

Nature of Accounting theory, principles, accounting policy, practices and procedures

Study Unit 1

Study Unit 1: Nature of Accounting theory, principles, accounting policy, practices and procedures

WHAT IS ACCOUNTING ALL ABOUT?

What is the definition of Accounting?

- Orderly and systematic
- ... identification and recording...
- ... of the monetary values of the economic transactions...
- ... of an individual, entrepreneur, business...
- Reporting the results of these transactions
- Providing this information to users (decision-makers)
- (Includes book-keeping)

Orderly and systematic

- Need to have a formalised approach / process
- This means you have to learn the rules, concepts and theories before you can perform the process
- Know the terminology (language that accountants speak!)

Identify and record

- Need to know what transactions need to be dealt with, and how to deal with them
- Need to record them the same way EVERY time they happen
- You'll need to know how to record the transactions, what they look like once they're recorded properly

Monetary values

- All the economic transactions need to be given a monetary value in order to record them
- Some of these are simple, some are tougher to attach a value
 - (eg: what value do you give a machine you built that doesn't exist anywhere else?!)

Individual or business

- Accounting isn't just for businesses, it can be very useful for individuals to know how to record monetary transactions
- A process to assist people and businesses in their cashflow, financial decision-making

Reporting the results

- Sometimes you have to report your financial results to others (eg: banks, shareholders, investors)
- What do they need to know?
- There are formats (ie: Standards) for this reporting process, you need to learn how to 'report' financial information

Provide the information to users

- Who is going to 'use' your financial information?
- 'Users' are people / businesses that will make economic decisions based on your financial information
- You have to know who these users may be, so that you can ensure you give them the information they need to make their decisions

Book-keeping vs Accounting

- Book-keeping: Identifying and recording the transactions
- Accounting INCLUDES book-keeping, but is SO much more!

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WHAT BUSINESSES NEED ACCOUNTING?

What types of businesses are there?

- We refer to 'entities', being an economic unit whose financial result can be determined on its own (profit or non-profit)
- Types of entities will depend on the ownership and structure
- Private vs Public sector?

What forms of ownership are there?

- Sole proprietorship (sole traders)
- Partnerships
- Close Corporations
- Companies

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WHO ARE THE USERS OF FINANCIAL INFORMATION?

Who are the users?

- Investors
- Employees
- Lenders
- Suppliers / creditors
- Customers
- Government
- Public

Internal vs External users?

- Management accounting:
 - Internal users
 - Need information to make decisions about how to run and control the business and money
 - Less rule-based
- Financial Reporting
 - External users
 - Specific set of standards governing how transactions are recorded and reported for users

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THE FINANCIAL STATEMENTS: IMPORTANT BACKGROUND

How do we present the financial information?

- Annual Financial Statements (AFS)
 - The format for these is provided by IFRS (International Financial Reporting Standards)
- Objective:
 - Provide users with useful information about the financial performance, financial position and changes in the financial position so they can make economic decisions

Characteristics of the information

- What attributes must the financial information have in order to be useful to users?
 - IFRS: The Conceptual Framework for Financial Reporting discusses these attributes
 - Known as: Qualitative Characteristics

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THE FINANCIAL STATEMENTS:

THE CONCEPTUAL FRAMEWORK

Qualitative Characteristics

- Fundamental Qualitative Characteristics:
 - Relevance
 - Appropriate for the users to base their decisions on
 - Faithful representation
 - The information should represent what really happened, (Ie: Relevant information should not be manipulated or omitted)

Qualitative Characteristics

- Further Qualitative Characteristics:
 - Comparability
 - Over time, within industries, similar businesses
 - Different entities should disclose (present) similar transactions the same way
 - Verifiability
 - Different people (analysts, observers, finance experts) should come to the same conclusions if they looked at the same information

Qualitative Characteristics

- Further Qualitative Characteristics:
 - Timeliness
 - The longer it takes to provide the users with the information, the less useful the information will be
 - Understandability
 - The financial statements should be drawn up in such a way that average users can get value from the information and understand it
 - It doesn't mean that information should be omitted purely because it's difficult to understand!

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THE FINANCIAL STATEMENTS: GOING CONCERN BASIS

Underlying assumption

- Going Concern basis
 - Entity assumes that they will be able to continue operating in the foreseeable future
 - ‘Foreseeable future’ = 12 months
 - ‘Continue operating’ = able to realise assets and settle liabilities in the normal course of business
 - Ie: Is your business going to continue trading? (Make money from buying and selling goods)
 - Or: Is your business going to close down

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THE FINANCIAL STATEMENTS

Quick revision

- Format of AFS: IFRS
- Conceptual Framework: In order to be useful -
 - Relevant
 - Faithful representationAlso:
 - Comparable; Understandable; Verifiable; Timely
- Going Concern as an underlying assumption

Financial Statements

- Statement of Profit or Loss and other Comprehensive Income
 - Performance for the year
- Statement of Financial Position
 - Position at the end of the year

Financial Statements

- Statement of Changes in Equity
 - Changes in ownership
 - How much money belongs to the owners
- Statement of Cashflows
 - Shows the movement of cash

Statement of Profit or Loss and Other Comprehensive Income

	<u>Current Year</u>	<u>Prior Year</u>
Revenue	300 000	250 000
Cost of Sales	<u>(200 000)</u>	<u>(200 000)</u>
Gross Profit	100 000	50 000
Other income	2 000	1 000
Distribution, administrative and other expenses	(80 000)	(30 000)
Profit / Total Comprehensive Income for the year	22 000	21 000

Statement of Financial Position

	<u>Current Year</u>	<u>Prior Year</u>
<u>Assets</u>		
Property, Plant and Equipment	450 000	480 000
Trade and other Receivables (Debtors)	30 000	25 000
Cash and Cash Receivables	58 000	42 000
Inventory	<u>27 000</u>	<u>22 000</u>
	565 000	569 000
<u>Equity & Liabilities</u>		
Share Capital	150 000	150 000
Retained Earnings	134 000	126 000
Long term Loan	237 000	252 000
Trade and other Payables (Creditors)	<u>44 000</u>	<u>41 000</u>
	565 000	569 000

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THE FINANCIAL STATEMENTS: ELEMENTS

Elements of the Financial Statements

- How do we categorise all the transactions and financial informations?
 - Statement of Profit or Loss and other Comprehensive Income
 - Income
 - Expenses
 - Statement of Financial Position
 - Assets
 - Liabilities
 - Equity