whisper
Balance Sheet
at end of event 3

| Assets | $ | Liabilities | $ |
|---|---|---|---|
| Cash | 7,000 | E.Z. Chair | 4,000 |
| Equipment | 5,000 | | |
| Motor Vehicle | 10,000 | Equity | |
| | | J A List | 18,000 |
| | $22,000 | | $22,000 |

**Income Statement for period ended with event 6**

The Weekly Whisper
Income Statement
for period ended with event 6

| | $ |
|---|---|
| Sales Income | 850 |
| Less Expenses | |
| Wages | 400 |
| Profit | $450 |

**Balance Sheet after event 6**

The Weekly Whisper
Balance Sheet
as at end of event 6

| Assets | $ | Liabilities | $ |
|---|---|---|---|
| Cash | 6,850 | E.Z. Chair | 4,000 |
| A/C's Receivable | 600 | | |
| Equipment | 5,000 | Equity | |
| Motor Vehicle | 10,000 | J A List | 18,450 |
| | $22,450 | | $22,450 |

**Balance Sheet after event 8.**

The Weekly Whisper

Balance Sheet

as at end of event 8

| Assets | $ | Liabilities | $ |
|---|---|---|---|
| Cash | 6,950 | E.Z. Chair | 4,000 |
| A/C's Receivable | 400 | | |
| Equipment | 5,000 | Equity | |
| Motor Vehicle | 10,000 | J A List | 18,350 |
| | $22,350 | | $22,350 |

**Statement of Changes in Equity for period ended with event 8**

The Weekly Whisper

Statement of Changes in Equity

for the period ended with event 8

| | $ |
|---|---|
| J A List Capital - Beginning | 0 |
| Capital Contributed | 18,000 |
| Profit for the period | 450 |
| | 18,450 |
| *Less*: Drawings | 100 |
| J A List Capital – after event 8 | $18,350 |

8.2 Link between the Balance Sheet and the Income Statement