

ACCOUNTING PRINCIPLES AND QUALITATIVE CHARACTERISTICS

The following accounting principles and qualitative characteristics underpin each of Units 1 to 4.

The explanations come from The Financial Reporting Handbook of 2010 (Institute of Chartered Accountants Australia, John Wiley & Sons, pages 27–31). Where appropriate, the accounting procedures developed in each unit should incorporate the application of accounting principles and the qualitative characteristics of accounting information.

Accounting principles

Entity

The business must be a separate accounting entity from its owner and from other entities. It is important to identify for whom the preparation of financial reports is being conducted. A common illustration of the entity principle is seen in the way in which the business will have separate records from the owner.

Reporting period

The ongoing life of a business is broken into regular intervals of time for the preparation of financial reports. Under accrual accounting profit is revenue earned less expenses incurred in that period.

Conservatism

It is acknowledged that gains will not be recognised until earned and losses will be recognised as soon as they are likely to occur. This principle is followed so as not to overstate assets and revenues and not understate liabilities and expenses.

Historical cost

All transactions are recorded at their original value. Therefore, items are shown in the accounting records at their historical (original) price.

Going concern

It is assumed that the business will be ongoing, i.e. the business will have an indefinite life. The purpose of this rule is so that a distinction can be made between

assets, which will provide benefit to future reporting periods, and expenses that are totally consumed within one reporting period.

Consistency

The accounting methods used by the business should be applied consistently from one reporting period to another. This allows valid comparisons of performance to be made.

Monetary unit

To understand the meaning of the reported information it is necessary to use a common unit of measurement. Australian dollars are used as this measure.

Qualitative characteristics

Relevance

To be useful, information must be relevant to the decision-making needs of users. Information has the quality of relevance when it influences the economic decisions of users by helping them evaluate past, present or future events or confirming, or correcting, their past evaluation. The relevance of information is affected by its nature and materiality. In some cases, the nature of information alone is sufficient to determine its relevance. In other cases, both the nature and materiality are important. Information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial report. Materiality depends on the size of the item or error judged in the particular circumstances of its omission or misstatement. Thus, materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic which information must have if it is to be useful.

Reliability

To be useful, information must also be reliable. Information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully that which it either purports to represent or could reasonably be expected to represent. If information is to represent faithfully the transactions and other events that it purports to represent, it is necessary that transactions are accounted for and presented in accordance with the transactions' substance and economic reality and not merely their legal form. To be reliable, the information contained in financial reports must be neutral, that is, free from bias. Financial reports are not neutral if, by the selection or presentation of information, they influence the making of a decision or judgment to achieve a predetermined result or outcome.

Comparability

Users must be able to compare the financial reports of an entity through time to identify trends in the entity's financial position and performance. Users must also be able to compare the financial reports of different entities to evaluate their relative financial position, financial performance and cash flows.

Hence, the measurement and display of the financial effect of like transactions and other events must be carried out in a consistent way throughout an entity and over time and in a consistent way for different entities.

Understandability

An essential quality of the information provided in financial reports is that it is readily understandable by users. For this purpose, users are assumed to have a reasonable knowledge of business, economic activities and accounting, and a willingness to study the information with reasonable diligence. However, information about complex matters should be included in the financial report because of its relevance to the economic decision-making needs of users, and should not be excluded merely on the grounds that it may be too difficult for certain users to understand.

GOODS AND SERVICES TAX

The Goods and Services Tax (GST) is to be included throughout the study design, except where it has been specifically excluded as shown in the relevant key knowledge dot points.

STOCK GAIN

Stock gains are to be determined by using the lowest available price in the balance column of the stock card, as required by the conservatism accounting principle.

STOCK LOSS

Stock losses are to be determined by following the First-In, First-Out (FIFO) assumption.

SALES RETURNS

Sales returns are to be calculated by using the latest issued cost price in the stock card (i.e. reversing the last out).

PURCHASES RETURNS

Purchases returns are to be calculated by using the cost price identified by supplier's credit note.

14 VCE STUDY DESIGN

ACCOUNTING 2012–2016 Characteristics of the study

FINANCIAL INDICATORS

Financial indicator Calculation Expressed as

Gross Profit Margin $\frac{\text{Gross Profit}}{\text{Sales}} \times 100$

percentage

Net Profit Margin $\frac{\text{Net Profit}}{\text{Sales}} \times 100$

percentage

Return on Assets $\frac{\text{Net Profit}}{\text{Average Total Assets}} \times 100$

percentage

Return on Owner's Investment $\frac{\text{Net Profit}}{\text{Average Capital}} \times 100$

percentage

Asset Turnover $\frac{\text{Sales}}{\text{Average Total Assets}}$

times per period

Creditors Turnover $\frac{\text{Credit Purchases}}{\text{Average Creditors}} \times 365$

number of days

Debtors Turnover $\frac{\text{Credit Sales}}{\text{Average Debtors}} \times 365$

number of days

Stock Turnover $\frac{\text{Cost of Goods Sold}}{\text{Average Stock}} \times 365$

number of days

Cash Flow Cover $\frac{\text{Net Cash Flow from Operating Activities}}{\text{Average Current Liabilities}}$

times per period

Quick Asset Ratio $\frac{\text{Current Assets} - (\text{Stock} + \text{Prepayments})}{\text{Current Liabilities} - \text{Bank Overdraft}}$

ratio

quick assets:1

Working Capital Ratio $\frac{\text{Current Assets}}{\text{Current Liabilities}}$

ratio

current assets:1

Debt Ratio $\frac{\text{Total Liabilities}}{\text{Total Assets}} \times 100$

percentage

Total Assets

percentage