



ACC1100 / ACF1100 Introduction to Financial Accounting

Lecture 1:
Introduction to Accounting and the Conceptual Framework

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Reference: Financial Accounting Reporting, Analysis and Decision Making (5th Edition)

Chapter 1: pp. 2 -20
Chapter 3: pp.156 - 161
Chapter 13



Welcome

- Accounting is FUN!!!



- ACC1100 versus ACC1200: Accounting for Managers
- The assessments and details of the unit will be discussed in this week's tutorials.
- Moodle!!!!!!!!



Accounting is NOT easy

Work is required!
Keep up to date!

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Going to lectures

Been to the movies lately?

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Textbooks
Required

1. **Financial Accounting: Reporting, Analysis and Decision Making**
(5th Edition)
Carlton, McAlpine-Miladenovic, Palm, Mittrione, Kirk and Wong.
Publisher Wiley (2016)

Recommended

2. **Financial Reporting Handbook 2017**
Claire Locke FCA.
ICAA, John Wiley & Sons,

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Ways to Fail

Ask either of these questions in the last week of semester

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To Pass

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Learning Objectives

1. Define what accounting is.
2. Identify the users of accounting information and the decisions they make.
3. Introduce Accounting Standards and the Conceptual Framework.
4. Explain the nature of a reporting entity.
5. Define assets, liabilities, income, expenses and owner's equity.
6. Understand the two recognition criteria that must be met before an item can be included in the financial statements.
7. Apply the definitions and recognition criteria to an unusual transaction.

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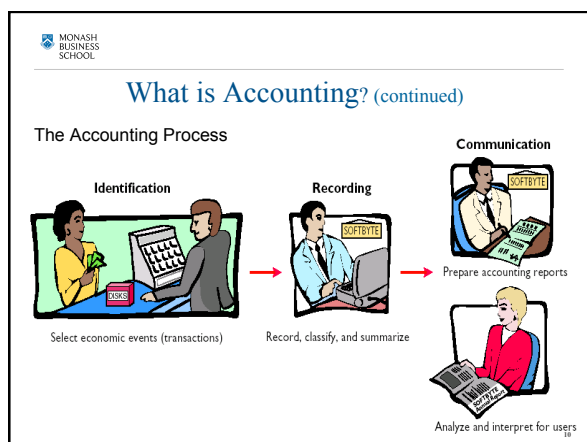
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What is Accounting?

An information system or process that:

economic events of an entity to permit informed judgements and **decisions** by interested users of the information.

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Why is Accounting Important?

- **Decisions** are made based on the information provided.
- Accounting information conveys information about business performance to others.
- Poor accounting practices by businesses can produce information that is inaccurate or misleading.
- This can lead to corporate collapses and financial ruin for many people involved.

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The Role of Accounting

- So overall, think of accounting as a process that identifies, records and communicates information to internal and external users of financial information for decision-making purposes.
- Users of accounting can be classified as either:

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Internal Users

Managers who plan, organise and run the business

Examples:

- Chief executive officers (CEOs)
- Chief financial officers (CFOs)
- Marketing managers
- Production supervisors
- Other employees

Detailed and frequent information is needed by these managers to make business decisions on a day-by-day basis.

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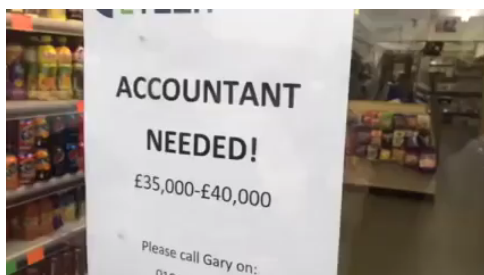
External users

Vary in their nature and information requirements.

Examples:

- Investors e.g., shareholders (use information to make decisions to buy, hold or sell shares)
- Creditors/Lenders e.g., suppliers, bankers (use information to evaluate risks of giving credit and lending money)
- Government and regulatory bodies e.g., ATO, ASIC (use information to determine an entity's compliance with rules and regulations)

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Forms of Business Organisations

Sole proprietorship (sole trader):

- Owned by one person:
 - e.g., lawn mowing business, handyman business.

Partnership:

- Owned by more than one individual:
 - e.g., accountants, solicitors, doctors.

Company:

- Organised as a separate legal entity and owned by shareholders:
 - e.g., BHP, CSR, Westpac, RM Williams.
- Most companies have limited liability.

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History of Regulation of Accounting

- Over time, Generally Accepted Accounting Principles (GAAP) were developed to guide the practice of accounting.
- As entities grew in size and complexity, more formal rules for accounting were required.
- Today, 'accounting standards' are mandatory for many entities to follow in the preparation of financial statements.

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History of Regulation of Accounting (continued)

- While these accounting standards provide 'rules' for dealing with various accounting issues, there exists an underlying 'conceptual framework' upon which the standards should be based.
- This framework attempts to derive a theory for determining the information to be provided in financial statements.

HIERARCHY OF ACCOUNTING REGULATION

1. **CONCEPTUAL FRAMEWORK**
The theory!!!!!!



2. **ACCOUNTING STANDARDS**
The rules!!!!!!

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What is the Conceptual Framework?

- The conceptual framework can be considered the
- Think of it as the underlying **set of concepts** and **theory** that underpins accounting.
- The conceptual framework is used as the basis for developing specific accounting rules and regulations.
- It is a set of concepts which define the **NATURE, SUBJECT and CONTENT** of accounting"

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2 Components - in Summary:

1. SAC 1

a) Definition of a 'reporting entity' →

2. The AASB Framework

- a) The objective of general purpose financial reporting →
- b) The qualitative characteristics of information
- c) the assumptions underlying financial reports
- d) the five elements of accounting and the criteria for their recognition →

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1. Statement of Accounting Concepts (SAC)1

1a) Definition of the Reporting Entity

Specifies which entities are required to prepare financial statements!!!!!!

- Defines a 'Reporting Entity' as any entity in which it is reasonable to expect the existence of **users** who **depend** on general-purpose financial reports for information for making and evaluating resource allocation decisions.
- If an entity meets this definition, it must prepare financial reports.

↑
We will learn to apply this concept in a later in the semester!

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2. The AASB Framework

The AASB Framework contains the following:

- a) Assumptions underlying financial reports
- b) Objective of financial reports (Appendix Chapter 1)
- c) Qualitative characteristics of financial reports (Appendix Ch 3)
- d) Elements of financial reports and their recognition criteria

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2a. Assumptions underlying Financial Reports

1. Going Concern

Entity assumed to continue indefinitely

2. Accrual Basis

records transactions when they occur rather than only when cash is received / paid

- DISCUSSED IN DETAIL NEXT WEEK!!!!!!
- Has since been removed as an assumption

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2b. Objective of Financial Statements

Found in the Appendix Chapter 1

To provide financial **information**:

- About the reporting entity that is **useful** to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity

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2c. Qualitative Characteristics of Useful Financial Information (Appendix Chapter 3)

Qualitative characteristics are the attributes that make the information provided in financial statements **USEFUL** to users

The characteristics are:

Fundamental Characteristics

- Relevance
 - Materiality (aspect of relevance)
- Faithful representation (Reliability)

Enhancing Characteristics

- Comparability
- Verifiability
- Timeliness
- Understandability

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Qualitative Characteristics of Financial Reports

Relevance: if it influences users' economic decisions through feedback or confirmatory value and comparability

Faithful Representation: complete, neutral and free from error

Materiality: does its omission or misstatement affect decision making

Understandability:

Comparability: must be able to compare financial statements over time and between entities

Verifiability: different knowledgeable and independent observers can reach consensus

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2d. Elements of Financial Statements

There are **five** elements of accounting:

1. Assets
2. Liabilities
3. Owner's Equity
4. Income
5. Expenses

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1. Assets

Definition:

“... a resource controlled by the entity as a result of a past event and from which future economic benefits are expected to flow to the entity”

Essential characteristics:

For non accounting students
one word

object that gives you **BENEFIT**

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Definition Criteria for Assets

(1) Future economic benefits (service potential)

- Potential to contribute, directly or indirectly, to the flow of cash to the entity
- Generate cash flows through the sale of, or use of, the asset

(2) Control by the entity

- Capacity of the entity to benefit from the asset and deny or regulate the access of others
- Does not necessary mean ownership (e.g., leases)
- Does the entity control the resource?

(3) Occurrence of past event

- Transaction or other event giving the entity control of the asset must have occurred
- e.g. Asset purchase or Non-reciprocal transfer (donation/grant)

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Recognition Criteria for Assets

Once the definition is satisfied, an asset should only be recognised (included) in the financial reports if the recognition criteria are satisfied!

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Recognition Criteria for Assets

The essential components of the recognition criteria are:

(1) Probable future economic benefits

- More likely than not
- Greater than 50% chance of occurring

(2) Reliable measurement

- Transaction to verify the cost
- Reasonable estimate
 - E.g., internally generated goodwill, brand names (Coke)?

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Important Terms

Recognised

- *Meets definition AND recognition criteria* and is therefore **included** in the **financial reports**

Disclosed

- *Meets definition but NOT recognition criteria* and is therefore **included** as a **note** to the **financial reports**

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Example - Assets

'Mike's Inner City Cab Service'
purchased a taxi for \$49,000 to carry
passengers around Melbourne.



Does the taxi meet the definition and recognition of an asset?

What do you think?

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Example - Assets

'Mike's Inner City Cab Service'
purchased a taxi for \$49,000 to carry
passengers around Melbourne.



Does the taxi meet the definition of asset?

- Provides future economic benefits? ✓ Yes
- Controlled by Mike? ✓ Yes
- Result of a past transaction? ✓ Yes

Do not do this!!!!!!
Do not do this!!!!!!

Example - Assets

Definition Criteria

I do not mind Yes because

(1) Future economic benefits

(2) Control by the entity

- In this scenario, the company purchased the taxi and can do what they like with the taxi. (i.e., modify it, sell it, paint it)
- They can deny or regulate the access of others.
- They have legal ownership of the taxi.

(3) Occurrence of past event

- Yes, the purchase of the taxi.

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Does it get put into report?

Recognition Criteria

• Probable occurrence

- Yes, it is highly likely that the company will use the taxi to transport customers and therefore derive the future economic benefits (cash inflows).

• Reliable Measurement

- The cost of the taxi can be reliably measured.
- The amount was stipulated as \$49,000 in the sales contract.

Conclusion

- As the purchase meets the asset definition and recognition criteria, Mike's Inner City Cab Service would recognise it as an **asset**.

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2. Liabilities

Definition:

“... 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”

Essential characteristics:

For non accounting students
one word
anything you **OWE**

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Definition Criteria for Liabilities

(1) Future outflow of economic benefits

- Settlement of the present obligation
 - E.g., bank contract specifies future outflow
 - Giving up resources to settle the obligation

(2) Present obligation

- Legally enforceable obligations (consequences)
 - Contractual arrangements (e.g., a bank loan)
- Good business practice or equitable obligations (e.g., repair faults outside warranty period)
- Constructive obligation – based on a pattern of events (e.g., paying out year-end bonuses regularly)
- Equitable obligation - fairness
- Does not include future commitments (e.g., decision to purchase asset in the future)

(3) Occurrence of past event

- Transaction creating the present obligation must have occurred
 - A present obligation cannot be created by a future transaction

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Recognition Criteria for Liabilities

The essential components of the recognition criteria are:

(1) Probable future outflow of economic benefits

- More likely than not
- Greater than 50% chance of occurring
- E.g., a pending decision in a law suit

(2) Reliable measurement

- Transaction to verify the cost
- Reasonable estimate

You will notice these are the same criteria as considered for assets

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Example - Liabilities

'Mike's Inner City Cab Service'
borrowed \$43,000 from the Bank
to purchase the taxi.



Does the bank loan meet the definition and recognition of a liability?

Example - Liabilities

Definition Criteria

- **Future outflow of economic benefits**
- **Present obligation**
 - Yes, the company is legally obliged to repay funds borrowed from the bank under the loan contract it entered into.
- **Past transaction**
 - Yes, entering into the loan contract.

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Recognition Criteria

- **Probable occurrence**
 - Yes, the company is legally obligated to repay funds and failure to do so will result in financial recourse. As such, it can be argued that it is more likely than not that the company will repay funds.
- **Reliable Measurement**
 - Yes, the loan amount of \$43,000 is stipulated in the contract.

Conclusion

- As the loan meets the liability definition and recognition criteria of the Conceptual Framework, Mike's Inner City Cab Service would recognise it as a liability.

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3. Owners Equity

Definition:

“... the residual interest in the assets of the entity after deduction of its liabilities”

This ‘definition’ is more of a formula, and creates the ‘Accounting equation’, the foundation of accounting:

Owner's Equity = *Assets* - *Liabilities*

or

Assets = *Liabilities* + *Owner's Equity*

FORMULA DISCUSSED IN DETAIL NEXT WEEK!!

For non accounting students
one word

WORTH or WEALTH of the business

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Owner's Equity - Example

'Mike's Inner City Cab Service' has a taxi worth \$49,000, and a bank loan of \$43,000 owing to the Bank. What is Mike's owner's equity?

Owner's Equity = Assets - Liabilities

\$6,000 = \$49,000 - \$43,000

This is Mike's **net wealth** in his business.

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4. Income (Revenue)

Definition:

“... 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”

Essential characteristics:

1. An inflow of economic benefits (increase in assets or decrease in liabilities)
2. Result in an increase in equity, but
3. Excludes owner's contributions of equity

For non accounting students

action that makes us **BETTER OFF**

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Definition Criteria for Income

(1) **Inflows** (*increases in assets or decreases in liabilities*)

- Cash / credit sale (enhances debtors) / or forgiveness of debt (e.g., discount received)

(2) **Resultant increase in equity**

- Increase in net wealth

(3) **Other than contributions by equity participants**

- Income can not be capital contributed by owners

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Recognition Criteria for Income

The essential components of the recognition criteria are:

(1) **Probable future inflows**

- More likely than not
- Greater than 50% chance of occurring

(2) **Reliable measurement**

- Transaction to verify the cost
- Reasonable estimate
 - E.g., internally generated goodwill, brand names (Coke)?

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Example - Income

'Mike's Inner City Cab Service' received \$10 from a passenger for a short trip in Melbourne.



Does the taxi fare meet the definition and recognition of income?

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Definition Criteria

(1) Inflows (increase in assets or decreases in liabilities)

(2) Resultant increase in equity

- Yes, assets (via cash) are increased (& no effect on liabilities) therefore equity increases

(3) Other than contributions by equity participants

- Yes, the cash was not contributed by Mike

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Recognition Criteria

• **Probable occurrence**

- Yes, Mike has provided the service and has already received the cash

• **Reliable Measurement**

- Yes, the taxi would have a trip meter device that can accurately charge customers and provide an invoice. In this instance, \$10

Conclusion

- As the taxi fare meets the income definition and recognition criteria of the Conceptual Framework, Mike's Inner City Cab Service would recognise it as income

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5. Expenses

Definition:

"...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"

Essential characteristics:

1. An outflow of economic benefits (decrease in asset or increase in liability)
2. Result in a decrease in equity, but
3. Excludes distributions to owners

For non accounting students

action that makes us **WORSE OFF**

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Definition Criteria for Expenses

(1) **Outflows** (decrease in assets or increase in liabilities)

- Salaries paid or owed

(2) **Resultant decrease in equity**

- Reduction in net worth

(3) **Other than distributions to equity participants**

- Not dividends or withdrawals (drawings) by owner

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Recognition Criteria for Expenses

The essential components of the recognition criteria are:

(1) **Probable outflow**

- More likely than not
- Greater than 50% chance of occurring

(2) **Reliable measurement**

- Transaction to verify the cost
- Reasonable estimate
 - E.g., internally generated goodwill, brand names (Coke)?

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Example- Expenses

'Mike's Inner City Cab Service' used \$100 worth of petrol after transporting passengers.



Does the use of the petrol meet the definition and recognition of an expense?

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Example- Expenses

(1) **Outflows** (decrease in assets or increase in liabilities)

- Yes, Mike used the fuel so there is a decrease in an asset (fuel)

(2) **Resultant decrease in equity**

- Yes, the decrease in the asset (fuel) results in a decrease in equity

(3) **Other than distributions to equity participants**

- Yes, it was not a distribution to Mike

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Recognition Criteria

• **Probable occurrence**

- Yes, Mike has already used the fuel.

• **Reliable Measurement**

- Yes, the fuel company would have provided us with a receipt that documents the initial cost of the fuel (\$100) and therefore we can quantify the usage amount.

Conclusion

- As the usage of the fuel meets the expense definition and recognition criteria of the Conceptual Framework, Mike's Inner City Cab Service would recognise it as an expense.

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Students should be able to:

- Understand the definitions and recognition criteria of the elements
- Apply to an unusual transaction



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Approach to Answering a Question on How to Record this Unusual Transaction

1. Identify 2 element **S**
2. Analyse Definition step by step for the first element
3. Analyse Recognition criteria step by step for the first element
4. Repeat steps 2 & 3 for the second element
5. Conclusion

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Template

Definition	
Future Economic Benefits	
Control	
Past Event	
Recognition Criteria	
Probable	
Reliable Measurement	
Conclusion	



Put it Into Practice



[HOME](#)
[THE HORSE](#)
[LEAVING AUSTRALIA](#)
[THE LEGEND](#)
[THE FACTS](#)

[THE PHAR LAP STORY](#)
[E-CARDS](#)
[AT THE MUSEUM](#)



Phar Lap: Australia's wonder horse

He triumphed during the Great Depression of the early 1930s, when a hero was most needed by the people of Australia.

He conquered the local racing scene—36 wins from his last 41 starts—and then won North America's richest race, the Agua Caliente Handicap, in 1932.

A fortnight later he went to the great equine heaven in the skies, struck down by a mystery illness that many suspected was the work of gangsters.

AUSTRALIA'S WONDER HORSE



Question 1

- You own a Museum.
- The owner of the horse, Phar Lap (one of the greatest horses to ever race), has donated him to your museum as a gift
- (after taxidermy)



How should the museum account for this gift using the Conceptual Framework for guidance?



Step 1

1. Identify two possible elements



Asset

Definition	
Future Economic Benefits	
Control	
Past Event	
Recognition Criteria	
Probable Occurrence	
Reliable Measurement	
Conclusion	

	
Income	
Definition	
Inflow through increase in A or decrease in L	
Results in an increase in OE	
Not an owner's contribution	
Recognition Criteria	
Probable Occurrence	
Reliable Measurement	
Conclusion	

	
Learning Objectives	
1. Define what accounting is	
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