

Essential Insight – Course Guide

Accounting and Finance Year 12 ATAR

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<p>Resource Hub Link: https://www.eibooks.com.au/acf</p> <ul style="list-style-type: none"> • Worked solutions to all questions. • Learning and Teaching Resources that align with book chapters. • SCSA Syllabus categorised to align with book chapters. • Current Sponsorship Opportunities • Community Partnership Opportunities • + Much more 	
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Accounting and Finance has components which are theoretically focused, and others which are primarily practically focused with some supporting theory. The table below breaks down what each textbook includes and how these can be used.

Textbook	This textbook includes:	This textbook is useful for:
Course Guide	<ul style="list-style-type: none"> • Theory for the theory-focused chapters of the course. • Student review questions for the theory focused chapters to assist student mastery of theory and useful for revision prior to assessments. • Key summary information from the practically focused chapters. <p>Note: Elaborated step-by-step explanation of practical chapters with practical review questions are included in the Practical Guide.</p>	<ul style="list-style-type: none"> • Student learning and teaching of theory chapters with practice questions. • Revising both theory and practical chapters when completing practice questions or revising prior to assessments. <p>Note: This textbook is similar in nature to a revision guide for the entire course, but it is also adequate for the learning and teaching of the theory chapters.</p>
Practical Guide	<ul style="list-style-type: none"> • All practical and theory for practical-focused chapters. • Step-by-step worked examples and practice questions to scaffold students from initial concept attainment to exam level. <p>Note: Chapters which are primarily theory-focused are included in the Course Guide.</p>	<ul style="list-style-type: none"> • Student learning and teaching of practical content-adjacent to relevant theory. • Student practice of practical chapters.
Exam Guide	<ul style="list-style-type: none"> • SCSA Year 12 exams categorised to match the chapters of the course and practical guides. 	<ul style="list-style-type: none"> • Student practice of exam questions at the end of all chapters of the textbook and prior to assessments.

These textbooks have been written succinctly whilst also covering all necessary content and skills required from initial concept attainment to exam level. The thorough nature of this book provides confidence that this resource contains all skills and content needed to achieve top ATAR results. The succinct nature of these textbooks is designed to assist with reducing barriers for all students. This succinct nature should also allow students to spend less time taking notes and more time applying higher order skills to gain mastery.

There are several research tasks throughout the textbooks that allow students to develop research skills and the ability to decipher paragraphs of text to apply relevant skills. These can also be adapted to be used as assessment project tasks.

A PDF copy of the textbook is available for teachers for use of projecting the textbook during class. If interested, please contact the email address on the Resource Hub linked on this cover page.

Chapters	
Unit 3	Unit 4
1. Introduction to Management and Financial Accounting 2. Internal and External Audit 3. Internal Control and Asset Management 4. Insolvency 5. Sources of Finance 6. Investment Options 7. Corporate Social Responsibility (CSR) 8. Cost Accounting 9. Cost-Volume-Profit Analysis (CVP) 10. Budgets 11. Business Planning 12. Capital Investment	13. Accounting Standards 14. AASB Conceptual Framework for Financial Reporting 15. Companies 16. Regulatory Bodies 17. Corporate Social Disclosure (CSD) 18. Cash Flows 19. Key Performance Indicators (KPIs) 20. Ratios

Chapters highlighted in blue are theory-focused chapters. Chapters highlighted in green are practical-focused chapters.

Foreword from Chartered Accountants Australia & New Zealand To Essential Insight Accounting and Finance Students

What does it mean to be an accountant?

If you're reading this, you already have an aptitude or interest in numbers and problem solving, but accounting careers are about so much more than that.

While the subjects you choose during high school will help you shape your futures, the beauty of accounting is that its relevant to any career you choose.

Accountants are woven throughout the global economy. A career in accounting opens doors in just about every corner of the world, across sectors, industries and businesses of every size.

Indeed, we'd like to tell you that accounting offers you a pathway to turn your passions into a career because it's hard to think of an industry or sector that doesn't have an accountant helping guide the big decisions.

Behind every athlete, every business big or small, every brand you love, every game you lose yourself in, there are financial experts making epic things possible. As an accountant, you're the go-to problem solver, using your money smarts and business skills to help your company or clients reach their goals.

And for the foreseeable future, there's huge demand for accountants. If you're seeking job security, global experiences, excellent earning potential, a dynamic lifestyle, influence, and you thrive on challenges, accounting could be your pathway to a fulfilling, impactful and epic career.

If you're interested in learning more about careers in accounting, we've teamed up with Year 13 to show you there's more to accounting than meets the eye. Visit year13.com.au/academy/business-class to learn more and consider joining our student membership program at cacanz.com/epic-future.

Until we see you in the accounting profession, continue to be passionate about your studies and dream big!

Samantha Wilson FCA
General Manager, CA Program



Why a career in accounting is the ultimate flex



You're at the heart of every business

Behind every athlete, every business big or small, every brand you love, and every game you lose yourself in, there is a financial expert making epic things possible.

As an accountant, you're the go-to problem solver, using your money smarts and business skills to help your company or clients reach their goals. It's about putting together clues to create a plan for the business, looking at the big picture, and coming up with a clever strategy for success.

You can be whatever you want

Accounting can open the door to just about any industry your heart desires. Imagine being the mastermind behind the next big social media sensation, the genius orchestrating live events and music festivals, or a change-maker in a not-for-profit organisation.

Explore exciting fields like sports, entertainment, gaming and tech. You could even roll with big names like Disney, Nike, and YouTube.

The top 10 perks of accounting

- 1. Job security:** You'll always be hot property.
- 2. Awesome earning opportunities:** Live the good life earning the big bucks.
- 3. Travel the world:** With skills as your passport, the world's your oyster.
- 4. Work in any industry:** Pursue your passions.
- 5. Fresh opportunities:** New gigs are always popping up.
- 6. Varied roles:** On the roles buffet, pick your fave flavour.
- 7. Climb high:** Follow the footsteps of big-shot CEOs.
- 8. Earn respect:** This career's got major street cred.
- 9. Transferable skills:** Pack up your skills and take them to any industry you fancy.
- 10. Life-work balance:** Live your best life while enjoying an awesome career.



Unlock a world of opportunities and skills



Accounting is your ticket to freedom

In Australia and New Zealand, accounting is one of the largest professions and is where the cash is at. Grads pull in an average annual salary* of \$60,000. But CA-certified pros? They're cashing in up to \$175,000 (oh yeah!).** The best part? You can work anywhere in the world – in your dream industry.

Less number crunching, more epic

AI's got your back. It's transforming the way modern accountants work. Now you can focus on the exciting stuff – you're a data wizard, insights detective, and strategic mastermind!

Skills that can take you anywhere!

Do you dream of growing a side hustle, becoming an entrepreneur, or a champion for social justice? Accounting skills can make it happen.

- Be a problem-solving pro
- Hone your decision making game
- Polish your people skills
- Level up on logic and fairness
- Be money wise in business and life

* Indicative average only – exact salary will depend on location, industry, and role. Hays Salary Guide FY23/24 Accounting and Finance.

** Data obtained for senior qualified accountants in managerial roles in Queensland, Australia. Hays Salary Guide FY23/24 Accounting and Finance.

TIP: Accounting skills like *problem-solving, negotiation, and analytical thinking, can help you get ahead both in your career and your life.*

Real accountants (CAs) making epic things happen



Meet Amanda Gore CA

Crime Fighter

Founder and Director of The Centre for Global Advancement (C4GA).

- She's a real-life crime fighter based in Kenya.
- Combats wildlife and environmental crime by following money trails.
- Travels globally training authorities to detect and investigate financial crimes.
- Is passionate about helping the planet.



Meet Rishabh Tandon CA

Business Trailblazer

Music Licensing Expert at YouTube.

- He's Aussie-born, and now lives and works in New York City.
- Collaborates with music artists, songwriters, and creators.
- Ensures musicians get rewarded for their creativity.
- Has turned his passion for music and travel into a career.



Meet Rebecca Glover CA

Community Empowerer

Senior Finance Director at World Vision.

- She works for the world's biggest humanitarian organisation.
- Ensures World Vision's resources are put to their best use.
- Finds working in a not-for-profit to be incredibly fulfilling.
- Is driven by her passion to create a brighter, better world.

What's next? Uncover the steps for an epic future

1

Get a head start

There are no prerequisites you need to study in high school. But diving into subjects like business, enterprise studies, accounting, agriculture, maths, technology, economics, and science, can help you get ahead of the game!

2

Explore your interests

Discover the ins and outs of the businesses, brands and causes you're passionate about.

3

Gain practical experience

Ask to do some interning at a local business. Some places take high school students as 'cadets', so you could kick-start your career right from high school.

4

Complete high school

Do your HSC (AU) or NCEA (NZ).

Study accounting

Apply for and complete an undergraduate qualification, such as a Bachelor of Accounting, Bachelor of Business or Commerce with a major in accounting. Or consider an accounting or business diploma from a Polytech or TAFE, or other government-registered higher education provider.

5

6

Start your career

Make epic things happen in an industry you love.

Boost your career

In today's fast-paced world, professionals need an edge, and the CA Program's globally recognised qualification provides exactly that.

7

TIP: Look into programs like the Year13's Virtual Work Experiences to get a taste of the business world and the skills that'll help you succeed.

Top tips from accounting students



Mitchell

"It's remarkable how many CEOs and directors of large companies are Chartered Accountants. Studying accounting can lead you to incredible opportunities."

Bachelor of Business and Accounting student at Monash University, Australia.

"I understand the pressure of making a career choice in high school. Gather as much information as possible to make an informed decision. Attend information nights or networking events. Now's the best time to explore all your options."

Bachelor of Commerce (Accounting and Finance) student at the University of Auckland, New Zealand.



Kjirsti



Benjamin

"With accounting skills you could work in London in a big corporate firm, or stay local and support small businesses. Clarify your goals, dreams and ambitions, then pursue your degree and work hard. When you look up, you'll find you have all you want and more."

Bachelor of Commerce (Accounting and Taxation) student at the University of Canterbury, New Zealand.



TIP: Have questions? Ask us anything or request a school visit from our awesome speaker squad (CAs and accounting students) to share their real-world stories and insights.

How to become Financially Independent and Retire Early (FIRE) for Essential Insight Accounting and Finance Students



Dave Gow, author of Strong Money Australia.

Who am I?

Hi, my name is Dave Gow from Perth, Western Australia. I became financially independent and retired at the age of 28. My partner and I achieved financial independence whilst working regular jobs with yearly incomes of around \$75,000 and without going to university. What allowed us to achieve FIRE was the application of strong, tried and tested, financial principles. Now that I'm financially independent I have the freedom to pursue my passions such as environmental volunteering and helping others learn about how to use their money to create freedom. I do this through my book, blogs and podcasts, and articles written for leading investment platforms.

Tim Coveney, the author of the ACF ATAR book you are reading, told me that many ACF ATAR students are interested in the idea of becoming financially independent and possibly having the option to retire early. Whilst the ACF ATAR course doesn't specifically teach financial independence, studying financial independence will help build your financial literacy skills and be useful personally and professionally. I have created a range of resources to share with you on the following links which will help bridge the gap between what you learn while studying ACF ATAR and FIRE.

Resource links

The below resources are designed to help you start your journey learning about FIRE. You may enjoy discussing these concepts with your teachers, parents and friends.

	Beginner's Guide to FIRE	Strong Money Australia Book
QR Code		
Link	https://strongmoneyaustralia.com/beginners/	https://strongmoneyaustralia.com/book/
Description	Here you'll find everything you need to know about how to start working towards financial independence. Articles, podcasts, Q&A, and free eBooks.	Dave's book shares the complete roadmap to reaching financial independence in Australia. Available in paperback, eBook, and audiobook.

How can learning about FIRE help high school Accounting and Finance ATAR students?

There are many reasons why Accounting and Finance students should prioritise learning about financial independence. Achieving financial independence is not just about earning, it is about managing resources wisely and creating a sustainable financial future. Financial independence is essentially the ability to cover your living expenses without relying on a regular paycheck. By understanding the principles of financial independence students can develop a roadmap to achieve their own financial goals, such as buying a home, starting a business, and maybe even early retirement. This knowledge empowers you to take control of your financial future and make thoughtful decisions that give you more control over your life.

As accounting and finance students, the skillset you develop uniquely positions you to navigate the complexities of personal finance with precision and essential insight.

We all have to navigate the complexities of finance, such as loans, investments, superannuation, and money management. Learning about financial independence and wealth creation equips you with the mental and practical skills to make better financial decisions that align with your goals and avoid costly mistakes.

Understanding personal finance puts you way ahead of the game. You're able to move forward with confidence, and make informed decisions based on the knowledge you've gained. And as you build that strong foundation, you ensure a bright future in an area that most people struggle with. You can spot opportunities, overcome financial hurdles, and move through life with greater certainty.

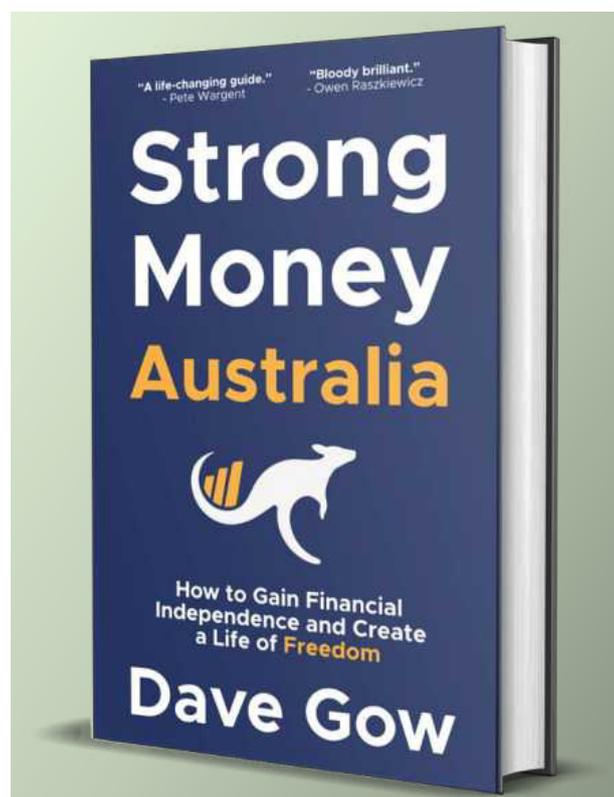
As future professionals in finance, you may be entrusted to advise others on similar matters. Acquiring expertise in the growing field of financial independence equips you to provide valuable guidance to clients, colleagues, or businesses.

But more than that, pursuing financial independence on a personal level gives you a profound sense of security, enabling you to pursue professional and personal goals with confidence. In essence, Integrating financial independence education into your studies benefits you personally, and also prepares you to be a well-rounded and capable financial professional.

Embrace the journey toward financial independence and let your financial acumen serve as a cornerstone for a secure and fulfilling future.

Wishing you all the best for your future studies,

Dave Gow
Strong Money Australia



Strong Money Australia by Dave Gow.
A book on How to Gain Financial Independence and Create a Life of Freedom.



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Ainokura, Gokayama.

Syllabus – Unit 3

Syllabus – Unit 3	
Introduction to Management and Financial Accounting	<p>Financial institutions and systems: Financial systems and fundamental principles</p> <ul style="list-style-type: none"> distinguish between management accounting and financial accounting <p>Recording, using and evaluating financial information: Evaluating financial information for planning, coordinating, controlling and investing</p> <ul style="list-style-type: none"> differences between internal and external reporting, including: <ul style="list-style-type: none"> users: internal and external regulation: accounting standards types of financial statements types of reports the role and function of the accountant in managing business operations
Internal and External Audit	<p><i>Note: External audit is Unit 4 but is included here given the nature of examination questions to compare 'internal and external audit'.</i></p> <p>Government and the community: The role and influence of governments and other bodies</p> <ul style="list-style-type: none"> the function of the external audit, including: <ul style="list-style-type: none"> protecting external users providing confidence to stakeholders in Australian capital markets the role of the external auditor appointed by the shareholders and reappointed at the annual general meeting (AGM) <ul style="list-style-type: none"> perform an independent audit of the financial statements <p><i>Note: The below syllabus sections are in both 'internal control and asset management' and 'internal and external audit' given the overlap in syllabus but distinctly different content/ examination questions.</i></p> <p>Recording, using and evaluating financial information: Evaluating financial information for planning, coordinating, controlling and investing</p> <ul style="list-style-type: none"> internal audit and control, including: <ul style="list-style-type: none"> purpose of internal audit review of business procedures and policies detection and correction of errors and deficiencies
Internal Control and Asset Management	<p>Financial institutions and systems: Financial systems and fundamental principles</p> <ul style="list-style-type: none"> the important financial principles of asset management <ul style="list-style-type: none"> appropriate levels of investment in non-current assets appropriate management of accounts receivable, inventory and cash appropriate management of short and long term debt appropriate level of equity capital <p><i>Note: The below syllabus sections are in both 'internal control and asset management' and 'internal and external audit' given the overlap in syllabus but distinctly different content/ examination questions.</i></p> <p>Recording, using and evaluating financial information: Evaluating financial information for planning, coordinating, controlling and investing</p> <ul style="list-style-type: none"> internal audit and control, including: <ul style="list-style-type: none"> purpose of internal audit review of business procedures and policies detection and correction of errors and deficiencies <p><i>Note: Internal audit is in a separate chapter but the syllabus point emphasises how these topics are linked.</i></p>
Insolvency	<p>Government and the community: The role and influence of governments and other bodies</p> <ul style="list-style-type: none"> the concept of insolvency as defined by the Corporations Act 2001 <ul style="list-style-type: none"> alternative actions for insolvent companies, including: <ul style="list-style-type: none"> voluntary administration liquidation receivership order of priority of the distribution of funds when insolvent
Sources of Finance / Investment Options	<p>Financial institutions and systems: Financial institutions</p> <ul style="list-style-type: none"> role of financial institutions and the management of business finance <ul style="list-style-type: none"> short term: cash management trusts, money market and term deposits long term: shares, debentures, unsecured notes, trusts and term deposits the management of business finance with short term and long term perspectives
Corporate Social Responsibility (CSR)	<p>Government and the community: The influence of social, environmental and ethical factors</p> <ul style="list-style-type: none"> identification of the costs and potential income associated with engaging in socially and environmentally responsible practices the ethical issues encountered in financial dealings between business owners/managers and their employees, clients and investors
Cost Accounting	<p>Financial institutions and systems: Financial systems and fundamental principles</p> <ul style="list-style-type: none"> the nature of cost concepts for materials, labour and overheads classification of cost <ul style="list-style-type: none"> behaviours: fixed, variable and mixed costs relationships to cost objects: direct and indirect costs treatment of costs: product and period time orientation of costs: past and future the concept of mark up and the calculation of the unit price of a product <p>Recording, using and evaluating financial information: Recording, processing and communicating financial information</p> <ul style="list-style-type: none"> cost accounting limited to calculation of the unit price of a product/service using only job order costing processes <ul style="list-style-type: none"> calculation of direct materials, direct labour and overhead costs calculation and application of predetermined overhead recovery rates only using normal capacity calculation of unit cost and the setting of selling/quotation prices for a job costing product/service use of standard costing and variance analysis for: <ul style="list-style-type: none"> materials price and usage labour rate and efficiency

Syllabus – Unit 3

<p>Cost Volume Profit (CVP)</p>	<p>Financial institutions and systems: Financial systems and fundamental principles</p> <ul style="list-style-type: none"> explain the relationship between volume of activity, costs and profit <p>Recording, using and evaluating financial information: Evaluating financial information for planning, coordinating, controlling and investing</p> <ul style="list-style-type: none"> cost-volume-profit (CVP) analysis for decision making purposes <ul style="list-style-type: none"> cost behaviour contribution margin break-even point margin of safety interpretation of CVP results and testing of sensitivity to changing decisions about: <ul style="list-style-type: none"> volumes, product mixes, pricing and costs and the impact of capacity constraints make or buy decisions close down product/business unit decisions accept or reject special orders decisions <p>Recording, using and evaluating financial information: Recording, processing and communicating financial information</p> <ul style="list-style-type: none"> cost-volume-profit (CVP) processing for a single and multi-product (maximum three products) business <ul style="list-style-type: none"> calculation of contribution margin calculation of contribution margin per unit calculation of weighted average contribution per unit calculation of margin of safety calculation of selling price, variable cost, fixed cost, profit or sales volume calculation of break-even point calculation of the effect on profit/loss of make or buy decisions calculation of the effect on profit/loss of closing a department/dropping a segment product decision calculation of the gain or loss on special order decisions
<p>Budgets</p>	<p>Financial institutions and systems: Financial systems and fundamental principles</p> <ul style="list-style-type: none"> the nature and importance of the master budget the components of the master budget <ul style="list-style-type: none"> operating capital expenditure financial <p>Recording, using and evaluating financial information: Evaluating financial information for planning, coordinating, controlling and investing</p> <ul style="list-style-type: none"> purpose and function of cash budgets <ul style="list-style-type: none"> importance of cash to business viability interpretation of cash budgets purpose and function of budgeted income statement interpretation of budgeted income statement difference between cash and accrual performance purpose and function of performance reports interpretation of performance reports for cash budgets and budgeted income statements <p>Recording, using and evaluating financial information: Recording, processing and communicating financial information</p> <ul style="list-style-type: none"> preparation of cash budgets, including debtors' and creditors' schedules preparation of budgeted income statements preparation of performance reports for cash budgets and budgeted income statement <p><i>Note: The below syllabus section is in both 'capital investment' and 'budgets' given the overlap in syllabus but distinctly different content/examination questions.</i></p> <p>Evaluating financial information for planning, coordinating, controlling and investing</p> <ul style="list-style-type: none"> interpretation of capital investment/budgeting techniques to evaluate capital expenditure
<p>Business Planning</p>	<p><i>Note: Some of the below syllabus sections are in both 'business planning' and 'capital investment' given the overlap in syllabus but distinctly different content/ examination questions.</i></p> <p>Recording, using and evaluating financial information: Evaluating financial information for planning, coordinating, controlling and investing</p> <ul style="list-style-type: none"> importance of business planning, including a consideration of: <ul style="list-style-type: none"> goals, objectives and generic business strategies: cost leadership versus differentiation, strategic initiatives and performance management reducing costs and risk
<p>Capital Investment</p>	<p>Recording, using and evaluating financial information: Recording, processing and communicating financial information</p> <ul style="list-style-type: none"> capital investment/budgeting techniques for capital expenditure, limited to calculations for cash flows using straight-line depreciation method only and net of taxation <ul style="list-style-type: none"> discounted cash flows [net present value (NPV) only] payback period <p>Financial institutions and systems: Financial systems and fundamental principles</p> <ul style="list-style-type: none"> nature and importance of capital investment decisions concept of the time value of money factors affecting capital investment decisions, including: <ul style="list-style-type: none"> consumer preferences competition government regulation <p><i>Note: Some of the below syllabus sections are in both 'business planning' and 'capital investment' given the overlap in syllabus but distinctly different content/ examination questions.</i></p> <p>Recording, using and evaluating financial information: Evaluating financial information for planning, coordinating, controlling and investing</p> <ul style="list-style-type: none"> interpretation of capital investment/budgeting techniques to evaluate capital expenditure <ul style="list-style-type: none"> reducing costs and risks <p><i>Note: The below syllabus section is in both 'capital investment' and 'budgets' given the overlap in syllabus but distinctly different content/examination questions.</i></p> <p>Evaluating financial information for planning, coordinating, controlling and investing</p> <ul style="list-style-type: none"> interpretation of capital investment/budgeting techniques to evaluate capital expenditure

Syllabus – Unit 4

Syllabus – Unit 4	
Accounting Standards	<p>Financial institutions and systems: Financial systems and fundamental principles</p> <ul style="list-style-type: none"> • the purpose of accounting standards in: <ul style="list-style-type: none"> ▪ protecting external users ▪ assisting directors in discharging their obligations ▪ providing confidence to investors in Australian capital markets
AASB Conceptual Framework for Financial Reporting	<p>Financial institutions and systems: Financial systems and fundamental principles</p> <ul style="list-style-type: none"> • the purpose of the <i>Conceptual Framework</i> and its key elements <ul style="list-style-type: none"> ▪ the nature of the reporting entity ▪ the objective of general purpose financial reports ▪ evaluation and application of the fundamental and enhancing qualitative characteristics of financial information ▪ evaluation and application of asset, liability, income and expense recognition criteria
Companies	<p>Financial institutions and systems: Financial systems and fundamental principles</p> <ul style="list-style-type: none"> • characteristics of public and large proprietary companies <ul style="list-style-type: none"> ▪ liability of owners ▪ number of members and directors ▪ continuity of existence ▪ legal entity ▪ transferability of ownership ▪ separation of ownership and management <p>Government and the community: The role and influence of governments and other bodies</p> <ul style="list-style-type: none"> • the purpose and nature of the <i>Corporations Act 2001</i>, and its impact on company formation and operations <ul style="list-style-type: none"> ▪ powers and duties of directors ▪ a written constitution ▪ replaceable rules ▪ prospectus ▪ rights of shareholders <p>Recording, using and evaluating financial information: Recording, processing and communicating financial information</p> <ul style="list-style-type: none"> • preparation of the general journal and general ledger for the following: <ul style="list-style-type: none"> ▪ issue of ordinary shares payable in full on application ▪ bonus share issues ▪ interim and final dividends (recommended, declared or paid) ▪ share issue costs • preparation of the retained earnings ledger account, including: <ul style="list-style-type: none"> ▪ profit or loss ▪ dividends ▪ transfers to and from reserve accounts ▪ debit or credit opening balances <p>Recording, using and evaluating financial information: Recording, processing and communicating financial information</p> <ul style="list-style-type: none"> • preparation of financial statements in accordance with the <i>Conceptual Framework</i> and in accordance with the standards <ul style="list-style-type: none"> ▪ statement of comprehensive income (one statement version only) ▪ statement of financial position ▪ statement of changes in equity <ul style="list-style-type: none"> ○ retained earnings ○ equity ○ share capital ○ reserves • notes to financial statements/notes to accounts, limited only to: <ul style="list-style-type: none"> ▪ share capital ▪ other components of equity ▪ property, plant and equipment ▪ dividends <p>Note: preparation of the above financial statements is restricted to the following issues:</p> <ul style="list-style-type: none"> • revaluation of property, plant and equipment: non-depreciable assets only • cash dividends • bonus share issues • transfers to or from general reserve • preliminary expenses • issue of ordinary shares, including share issue costs • purpose and nature of the following balance day adjustments: <ul style="list-style-type: none"> ▪ accrued expenses ▪ prepaid expenses/stock of supplies ▪ accrued income ▪ income in advance ▪ doubtful debts ▪ depreciation • for the purpose of calculating income tax expense, profit before tax is deemed to equal taxable income
Regulatory Bodies	<p>Government and the community: The role and influence of governments and other bodies</p> <ul style="list-style-type: none"> • the nature and importance of the following groups which regulate and influence the general purpose financial reporting of companies in Australia: <ul style="list-style-type: none"> ▪ the Financial Reporting Council (FRC) ▪ Australian Securities and Investments Commission (ASIC) ▪ International Accounting Standards Board (IASB) ▪ Australian Accounting Standards Board (AASB) ▪ Australian Securities Exchange (ASX) ▪ lobby groups
Corporate Social Disclosure (CSD)	<p>Government and the community: The influence of social, environmental and ethical factors</p> <ul style="list-style-type: none"> • the extent and nature of corporate social disclosure • the difficulties faced by accountants in producing social and environmental information • the use made of corporate social disclosure by the company and other users • critical evaluation of corporate social disclosure as made by Australian companies

Syllabus – Unit 4	
Cash Flows	<p>Financial institutions and systems: Financial systems and fundamental principles</p> <ul style="list-style-type: none"> • Statement of Cash Flows as per AASB 107, including: <ul style="list-style-type: none"> ▪ benefits of the cash flow statement information ▪ concepts of cash and cash equivalents <p>Recording, using and evaluating financial information: Recording, processing and communicating financial information</p> <ul style="list-style-type: none"> • cash flow statement from comparative balance sheets and income statements using the direct method only – notes not required and GST not included <p>Recording, using and evaluating financial information: Evaluating financial information for planning, coordinating, controlling and investing</p> <ul style="list-style-type: none"> • interpretation of the movements in cash flow items
Key Performance Indicators (KPIs)	<p><i>Note: The below syllabus sections are in both the 'Ratios' chapter and 'Key Performance Indicators' chapter given the overlap in syllabus but distinctly different content/ examination questions.</i></p> <p>Recording, using and evaluating financial information: Evaluating financial information for planning, coordinating, controlling and investing</p> <ul style="list-style-type: none"> • examination and interpretation of annual reports, financial statements and stock exchange data to assess the position and performance of a public company • purpose of annual reporting and the use of key performance indicators by directors for accountability and decision-making purposes
Ratios	<p>Recording, using and evaluating financial information: Recording, processing and communicating financial information</p> <ul style="list-style-type: none"> • preparation of the following ratios – application of GST not required <ul style="list-style-type: none"> ▪ liquidity ratios <ul style="list-style-type: none"> ○ working capital/current ○ quick asset ▪ efficiency ratios <ul style="list-style-type: none"> ○ debtor's collection ○ inventory/stock turnover ▪ profitability ratios <ul style="list-style-type: none"> ○ profit ○ rate of return on assets ○ times interest earned ▪ leverage ratio <ul style="list-style-type: none"> ○ debt to equity ▪ market ratios <ul style="list-style-type: none"> ○ earnings per share ○ price/earnings ○ dividend yield <p><i>Note: Some of the below syllabus sections are in both the 'Ratios' chapter and 'Key Performance Indicators' chapter given the overlap in syllabus but distinctly different content/ examination questions.</i></p> <p>Recording, using and evaluating financial information: Evaluating financial information for planning, coordinating, controlling and investing</p> <ul style="list-style-type: none"> • examination and interpretation of annual reports, financial statements and stock exchange data to assess the position and performance of a public company • purpose of annual reporting and the use of key performance indicators by directors for accountability and decision-making purposes • interpretation of the following ratios: <ul style="list-style-type: none"> ▪ liquidity ratios <ul style="list-style-type: none"> ○ working capital/current ○ quick asset ▪ efficiency ratios <ul style="list-style-type: none"> ○ debtor's collection ○ inventory/stock turnover ▪ profitability ratios <ul style="list-style-type: none"> ○ profit ○ rate of return on assets ○ times interest earned ▪ leverage ratio <ul style="list-style-type: none"> ○ debt to equity ▪ market ratios <ul style="list-style-type: none"> ○ earnings per share ○ price/earnings ○ dividend yield • limitations in assessing performance from financial statement analysis and from traditional financial accounting <ul style="list-style-type: none"> ▪ historical cost accounting ▪ lack of comparability between entities ▪ lack of disclosure

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1. Introduction to Management and Financial Accounting



Activate Prior Knowledge

Respond to the following questions. Discuss your answers with a peer or the class.

<p>Financial statements are prepared by many businesses. Which <u>internal</u> business staff would use these statements? Who are some <u>external</u> users of financial statements?</p>	
<p>How might the needs of internal users and external users of financial statements be different? Why?</p>	
<p>Do you think internal reports are subject to more or less regulation than external reports? Why?</p>	
<p>What activities does an accountant provide for a business?</p>	

Introduction to Management and Financial Accounting – Syllabus

Syllabus – Unit 3	
Introduction to Management and Financial Accounting	Financial institutions and systems: Financial systems and fundamental principles <ul style="list-style-type: none">• distinguish between management accounting and financial accounting Recording, using and evaluating financial information: Evaluating financial information for planning, coordinating, controlling and investing <ul style="list-style-type: none">• differences between internal and external reporting, including:<ul style="list-style-type: none">▪ users: internal and external▪ regulation: accounting standards▪ types of financial statements▪ types of reports• the role and function of the accountant in managing business operations

Introduction to Management and Financial Accounting – Introduction

This chapter is an overview of what you will be covering during the Year 12 Accounting and Finance ATAR course. The focus of Unit 3 is management accounting, which is also referred to as internal reporting. The focus of Unit 4 is financing accounting, which is also referred to as external reporting or annual reporting. This chapter also discusses the role and function of a company's accountants in managing business operations.

Whilst this chapter is an introduction to the course, it is common for questions in tests or exams to assess the content in this chapter. E.g. students may be asked to compare the types of reports or users of internal reports and external reports. Content in this section will make more sense after reviewing the entire course. E.g. the examples of internal and external reports or types of regulation will be familiar once students have learnt the relevant practical skills and theory throughout the course.



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Management Accounting (Internal Reporting) vs. Financial Accounting (External Reporting)

		Unit 3: Management Accounting / Internal Reporting	Unit 4: Financial Accounting / External Reporting
Users <i>Know up to 4 of each</i>		Internal users: <ul style="list-style-type: none"> • Directors. • Management. • Employees. • Internal accountants. • Division heads. • Sales managers. • Production managers. 	External users: <ul style="list-style-type: none"> • Shareholders/investors. • Creditors. • Government agencies (ATO, ASIC). • Lobby groups. • Employees. • Suppliers. • Customers.
Purpose		Provide financial information to assist internal users make internal decisions.	Provide financial reports to assist external users make decisions about a company.
Users rely on these reports to make decisions about the business's		<ul style="list-style-type: none"> • Ability to meet objectives and goals. • Control day to day efficiency. 	<ul style="list-style-type: none"> • Financial performance (profit, income and expenses). • Financial position (assets, liability, equity). • Liquidity (the ability to pay debts as they fall due).
Types of reports	Examples <i>Note: These are things you do in Unit 3 or Unit 4</i>	<ul style="list-style-type: none"> • Master budget. • Cash budget. • Performance reports. • Budgeted income statement. • Capital budget. • CVP analysis. • Cost accounting. 	Annual report containing GPFRs – Statement of: <ul style="list-style-type: none"> • Financial position. • Comprehensive income. • Cash flows. • Changes in equity.
	Future or historic focus	<ul style="list-style-type: none"> • Future focus (assists in planning). 	<ul style="list-style-type: none"> • Historic focus (outlines what has happened previously).
	Time period	<ul style="list-style-type: none"> • No specific time period – e.g., week, month, three months, year. 	<ul style="list-style-type: none"> • Specified time period – usually the financial year.
	Regulation	<ul style="list-style-type: none"> • Internal reports not subject to external regulation. • Internal company policies govern internal reports. 	<ul style="list-style-type: none"> • Regulation required for external reporting of financial statements. External regulation includes: <ul style="list-style-type: none"> • Corporations Act. • Australian Accounting Standards • Australian Securities Exchange (public companies). • ASIC requires Annual reports to be lodged for public and large proprietary limited companies. • An audit may be required for annual reports.

Note: GPFRs stands for 'General Purpose Financial Reports'.

Role and function of a company's accountants in managing business operations

		Role and function of accountant in managing business operations
Role		<ul style="list-style-type: none"> • Collect, record, analyse and report a business's financial operations. • Provide financial advice to internal users to enhance financial operations, achieve business goals and meet obligations to external users. • Accountants are employed either by: <ul style="list-style-type: none"> ○ A business directly. ○ Professional accounting firms who perform tasks for businesses. ○ External agencies.
Function	Overview	The function of an accountant's is to provide various financial services/tasks (see examples below).
	Examples <i>Know any 3</i> <i>Make sure to describe each if asked in the question.</i>	<i>Hint: think of the things you have learnt during the course/the syllabus.</i> <ul style="list-style-type: none"> • General purpose financial report preparation. • Capital investment decision analysis. • Tax report preparation. • Budget preparation. • CVP analysis. • Financial transaction recording. • Production of financial reports. • Analysis of financial reports. • Cash budgeting. • Capital budgeting. • Internal control strategy implementation. • Internal auditing. • Cost accounting information production.

Practice Questions

Questions 1-10: Introduction to Management and Financial Accounting.

Exam Questions

See 'Introduction to Management and Financial Accounting' chapter of the Exam Guide for practice exam questions. The Exam Guide can be found by navigating to the Resource Hub link on the front page.

Question 1

Identify the internal user of internal reports.

- a. Shareholders.
- b. Division heads.
- c. Suppliers.
- d. Creditors.

Question 2

The purpose of external reporting is to:

- a. Provide financial reports to assist external users make decisions about a company.
- b. Allow government agencies to assess the performance of a business.
- c. Provide financial information to assist management to make internal decisions.
- d. Reflect on previous business performance.

Question 3

The function of an accountant is to:

- a. Meet obligations to external users of financial reports.
- b. Prepare internal reports.
- c. Provide various financial services/tasks.
- d. Collect, record, analyse and report a business's financial operations.

Question 4

Identify which of the following statements is true about financial reporting.

- a. Users make decisions about how to control day to day efficiency.
- b. Reports do not need to be prepared with a specific time period.
- c. Reports have a historic focus.
- d. Reports are governed by internal company policies.

Question 5

Management accounting's primary purpose is to:

- a. Control and day to day efficiency.
- b. Assist with planning.
- c. meet objectives and goals.
- d. Provide financial information to assist internal users make internal decisions.

Question 6

The types of reports prepared in management accounting does not include:

- a. Performance reports.
- b. Statement of cash flows.
- c. Master budget.
- d. Budgeted income statement.

Question 7

Compare internal and external reporting based on the impact of regulation.

Question 8

Outline the role and function of an accountant.

2. Internal and External Audit



Activate Prior Knowledge

Respond to the following questions. Discuss your answers with a peer or the class.

<p>What kind of errors or omissions could exist in financial statements? Why might these occur?</p>	
<p>Why would a company want the financial reports they have prepared to be reviewed?</p>	
<p>Do financial reports need to be reviewed by an external third party? Why?</p>	

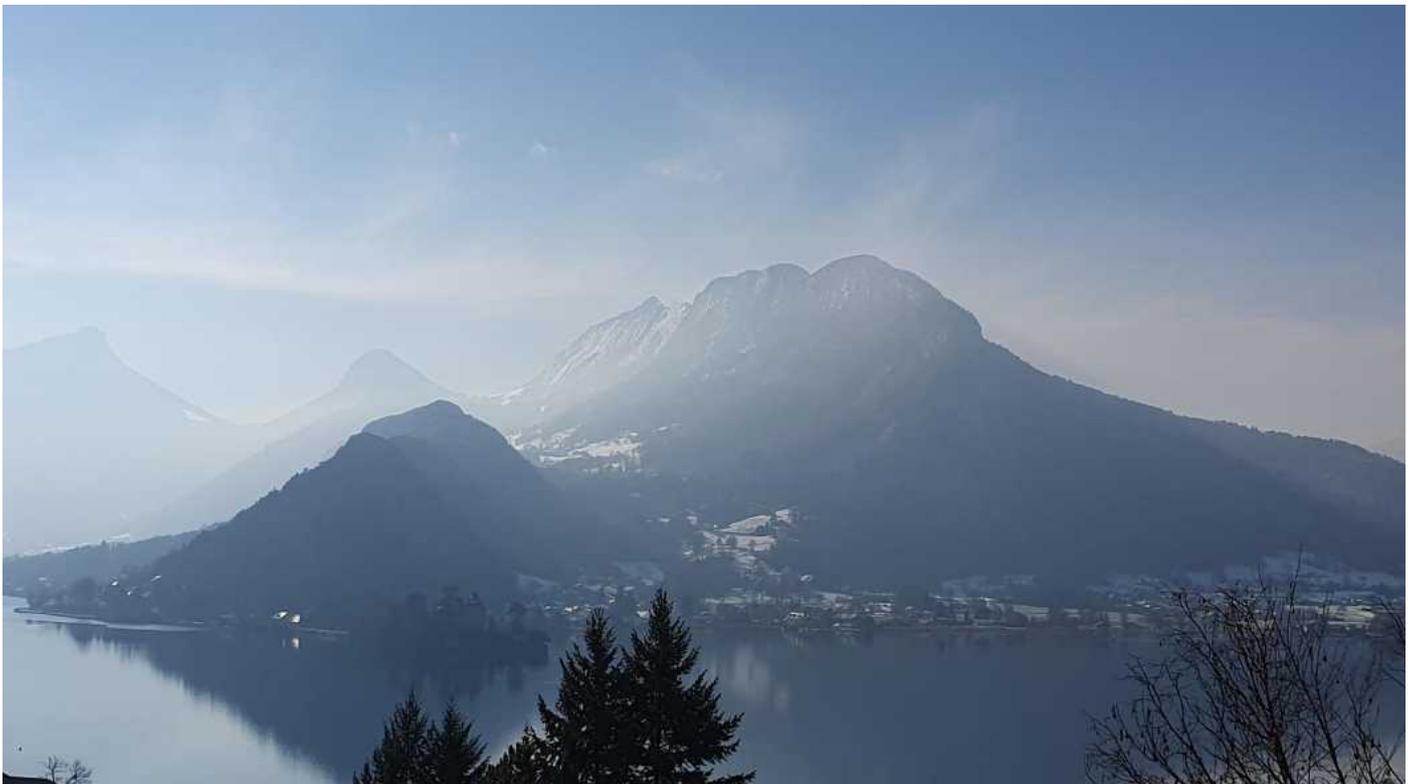
Internal and External Audit – Syllabus

Syllabus – Unit 3	
Internal and External Audit	<p><i>Note: External audit is Unit 4 but is included it here given the nature of examination questions to compare 'internal and external audit'.</i></p> <p>Government and the community: The role and influence of governments and other bodies</p> <ul style="list-style-type: none">• the function of the external audit, including:<ul style="list-style-type: none">▪ protecting external users▪ providing confidence to stakeholders in Australian capital markets• the role of the external auditor appointed by the shareholders and reappointed at the annual general meeting (AGM)<ul style="list-style-type: none">▪ perform an independent audit of the financial statements <p><i>Note: The below syllabus sections are in both 'internal control and asset management' and 'internal and external audit' given the overlap in syllabus but distinctly different content/examination questions.</i></p> <p>Recording, using and evaluating financial information: Evaluating financial information for planning, coordinating, controlling and investing</p> <ul style="list-style-type: none">• internal audit and control, including:<ul style="list-style-type: none">▪ purpose of internal audit▪ review of business procedures and policies▪ detection and correction of errors and deficiencies

Internal and External Audit – Introduction

An audit is a review, or inspection, of various aspects of a business such as its financial information, policies, procedures or systems. Internal audits focus on the review of the business, by the business itself, to help increase efficiency and ensure that business goals are being met. External audits are carried out by parties which are independent of a business to ensure that financial information presented to external users is accurate and follows regulatory requirements.

Internal audit is in the Unit 3 syllabus and external audit in the Unit 4 syllabus. They have been included together in this chapter given the nature of examination questions to require students to compare each of these types of audit. The reference to GPFs and regulation regarding external audit will make more sense once these are covered in Unit 4. It is recommended that students review this chapter after Unit 4 has been covered.



Annecy, France.

Internal and External Audit – Summary table

		Internal Audit	External Audit
Purpose of the Audit / Auditor		<ul style="list-style-type: none"> Monitor and examine the effectiveness of internal policies (internal control processes). Ensure policies are followed throughout the business. 	<ul style="list-style-type: none"> Independently audit GPFs on behalf of external stakeholders.
Users of audit report		Internal users such as: <ul style="list-style-type: none"> Directors. Managers. Division heads. 	External stakeholders such as: <ul style="list-style-type: none"> Investors. Creditors. Government agencies.
Function / Role of the Audit / Auditor	Monitoring and Reviewing Role	Monitors and reviews: <ul style="list-style-type: none"> Policies. Procedures. Systems. <p>Policies, procedures and systems are internal documents that guide how the business achieves business goals.</p>	Monitors and reviews that a company's financial records are: <ul style="list-style-type: none"> Maintained appropriately, and Accurately represent the company's performance and position for the period audited. <p>The external (independent) audit report:</p> <ul style="list-style-type: none"> Recommends reviews or corrections to financial reports. Declares GPFs are accurate assessment of company finances.
	Reporting Role	The internal audit is reported to management. This report: <ul style="list-style-type: none"> Confirms compliance with regulation and law. Provides confidence the company will be prepared for an external audit. Reports any fraud, theft or inconsistencies detected. Suggests new internal control policies (see internal control chapter). Raises any issues with current policies. Reports policies not followed by staff. 	Prepare an external (independent) auditor's report. This report: <ul style="list-style-type: none"> Is presented to the board of directors. Must be attached to the company's annual report (GPFs) for external users. Gives confidence to external users to make financial decisions in Australian capital markets.
Examples of issues / errors revealed by audit		Issues in internal control such as: <ul style="list-style-type: none"> Theft of assets such as cash. Accounts receivable not collected. Poor procedures e.g., not protecting assets thoroughly. 	<ul style="list-style-type: none"> GPF's information not accurate. Regulation not followed when GPFs were prepared. Accounting standards not followed.

Note: Pay attention to how many marks the question is worth and what section of table is in the question. For example, 'describe the function of an internal audit' can be worth three marks. In this instance choose any three internal audit functions (add more if time). However, if the question is specific to the 'monitoring role' and 'reporting role' make sure to include both sections in your response.

Practice Questions

Questions 1-11: Internal and External Audit.

Exam Questions

See 'Internal and External Audit' chapter of the Exam Guide for practice exam questions. The Exam Guide can be found by navigating to the Resource Hub link on the front page.

Question 1

Users of internal reports do not include:

- a. Directors.
- b. Managers.
- c. Investors.
- d. Division heads.

Question 2

An example of an error revealed by an external audit includes:

- a. Theft of assets such as cash.
- b. Regulation not followed.
- c. Accounts receivable not collected.
- d. Assets not protected thoroughly.

Question 3

The purpose of an external audit is to:

- a. Identify policies not being followed by staff.
- b. Ensure internal policies are followed throughout a business.
- c. Identify if accounts receivable has not been collected.
- d. Independently audit financial reports such as a statement of cash flows for external users.

Question 4

The role of an independent audit does not include:

- a. Preparation of an auditor's report for external users.
- b. Confirm regulation and law compliance.
- c. Monitor policies, procedures and systems.
- d. Report any fraud detected.

Question 5

The purpose of an internal auditor does not include:

- a. Ensure policies are followed throughout a business.
- b. Independently auditing GPFs.
- c. Examine the effectiveness of internal policies.
- d. Monitor internal policies.

Question 6

Identify which of the following is not a user of an external audit.

- a. Investors.
- b. Government agencies.
- c. Managers.
- d. Creditors.

Question 7

Explain the reporting role of an internal auditor.

Question 8

Outline the purpose of external audits regarding the:

- Purpose of the audit.
- Examples of issues that may be revealed by the audit.

Question 9

Compare the purpose and users of internal audits and external audits.



Audit

Financial Sleuth

As an auditor, you're not just a number-cruncher, you're a truth-seeker on a mission to uphold accuracy. You'll make epic things happen as a true number detective dedicated to unraveling financial mysteries.

Is it a good match for me?

If you're naturally curious, teamwork is your second nature, and excel at both communication and finding creative solutions, then you're a perfect match.

Where could I work?

Any accounting firm or most large corporates like banks, or multinational consumer companies like Xbox, YouTube, Coca-Cola, L'Oreal. Or even in a charity like Children International.

How do I get there?

You don't need to study anything specific in high school, but business-related subjects can help you get a head start.

Ability to work overseas



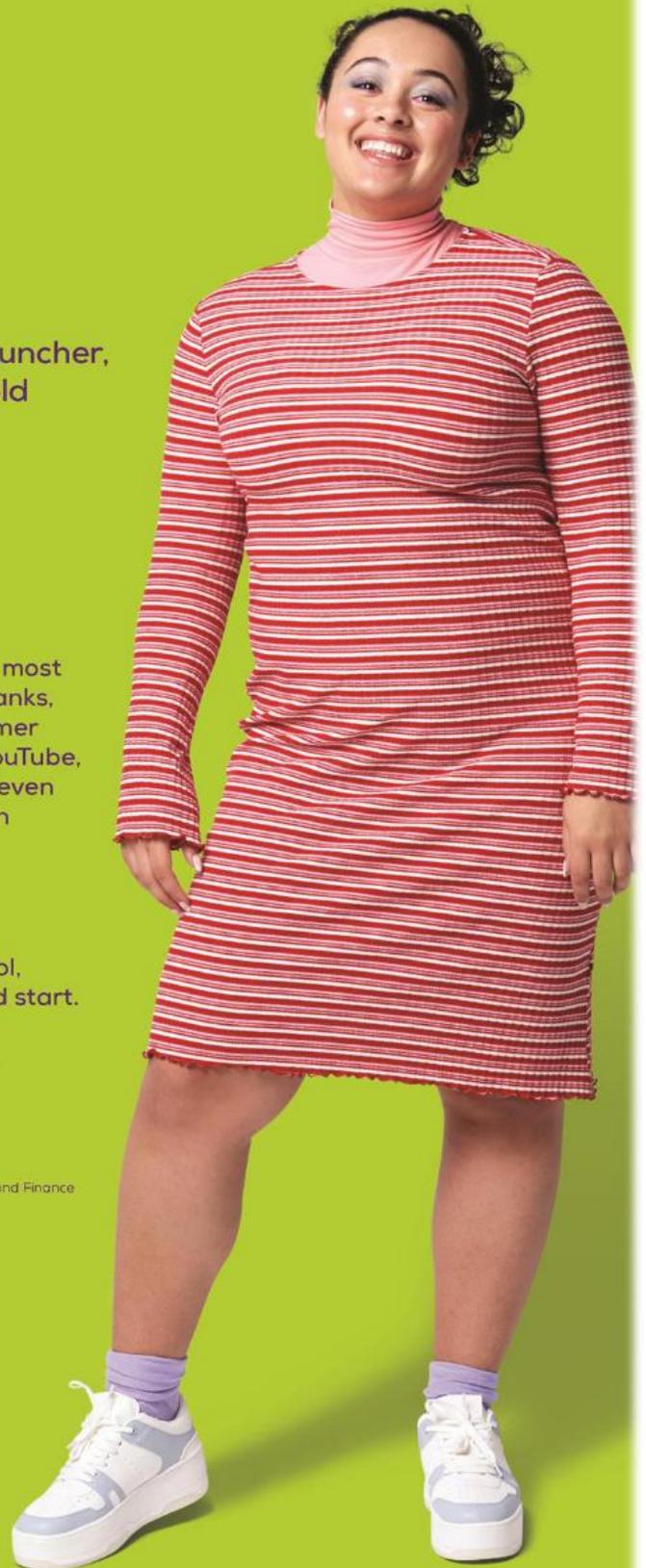
Graduate salary*



*Hays Salary Guide FY23/24 Accounting and Finance

Find your passion at caanz.com/epic-future

make epic things happen



3. Internal Control and Assessment Management



Activate Prior Knowledge

Respond to the following questions. Discuss your answers with a peer or the class.

<p>What would happen if a business kept cash levels excessively high? What if cash levels were too low?</p>	
<p>What may happen if a business had an excessively high value of accounts receivable? What if accounts receivable was too low?</p>	
<p>What could a business do to ensure accounts receivable does not become too high?</p>	

Internal Control and Asset Management – Syllabus

Syllabus – Unit 3	
Internal Control and Asset Management	<p>Financial institutions and systems: Financial systems and fundamental principles</p> <ul style="list-style-type: none"> • the important financial principles of asset management <ul style="list-style-type: none"> ▪ appropriate levels of investment in non-current assets ▪ appropriate management of accounts receivable, inventory and cash ▪ appropriate management of short and long term debt ▪ appropriate level of equity capital <p><i>Note: The below syllabus sections are in both 'internal control and asset management' and 'internal and external audit' given the overlap in syllabus but distinctly different content/ examination questions.</i></p> <p>Recording, using and evaluating financial information: Evaluating financial information for planning, coordinating, controlling and investing</p> <ul style="list-style-type: none"> • internal audit and control, including: <ul style="list-style-type: none"> ▪ purpose of internal audit ▪ review of business procedures and policies ▪ detection and correction of errors and deficiencies <p><i>Note: Internal audit is in a separate chapter but the syllabus point emphasises how these topics are linked.</i></p>

Internal Control and Asset Management – Introduction

Internal control refers to specific strategies to manage various elements of a business. Internal control should be familiar to students from the Year 11 course. In the Year 12 course, internal control is expanded upon with the concept of asset management. In the context of the year 12 course, students review the importance of different elements of a business and what may happen if the value of these elements becomes too high or too low.

For a concise example, cash is important to fund business activities and pay debts as they fall due. If a business has too much cash on hand, then this may mean the business could be using the cash in more effective ways to generate profit i.e. investing cash or using the cash to buy non-current assets to generate income. If cash levels become too low, then the business may find it difficult to fund business operations or pay debts as they fall due. The business should employ internal control strategies to ensure that cash levels remain appropriate, and the business operates efficiently and effectively.

Asset management vs. Internal control

	Asset management	Internal control
Define	The organisation of assets to achieve KPIs of business.	Processes to enhance efficiency and reliability of accounting records and safeguard assets.
Objectives / Principles	See importance row in asset management table on next page.	<ul style="list-style-type: none"> • Ensure accounting information is reliable. • Safeguard resources against inefficiency, fraud and wastage. • Compliance with government regulation and business policy.

Notes:

- KPIs stands for 'Key Performance Indicators'. KPIs are covered in more detail in Unit 4.
- Questions / Marking keys tend to treat internal control as 'strategies to achieve asset management.'

Assessment Tip

Example exam questions:

- Discuss the principles of asset management in the context of appropriate investment in non-current assets.
- Explain the importance of the principle of asset management, with particular reference to the appropriate management of inventory.

In asset management extended questions, structure responses as below using the summary tables on following pages:

1. Importance of the category of asset management in the question.
2. Describe what happens when this category is too high (surplus).
3. Describe what happens when this category too low (shortage).
4. Strategies to manage this category (from internal control summary table).

Response structure:

Importance of the category of asset management in the question.



Describe what happens when this category is too high



Describe what happens when this category too low



Strategies to manage this category (from internal control summary table)



Mer de Glace, Chamonix.

Asset management – Summary Table

Application of asset management over:	Importance of appropriate management	Surplus may lead to (When too high may lead to...)	Shortage may lead to (When too low may lead to...)
Non-current asset investment levels	<ul style="list-style-type: none"> • Produce future revenue. • Support business growth. 	<p>Over investment:</p> <ul style="list-style-type: none"> • NCAs not required, reducing productivity. • High debt from purchasing NCAs that becomes difficult to pay. • Owners receive low returns relative to their investment due to poor business productivity. • Lost business opportunities that could have produced higher returns due to cash spent on NCAs rather than other opportunities. • High NCA security and maintenance costs. 	<p>Under investment:</p> <ul style="list-style-type: none"> • Loss of sales due to lack of inventory produced or services able to be performed. This is due to lack of NCAs required to make goods or perform services. • Growth difficulties due to lack of NCAs required to grow business.
Cash	<ul style="list-style-type: none"> • Enable liquidity. • Allow payment of operating cash flows and current liabilities. 	<p>Surplus:</p> <ul style="list-style-type: none"> • Cash at bank receives low interest return compared to other investment options. <p><i>If there is spare time in an exam describe other investment options. Investment options are covered in a future chapter.</i></p>	<p>Shortage:</p> <ul style="list-style-type: none"> • Liquidity issues i.e., lack of ability to pay debts as they fall due as a result of low cash levels. • Limited ability to purchase current assets for day to day operation. • Limited ability to purchase NCAs.
Inventory	<ul style="list-style-type: none"> • Inventory can be a significant portion of assets and revenue generation tool. 	<p>Over investment:</p> <ul style="list-style-type: none"> • High inventory storage and security expenses. • High inventory management costs. • Inventory can expire or become redundant. • Cash used for inventory could have been invested elsewhere. 	<p>Under investment:</p> <ul style="list-style-type: none"> • Limited ability to make sales. • Consumers purchase from competitors with stock.
Accounts Receivable	<ul style="list-style-type: none"> • Allows sales to customers who prefer credit payment. 	<p>Surplus:</p> <ul style="list-style-type: none"> • Cash flow issues due to high accounts receivable. • Risk of bad debts. 	<p>Shortage:</p> <ul style="list-style-type: none"> • Loss of sales from customers who prefer credit payment.
Accounts Payable (Short term debt)	<ul style="list-style-type: none"> • Allows purchase of current assets whilst managing cash flow. 	<p>Surplus:</p> <ul style="list-style-type: none"> • Liquidity issues or insolvency i.e., inability to pay debts as they fall due. • Strained relationships with suppliers due to high debt or late payments. • Reduced credit rating which can impact ability to obtain finance. 	<p>Shortage:</p> <ul style="list-style-type: none"> • Cash flow issues. I.e. High cash outflow rather than use of credit which may reduce cash available to pay debts. • Missed investment opportunities due to cash shortages. • Limited sources of short term finance.
<p>Equity (Capitalisation)</p> <p>A scaffolded description of equity is on the following page.</p>	<ul style="list-style-type: none"> • Allows growth and covers running costs. 	<p>Over-capitalisation – high debt and equity relative to assets:</p> <ul style="list-style-type: none"> • Share market value decreases due to negative business perception. • Low shareholder returns due to high debt and equity. • Ineffective use of funds due to funds being used to pay debt and equity holders. 	<p>Under-capitalisation – low debt and equity relative to assets:</p> <ul style="list-style-type: none"> • Capital shortage (lack of funding) that limits business operations and growth.

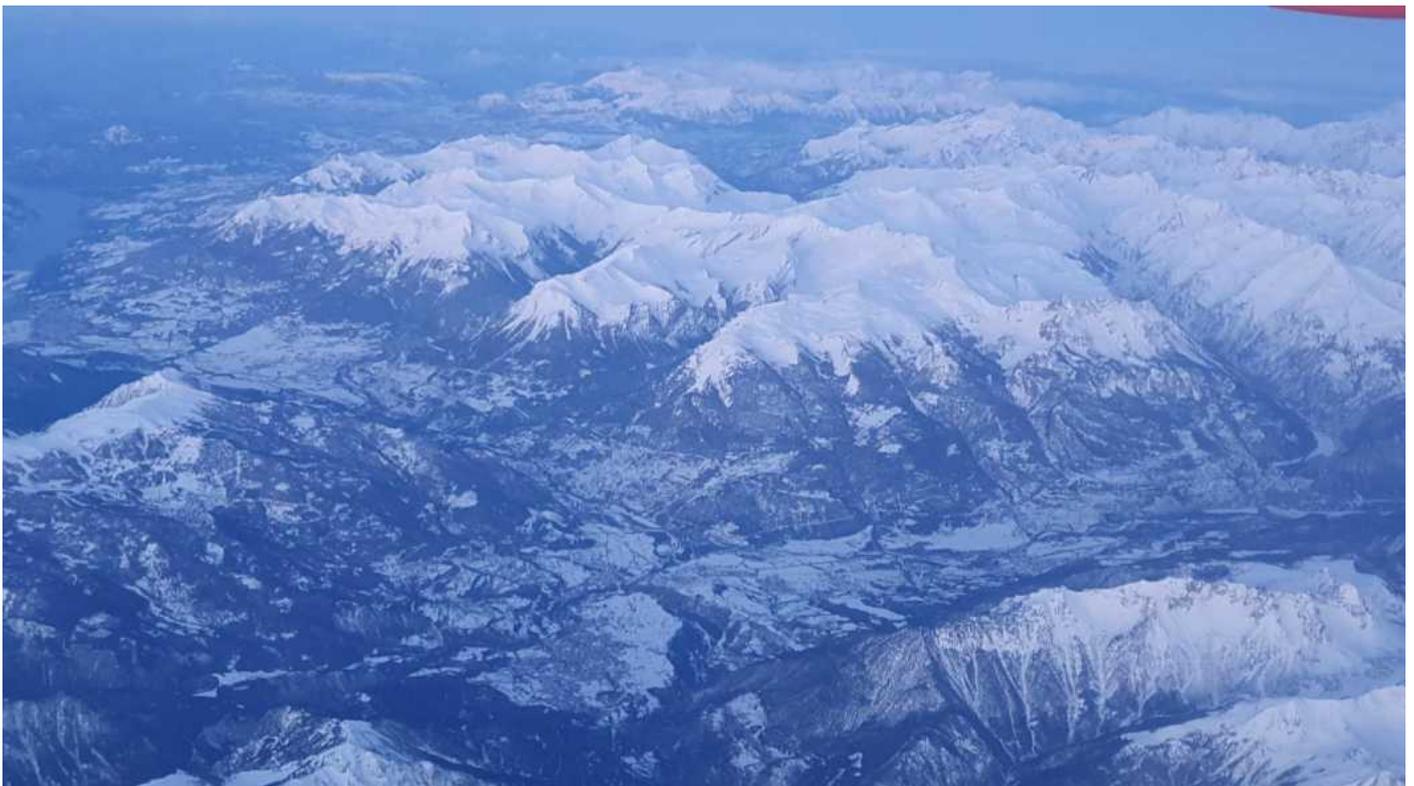
Notes for the previous Asset Management Summary Table:

- See internal control table for strategies to manage these.
- The terms surplus (too high) and shortage (too low) can be used for all areas. Some areas have other terminology that can be used – see table.
- Many of the impacts of each area being too high or too low are listed but not described. You may need to describe these in detail as part of an assessment. A research task in the practice questions involves researching descriptions.

Equity (Capitalisation)

The term “equity” is used interchangeably with the term capitalisation. In simple terms, capitalisation refers to raising funds for a business by taking on external debt or selling shares. Equity, in the context of capitalisation, has a slightly different definition to the term “equity” that students may be familiar with from the Year 11 Balance Sheet or Accounting Equation. I.e. Capitalisation includes both shareholder equity and non-current liabilities used to fund business activities.

An example of why too much shareholder equity relative to assets could be negative, is that; the low assets reflects that the business may generate a low profit relative to the amount of shareholders. This may limit the profit given to each shareholder in the form of dividends. Dividends are covered in more detail Unit 4. At this stage of the course, dividends can be thought of as a share of the profits distributed to shareholders.



Flight from Nice to Geneva.

Internal control – Summary Table

Application of internal control over:	Internal control area purpose	Internal Control Strategies <i>Know any 3 for each</i>
Non-current assets <i>Often referred to as 'investment in Non-current Assets'</i>	Ensure NCAs safeguarded and used in an efficient and effective manner.	<ul style="list-style-type: none"> • Appropriate levels of investment in NCAs. • Security checks/cameras/guards to prevent theft of NCAs. • Efficient use of NCAs to maximise profit. • Record keeping of NCAs. • Maintenance of NCAs. • Training of staff to use NCAs correctly. • Processes to approve the purchase of new NCAs. • Consistent depreciation processes for NCAs. • Insurance of NCAs.
Cash	Ensure cash is safeguarded from theft (intentional) or loss (accidental).	<ul style="list-style-type: none"> • Secure cash storage. • Secure cash movement from registers to safe. • Duty separation between cash processing e.g., different person at register and the safe. • Transaction records. • Regularly deposit cash to bank.
Inventory	Ensure inventory safeguarded and efficiently managed.	<ul style="list-style-type: none"> • Inventory levels kept appropriate. • Automated stock monitoring. • Automated stock purchase when inventory below a certain level. • Security of inventory – cameras, guards, customer bag checks, tags etc. • Appropriate storage e.g., cold storage for perishable goods. • Wastage minimisation. • Competitive prices. • Prioritising sale of old stock.
Accounts receivable <i>Often referred to as 'credit arrangement setup procedures'</i>	Ensure credit sale customers are reliable and debts are collected.	<ul style="list-style-type: none"> • Issue invoices to debtors in a timely manner. • Automate payment reminders to debtors. • Offer payment plans to debtors. • Offer discounts to debtors for prompt payment. • Credit checks on debtors prior to credit sales. • Credit limits on customers. • Develop process for writing off bad debts.
Accounts payable	Ensure payment of creditors and maintain positive supplier relationship.	<ul style="list-style-type: none"> • Negotiate prices and payment. • Ask for a payment plan from suppliers / creditors. • Ask for prompt payment discounts from suppliers / creditors. • Automate supplier/ creditor payment reminders. • Develop positive relationship with suppliers / creditors. • Transparently communicate any issues paying suppliers / creditors.

Notes:

- You can be creative to think of internal control strategies. Be careful when being creative to not provide example strategies that are too similar to each other and miss out on marks.
- Internal control strategies have only been listed, not described. Make sure you can describe how any three strategies support the internal control for each area. This is a research task in the practice questions.

Practice Questions

Questions 1-13: Internal Control and Asset Management.

Exam Questions

See 'Internal Control and Asset Management' chapter of the Exam Guide for practice exam questions. The Exam Guide can be found by navigating to the Resource Hub link on the front page.

Question 1

A surplus of accounts receivable can result in:

- a. Limited ability to make sales.
- b. Cash flow issues.
- c. Loss of sales from customers who prefer credit payment.
- d. Low interest rates.

Question 2

Over investment in non-current assets can result in

- a. Over reliance on NCAs.
- b. Loss of sales due to lack of inventory produced.
- c. High debt that becomes difficult to pay.
- d. Liquidity issues.

Question 3

It is important that a business does not have too little equity as this could result in

- a. Over capitalisation leading to a lack of funding.
- b. Over capitalisation leading to share market value decreases.
- c. Under capitalisation leading to low shareholder returns.
- d. Under capitalisation leading to a capital shortage that limits business operations and growth.

Question 4

It is important to appropriately manage levels of inventory because it:

- a. Allows growth and covers running costs.
- b. Allows liquidity.
- c. Allows revenue generation.
- d. Allows purchase of current assets whilst managing cash flow.

Question 5

A business being overcapitalised does not result in:

- a. Lack of fundings.
- b. Low shareholder returns.
- c. High debt and equity relative to assets.
- d. Ineffective fund use.

Question 6

Identify which of the following is not an effective strategy of internal control over non-current assets.

- a. Appropriate levels of investment in NCAs.
- b. Keeping accurate records of NCAs.
- c. Insurance of NCAs.
- d. Positive relationships with purchasers of NCAs.

Question 7

Identify which of the following would be effective to manage inventory levels.

- a. Asking suppliers for payment plans.
- b. Automated stock purchase when inventory is below a certain level.
- c. Developing processes for writing off bad debts.
- d. Regularly depositing cash to the bank.

Question 8

Explain issues that may arise in a business due to over investment in non-current assets.

Question 9

Describe methods that can be used to manage inventory.

Question 10

Outline the importance of asset management in the context of cash.



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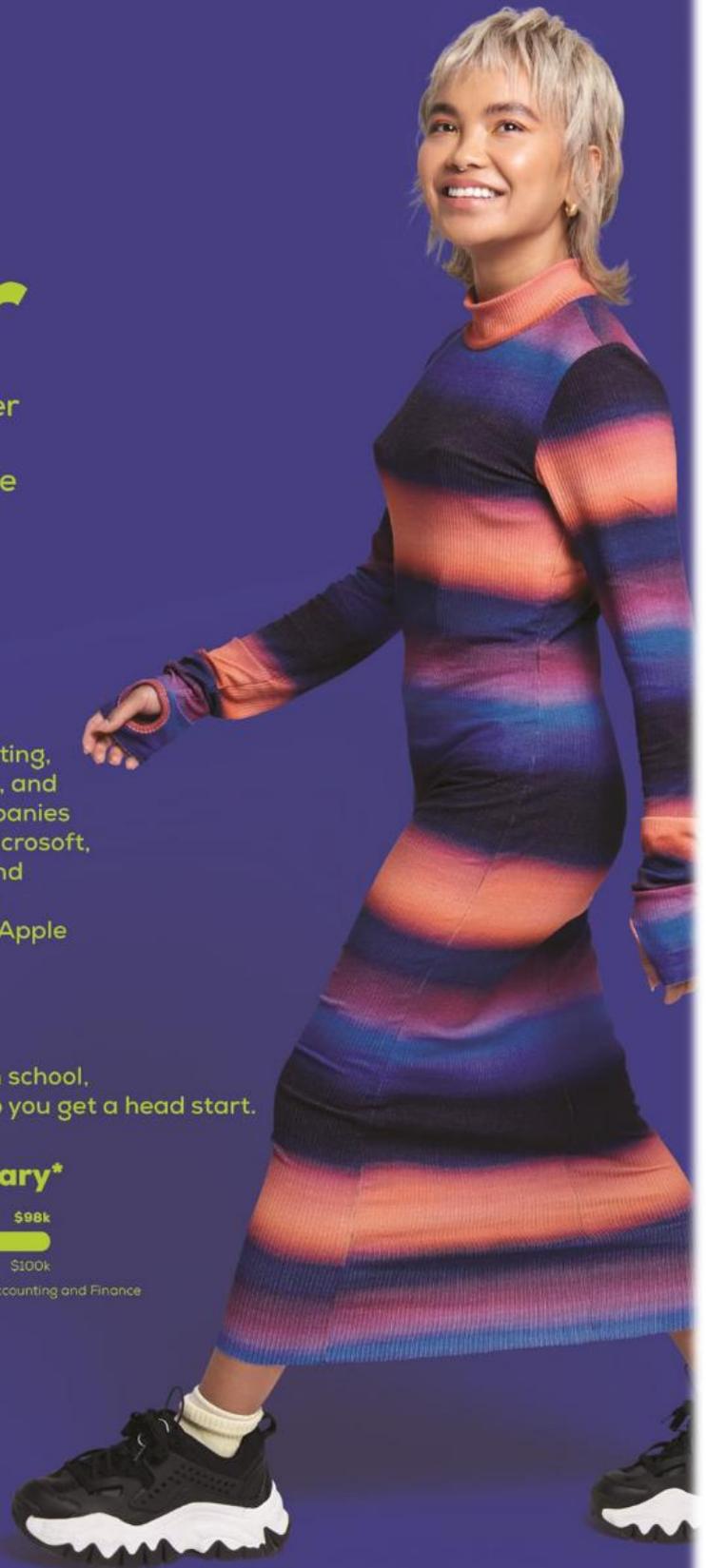
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4. Insolvency



Activate Prior Knowledge

Respond to the following questions. Discuss your answers with a peer or the class.

<p>You are running a business and discover it can no longer afford to pay its debts. What should you do?</p>	
<p>If a business was bankrupt but continued to trade, what consequences may occur? ? Why?</p>	
<p>A client owes you several thousand dollars which is over a year overdue and the business is ignoring payment. How could you try to get your money back?</p>	

Internal Control and Asset Management – Syllabus

Syllabus – Unit 3	
Insolvency	<p>Government and the community: The role and influence of governments and other bodies</p> <ul style="list-style-type: none"> • the concept of insolvency as defined by the <i>Corporations Act 2001</i> <ul style="list-style-type: none"> ▪ alternative actions for insolvent companies, including: <ul style="list-style-type: none"> ○ voluntary administration ○ liquidation ○ receivership • order of priority of the distribution of funds when insolvent

Insolvency – Introduction

Insolvency refers to a person or business being unable to pay their debts as they fall due. Whilst there are many possible specific causes of insolvency, some of the common general causes of insolvency are described in this chapter. There are varied groups which can determine a company to be insolvent and several factors which can be used to determine if a company is insolvent.

There are several different actions that can be used by business directors or creditors to resolve insolvency issues. Insolvency resolution actions are taken which are appropriate for the specific circumstances and has varied stages and outcomes. If a business is unable to continue operating during the insolvency resolution actions, the business is liquidated and ceases to exist. There is a specific order of repayment to creditors during liquidation.

Businesses may declare themselves insolvent and instigate the action of voluntary administration by themselves in an attempt to resolve insolvency issues. There are benefits for a business entering voluntary administration.

Insolvency – Define and Explain

Insolvency	
Define:	<ul style="list-style-type: none"> • The inability of a company to pay its debts when they fall due. • The company is not solvent.
Explain: <i>(definition plus below dot points)</i>	<ul style="list-style-type: none"> • A company's liabilities are greater than the value of its assets. • Directors have a legal responsibility to: <ul style="list-style-type: none"> ○ Ensure that once a company is aware they are insolvent that they do not continue to trade. ○ Appoint an administrator to run the company's affairs if the company is insolvent.

Solvent – Define

- The ability to all debts when due.

Insolvency – Possible causes

List of causes	Description of causes
Poor liquidity	Low levels of current assets that can be quickly converted into cash to pay debts.
High gearing	High external debt repayments which may become unmanageable.
High volume of credit sales	Poor management of accounts receivable may create cash flow issues.
Environmental forces	Natural disasters, pandemics may disrupt supply chains and consumer habits leading to low sales or high debt levels.
Competition	Competitors may have a greater competitive advantage resulting in poor performance.
Skill shortage	Difficulty to find skilled workers may limit business activities.
Poor business planning	Poor planning can result in poor assessment of strengths, opportunities, weaknesses and threats. This can lead to poor business performance.
Poor inventory management	Poor inventory management can result in theft and wastage.

Note: Know any five causes and descriptions. You can be creative when thinking of reasons, a business may fail. Think of topics covered during this course such as asset management, KPIs, ratios, capital investment etc.

Actions for possibly insolvent company

		Receivership	Voluntary Administration	Liquidation
Define		<ul style="list-style-type: none"> A creditor pursues debt recovery from a business that has defaulted on a secured loan. A receiver is appointed by the secured creditor to recover the debt. 	<ul style="list-style-type: none"> Administrator takes over the running of a company that has insolvency concerns. 	<ul style="list-style-type: none"> The wind up and deregistration of a company. Company unable to pay debts as they fall due . Assets sold to repay debts.
Process	Instigated by	<ul style="list-style-type: none"> Same as definition. 	<ul style="list-style-type: none"> Creditor owed money OR The majority of directors who are looking to resolve insolvency concerns. 	Instigated by either: <ul style="list-style-type: none"> Liquidation vote at a shareholder special meeting OR Court application for liquidation of a company by creditors.
	Process	Receiver: <ul style="list-style-type: none"> Manages some or all company assets which were security to the creditor's loan. Develops debt resolution plan for creditors. Directors board: <ul style="list-style-type: none"> Continue management of company. Company is not managed by the receiver. 	Administrator: <ul style="list-style-type: none"> Manages company. Develop insolvency resolution plan. Reports possible solutions to directors and creditors. 	External liquidator: <ul style="list-style-type: none"> Controls company. Achieves outcomes in below outcome row.
	Outcome (may include)	Receiver may recommend: <ul style="list-style-type: none"> Assets to be sold to repay secured debts. Once debts repaid the business either: <ul style="list-style-type: none"> Continues trading - If in a position to trade. Appoints an administrator – If not in a position to trade (see next column). 	Administrators assessment of business leads to either: <ul style="list-style-type: none"> Business resumes operation under directors control if the insolvency concerns can be resolved. Liquidator appointed to wind up the company with debts fully or partially repaid (see next column) in order of repayment to creditors (below this table). 	External liquidator will <ul style="list-style-type: none"> Repay debts fully or partially to creditors through asset sale. Follow order of repayment to creditors (below this table). Wind up company. Deregister company. Share trading of company halted on ASX. Investigate director conduct and if offences found, these are reported to ASIC.

Order of repayment to creditors (stakeholders) during liquidation

- Liquidator fees.
- Secured creditors.
- Outstanding employees' wages, superannuation, entitlements and retrenchment pay.
- Unsecured creditors.
- Shareholders.

Voluntary administration benefits

- Low cost.
- Allows the business to evaluate its financial position.
- Allows for consultation with creditors to discuss options.
- Allows for a legal process to negotiate debt payment with creditors.
- External administrator controls company to unbiasedly work through liquidity issues.

Companies can be determined as insolvent by:

- Court of law.
- Receiver.
- Administrator.

Factors a court considers to determine if a company is insolvent

- Ability to pay current debts.
- Repayment dates of existing debts.
- Ability to borrow new debts.
- The businesses assets.
- Working capital/cash flow sufficiency.
- Finance sources available.
- Predicted cash availability once existing debts are due or have been paid.

Note: Know any three to five.

Importance of insolvency legislation

Legislation helps stakeholders to:

- Ensure stakeholders rights protected.
- Ensure financial markets operate appropriately .
- Corporations Act provides:
 - Director responsibilities to prevent insolvent trading.
 - Process for resolving insolvency issues e.g., debt settlement, asset distribution.

Practice Questions

Questions 1-19: Insolvency.

Exam Questions

See 'Insolvency' chapter of the Exam Guide for practice exam questions. The Exam Guide can be found by navigating to the Resource Hub link on the front page.

Question 1

During the process of voluntary administration which of the following takes place:

- a. A liquidator winds up the company.
- b. The process is instigated by a majority of directors.
- c. Share trading of the company is halted on the ASX.
- d. A receiver manages some of the company assets.

Question 2

Which of the following is not an indicator of insolvency?

- a. Inability to pay debts as they fall due.
- b. A receiver develops a debt resolution plan for creditors.
- c. Very low sales relative to the previous financial year.
- d. An administrator has been appointed to run the company.

Question 3

The fourth group of creditors to be repaid when a business goes bankrupt is:

- a. Liquidator fees.
- b. Secured creditors.
- c. Shareholders.
- d. Unsecured creditors.

Question 4

Which of the following is not a possible outcome of liquidation?

- a. The directors are investigated.
- b. The business resumes under directors control.
- c. Debts are fully repaid.
- d. The company is deregistered.

Question 5

According to the Corporations Act 2001, when a business is insolvent, directors have a responsibility to:

- a. Allow to continue trading.
- b. Keep shareholders up to date.
- c. Prevent insolvent trading.
- d. Formally apologise to creditors.

Question 6

A factor that courts consider to determine if a business is insolvent does not include:

- a. The historical reputation of directors.
- b. The business assets.
- c. Repayment dates of existing debts.
- d. Ability to pay current debts.

Question 7

Which of the following is not a likely cause of insolvency?

- a. Competition having a greater competitive advantage leading to poor business performance.
- b. Pandemics disrupting a business's supply chains.
- c. Poor management of accounts receivable.
- d. Low levels of external debt relative to equity

Question 8

Explain the concept of insolvency.

Question 11

Outline three factors a court may consider to determine if a company is insolvent.

Question 12

Explain why a business might choose to engage in the process of voluntary administration?

Question 13

Identify possible outcomes of receivership.

Question 14

Outline the importance of insolvency legislation for stakeholders.

Question 15

List the order that stakeholders are repaid during liquidation.

Question 16

Explain voluntary administration including the process which occurs.



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5. Sources of Finance



Activate Prior Knowledge

Respond to the following questions. Discuss your answers with a peer or the class.

<p>Should only one source of finance be considered for all business financial needs? Why?</p>	
<p>A business needs a loan to cover the purchase of a current asset. Is a one year loan or ten year loan more appropriate? Why?</p>	
<p>A business requires the purchase of new machinery that will be used for several years. Is a one year loan or ten year loan more appropriate? Why?</p>	

Sources of Finance / Investment Options – Syllabus

Syllabus – Unit 3	
Sources of Finance / Investment Options	Financial institutions and systems: Financial institutions <ul style="list-style-type: none"> • role of financial institutions and the management of business finance <ul style="list-style-type: none"> ▪ short term: cash management trusts, money market and term deposits ▪ long term: shares, debentures, unsecured notes, trusts and term deposits ▪ the management of business finance with short term and long term perspectives

Sources of Finance – Introduction

The chapters in this book on “Sources of Finance” and “Investment Options” refer to the syllabus points regarding the management of business finance. The management of business finance involves making decisions to effectively acquire, allocate, and manage funds to achieve the company's goals and objectives.

The “Sources of Finance” chapter in this book focuses on debt finance and equity finance. Debt finance is external finance borrowed by a company e.g. a bank loan or accounts payable. Equity finance is external finance provided by investors who become shareholders e.g. a business issuing ordinary shares or preference shares.

The “Investment Options” chapter in this book focuses on the use of the cash of a business to purchase instruments which will generate a return over time e.g. the purchase of term deposits, the purchase of shares in other companies, the purchase of debentures.

Financial institution – Define and purpose

Financial institution	
Define	An entity with primary business regarding finances and monetary transactions. See examples of business regarding finances and monetary transactions in chapters on sources of finance and investment options.
Purpose	<ul style="list-style-type: none"> • Collect money. • Invest money. • Earn return on investments.

Finance key terms

Principal: An amount of money originally borrowed.

Interest: Cost of borrowing the principal.

Security/ Collateral: A valuable item acceptable to the creditor that could be converted to cash to satisfy debt if a debtor cannot repay a debt (debt default).

Sources of Finance – Overview of short term and long term options

	Short term debt / source of finance	Long term debt / source of finance
Repayment due	<ul style="list-style-type: none"> • Less than 12 months. 	<ul style="list-style-type: none"> • More than 12 months.
Should be used for / Importance	<ul style="list-style-type: none"> • Current asset purchase. • Operating costs. • Temporary cash shortage. 	<ul style="list-style-type: none"> • Non-current asset purchase: <ul style="list-style-type: none"> ◦ NCL for NCA repaid through revenue generated by NCA.
Examples	<ul style="list-style-type: none"> • Bank overdraft. • Credit from suppliers. • Commercial bills. 	<ul style="list-style-type: none"> • Issuing shares (Public company) (this is a form of equity finance). • Loans. • Mortgage. • Leasing. • Debentures. • Unsecured notes. • Commercial bills.

Debt finance and Equity finance – Comparison

	Debt finance	Equity Finance
Definition	External finance borrowed by a company.	External finance provided by investors who become share owners.
Balance Sheet / Statement of Financial Position / Conceptual Framework category	Liability.	Equity.
Repayment	<ul style="list-style-type: none"> • Principal must be repaid at future predetermined date. • Interest payments are paid by a company to lenders/creditors of the debt finance over the loan duration. 	<ul style="list-style-type: none"> • Does not need to be repaid. • May require payment of a dividend or bonus share issue depending on the type of shares issued.
Examples	Any debt that is not a share issue. E.g.: <ul style="list-style-type: none"> • Bank loan. • Accounts payable. 	Issuing shares: <ul style="list-style-type: none"> • Ordinary shares. • Preference shares.

Importance of leverage/gearing when considering sources of finance (debt or equity finance)

- Leverage impacts the stability of a company.
- When debt is too high relative to equity, this increases failure risk.
 - Increased risk due to high payments for principal plus interest.
- Equity (Shareholder) funds have optional payment through dividends.
 - Dividends are not always declared.



View from Frioul over Château d'If, Marseille.

Behaviour of Financial Managers

Management of business finance should:

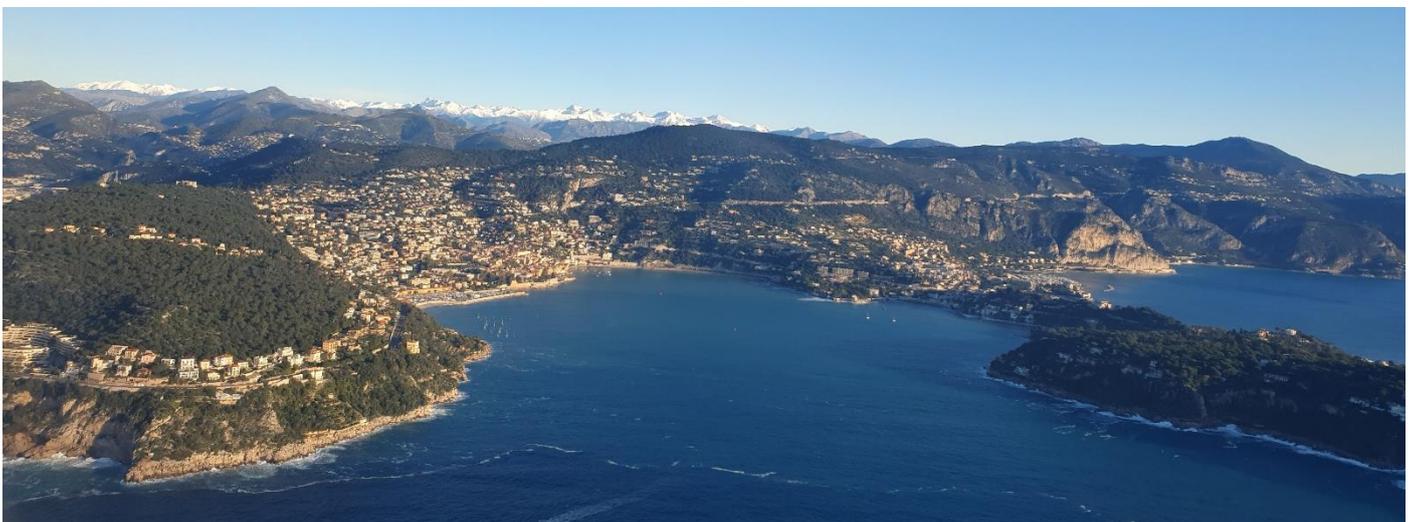
- Be flexible in their perspective by considering:
 - Varied finance options.
 - Long and short term finance sources.

Short term sources of finance

List	Describe
Bank overdraft	<ul style="list-style-type: none">• Withdrawal of money from a bank account beyond available funds (negative bank balance).
Credit from suppliers	<ul style="list-style-type: none">• Negotiation of credit payment with supplier.
Commercial bills	<ul style="list-style-type: none">• A form is short term or long term debt.• Unsecured.
Debt factoring	<ul style="list-style-type: none">• Selling accounts receivable to a debt collection entity for cash.• Accounts receivable sold at discounted rate.• Debt factoring entity pursues debts to make a profit.

Long term sources of finance

List	Describe
Issuing Shares (equity finance)	<ul style="list-style-type: none">• Listing a company on the ASX to raise public funds through share capital.• Prospectus needs to be published to invite investors to purchase company shares.• This option has no requirement for interest or repayment.
Loans	<ul style="list-style-type: none">• Borrowings from a financial institution.• Interest rate can be fixed or variable.• Repayments of interest and principal made at set intervals.• Finance repaid for up to 10 years.• Security often in the form of the asset financed and/or some of the businesses NCAs.
Mortgage	<ul style="list-style-type: none">• Borrowings from a financial institution.• Interest rate can be fixed or variable.• Repayments of interest and principal made at set intervals.• Finance repaid for 10 or more years.• Security often in the form of the asset financed and/or some of the businesses NCAs.
Leasing	<ul style="list-style-type: none">• A contract to use a NCA for a set period.• Provider of lease retains ownership.
Debentures	<ul style="list-style-type: none">• Secured loans financed by the public.• Entity pays the loan amount plus interest (often fixed) by an arranged date.
Unsecured notes	<ul style="list-style-type: none">• Loan issued by public companies which are financed by the public.• Unsecured.
Commercial bills	<ul style="list-style-type: none">• A form of short term or long term debt.• Unsecured.



Flight to Nice, France.

Practice Questions

Questions 1-13: Sources of Finance.

Exam Questions

See 'Sources of Finance' chapter of the Exam Guide for practice exam questions. The Exam Guide can be found by navigating to the Resource Hub link on the front page.

Question 1

A business is looking to purchase new machinery it intends to use for the next seven years. Which source of finance would be most appropriate?

- a. Bank overdraft.
- b. A loan.
- c. Credit from suppliers.
- d. Debt factoring.

Question 2

A long term source of finance would not include:

- a. Issue of preference shares.
- b. Mortgage.
- c. Debt factoring.
- d. Debentures.

Question 3

Short term finance should not be used by a business to:

- a. Pay for assets which will be used for several years.
- b. Purchase of current assets.
- c. Cover operating costs.
- d. Provide funds during a temporary cash shortage.

Question 4

The owners of a debentures in a company are considered to be:

- a. Unsecured creditors of the company.
- b. Part owners of a company.
- c. Full owners of a company.
- d. Secured creditors of the company.

Question 5

A business requires long term finance. Which of the following is not a long term source of finance?

- a. Leasing
- b. Debt factoring
- c. Unsecured notes
- d. Debentures

Question 6

The person in charge of managing a business's finance should:

- a. Be rigid in their approach.
- b. Consider short term finance options as a priority.
- c. Consider long and short term finance sources.
- d. Consider only a small range of finance options.

Question 7

Identify the unsecured source of finance.

- a. Commercial bills.
- b. Debentures.
- c. Mortgage.
- d. Term loan.

Question 8

Outline the importance of gearing when considering sources of finance.

Question 9

Compare when a business should use short term debt and long term debt.

Question 10

Explain the nature and purpose of financial institutions.

6. Investment Options



Activate Prior Knowledge

Respond to the following questions. Discuss your answers with a peer or the class.

<p>What would be the benefit to a business in investing money as opposed to having it sit in a bank account?</p>	
<p>Why would a business want to purchase shares in another company?</p>	
<p>A business has \$100,000 in cash that it will use to purchase equipment in nine months' time. Should the business invest this money in the share market? Why?</p>	

Investment Options / Sources of Finance – Syllabus

Syllabus – Unit 3	
Investment Options / Sources of Finance	Financial institutions and systems: Financial institutions <ul style="list-style-type: none"> • role of financial institutions and the management of business finance <ul style="list-style-type: none"> ▪ short term: cash management trusts, money market and term deposits ▪ long term: shares, debentures, unsecured notes, trusts and term deposits ▪ the management of business finance with short term and long term perspectives

Investment Options – Introduction

The chapters in this book on “Sources of Finance” and “Investment Options” refer to the syllabus points regarding the management of business finance. The management of business finance involves making decisions to effectively acquire, allocate, and manage funds to achieve the company's goals and objectives.

The “Sources of Finance” chapter in this book focuses on debt finance and equity finance. Debt finance is external finance borrowed by a company e.g. a bank loan or accounts payable. Equity finance is external finance provided by investors who become shareholders e.g. a business issuing ordinary shares or preference shares.

The “Investment Options” chapter in this book focuses on the use of the cash of a business to purchase instruments which will generate a return over time e.g. the purchase of term deposits, the purchase of shares in other companies, the purchase of debentures.

Behaviour of Financial Managers

Management of business finance should:

- Be flexible in their perspective by considering:
 - Varied finance options.
 - Long and short term investment options.

Investment – short term vs. long term

	Short term management of investment	Long term management of investment
Investment period	• Less than 12 months.	• More than 12 months.
Examples	<ul style="list-style-type: none"> • Cash management trusts. • Money markets. • Term deposits. 	<ul style="list-style-type: none"> • Shares. • Term deposits. • Debentures. • Unsecured notes. • Trusts.

Short term management of business investment / finance

List	Describe
Term deposits	<ul style="list-style-type: none"> • Deposit made to financial institution for a fixed term in return for principal plus interest. • Funds inaccessible until end of period. • Penalty if funds withdrawn early. • Low risk (due to guarantee of no loss), low return (due to low interest rate).
Cash management trusts	<ul style="list-style-type: none"> • Cash held by an entity for another entity. • Separates cash legal ownership from trust owner. • Separates some control from trust owner. • Cash in trust usually receives interest.
Money markets	<ul style="list-style-type: none"> • Investment by a mutual fund in liquid, current assets. • Low risk, low return.

Long term management of business investment / finance

List	Describe
Shares	<ul style="list-style-type: none">• Shares issued by a company to raise funds.• Investment option offers potential to receive dividends plus increase share value.• Higher risk, higher return.• Proprietary limited company is unable to issues shares to the public.
Term deposits	<ul style="list-style-type: none">• Deposit made to financial institution for a fixed term in return for principal plus interest.• Funds inaccessible until end of period.• Penalty fee if funds withdrawn early.• Low risk (due to guarantee of no loss), low return (due to low interest rate).
Debentures	<ul style="list-style-type: none">• Secured loans financed by the public.• Entity pays the loan amount plus interest (often fixed) by an arranged date.
Unsecured notes	<ul style="list-style-type: none">• Loan issued by public companies which are financed by the public.• Unsecured.
Trusts	<ul style="list-style-type: none">• Assets held by an entity for another entity.• Separates asset legal ownership from trust owner.• Separates some control from trust owner.• Assets in trust usually gain interest over time.• Assets distributed over time based on terms established with trust setup.• Often involves tax savings.

Practice Questions

Questions 1-12: Investment Options.

Exam Questions

See 'Investment Options' chapter of the Exam Guide for practice exam questions. The Exam Guide can be found by navigating to the Resource Hub link on the front page.

Question 1

A business has \$15,000 which is surplus to requirement for the next six months. Suggest a possible method of managing this finance.

- a. Investment in ordinary shares.
- b. Commercial bills.
- c. Debt factoring.
- d. Term deposit.

Question 2

A company provides a loan to another business which is not backed by security. This could be an example of:

- a. Cash management trusts
- b. Debentures
- c. Ordinary shares
- d. Unsecured notes.

Question 3

A business has \$50,000 and is investigating possible ways to manage this investment long term. Which of the following would not be suitable.

- a. Debentures.
- b. Money markets.
- c. Trusts.
- d. Shares.

Question 9

A business is considering purchasing shares of a mining company. Describe how investing in shares works and why a business may want to invest in shares.

Question 10

Explain the approach that managers of business finance should take when considering investment options.

Question 11

A business has \$1,250,000 of cash that has been sitting idle. The business would like to investigate possible investment options for this surplus cash for the next eight years. Outline three possible investment options.

7. Corporate Social Responsibility (CSR)



Activate Prior Knowledge

Respond to the following questions. Discuss your answers with a peer or the class.

<p>What is the primary purpose for a business to exist?</p>	
<p>When trying to achieve this primary purpose, should a business ignore any potential negative impacts of their business practices?</p>	
<p>How could a business have a positive impact on people and the environment?</p>	

CSR – Syllabus

Syllabus – Unit 3	
Corporate Social Responsibility (CSR)	<p>Government and the community: The influence of social, environmental and ethical factors</p> <ul style="list-style-type: none"> • identification of the costs and potential income associated with engaging in socially and environmentally responsible practices • the ethical issues encountered in financial dealings between business owners/managers and their employees, clients and investors

CSR – Introduction

Some of the Year 12 syllabus regarding this chapter on CSR is closely linked to the Year 11 syllabus, so students should be familiar with some of this content. CSR is the responsibility of a business to have a positive impact on people and the planet, not just profits (triple bottom line). To engage in CSR activities there are costs and potential benefits for a business. A business is further incentivised to engage in CSR activities as there may be negative consequences for the business if they do not engage in CSR activities. When making CSR decisions a business should consider both non-financial (qualitative) factors and just financial factors.

Related to CSR in this chapter, is the ethical issues that may be encountered in financial dealings between business owners/managers and their employees, clients and investors.

CSR – Summary table

	CSR
CSR Nature/ Purpose	<ul style="list-style-type: none"> • The responsibility of a business to have a positive impact on people and the planet, not just profits (triple bottom line). • Involves a business aligning business activities to: <ul style="list-style-type: none"> ○ Support the welfare of employees and communities. ○ Support positive environmental outcomes.
CSR costs	<ul style="list-style-type: none"> • Staff training in CSR methods. • Staff recruitment – especially for staff with specialist CSR skills. • Supply costs – cost of purchasing environmentally friendly items. • Purchase and installation costs e.g., electric car fleet, charging stations, solar panels. • Maintenance costs – cost of maintaining environmentally friendly assets. • Investment trade off – money spent on CSR could have been spent on alternative investment projects. • Cost of donations and sponsorships. • Distraction – may divert resources from cash inflow activities.
CSR benefits	<ul style="list-style-type: none"> • Reduce some costs e.g., resource use, waste. • Enhance entity reputation. • Favourable reputation may lead to: <ul style="list-style-type: none"> ○ Increased customer acquisition and sales. ○ Improved customer loyalty and sales. ○ Positive media coverage. ○ Improved staff morale. ○ Attract employees. ○ Retain employees. ○ Attract investors who value CSR and ethical behaviour. ○ Increase competitive advantage. ○ New promotional opportunities i.e., advertising campaigns.
CSR – consequences of not displaying CSR	<p><i>Note: the consequences will pretty much be the opposite of the benefits. Some examples are below.</i></p> <ul style="list-style-type: none"> • Lack of investor interest, reducing market price of shares. • Loss of customers and sales. • Lawsuits from public e.g., for habitat destruction, pollution.
CSR - Examples	<p><i>Note: CSR examples could be any activity that positively influences humans or the environment. You can be creative when thinking of this. It may be advantageous in an exam case study to refer to examples of CSR from the case study.</i></p>

Examples of CSR

		Describe	Examples
Environmental CSR Examples	Resource Conservation	Using minimal amounts of resources sustainability.	<ul style="list-style-type: none"> Not using plastic packaging. Turning off lights when not in rooms. Use energy efficiency appliances.
	Greenhouse Gas minimisation	Reducing the amount of greenhouse gases emitted during business operations.	<ul style="list-style-type: none"> Using renewable energy. Installing solar panels. Planting trees.
Social CSR Examples	Taxation Responsibility	Providing complete and accurate tax information.	Not avoiding tax e.g., by: <ul style="list-style-type: none"> Accounting for cash transactions. Not hiding profits overseas.
	Sponsorship	Providing funding for community events and projects. Business receives marketing material in return.	<ul style="list-style-type: none"> Helping build a new park named after the business. Sponsoring a local sport team with business advertising around the field.
	Charity donations	A gift of cash or assets to a non-profit organisation. The business receives nothing in return for the gift.	<ul style="list-style-type: none"> Donating money to a cancer research charity. Donating blankets to a homeless shelter.
	Employee wellbeing	Ensuring employees are safe and treated fairly in the workplace.	<ul style="list-style-type: none"> Allowing workers to take breaks. Paying workers fair wages.

Note: There are many possible CSR behaviours, these are just some examples. A research task may include reading a business's annual report to find examples of CSR or researching examples of companies who have/have not exhibited CSR.

CSR non-financial (qualitative) considerations

	List	Example
CSR non-financial (qualitative) considerations	Customers	Customers can react negatively to decisions made by businesses that have negative impacts on people or the environment. This can result in boycotting or protests outside business premises.
	Employees	Relocating factory operations to a different country and making staff redundant could reduce employee morale for employees who are required to move, lose their job, or lose colleagues who do not relocate.
	Investors	There is a growing trend for investors to factor a business's CSR record when making investment decisions. A company displaying poor CSR behaviour may find it difficult to attract future investors.
	Suppliers	Choosing a new cheaper supplier from overseas may impact the previously used local supplier. This supplier may experience decreased profits, employee layoffs etc. There may also be a negative perception amongst other stakeholders if a supplier is used which has a bad record of human rights abuses or environmental damage.
	Government regulation	A business behaves in a way that is not currently against the law but has a negative impact on people or the environment. This may cause the government to create and enforce strict regulation regarding business conduct in the future.
	Community	Prior to property development it may be important to consult with local first nations groups. Failure to liaise with these groups may cause negative backlash from first nations people and the wider community.
	Environment	When choosing whether to conduct mining operations, the impact to the environment may be considered. I.e. the impact to habitats, animals, plants, wildlife, greenhouse gas emissions etc.
	Competitors	By shutting down a non-profitable store in a specific region this may open the possibility of a competitor opening a shop in this area.

Note: The list above are brief hypothetical examples. You may be required to research or respond to questions more elaborately regarding a specific case study. When answering these questions make sure to explain your response relative to the case study. Often any given case study may impact more than one of the groups listed.

Ethical Behaviour – Define

Ethical behaviour is:

- When decisions are made to align with guiding moral standards and principles.
- Outlined in an entities Code of Conduct.

Ethical Issues – Examples

Ethical issue / Unethical practice	Description	Examples
Tax evasion schemes	<ul style="list-style-type: none"> • Accounting practices may be used to avoid tax legislation resulting in low or no tax paid. 	<ul style="list-style-type: none"> • Offshore business processes may be used to hide business profits in a country with a low company tax rate.
Cash sales	<ul style="list-style-type: none"> • Sales made in cash may not be recorded by a business to prevent taxation. 	<ul style="list-style-type: none"> • A job is completed and the cash payment received is kept in a safe and not reported to the tax office.
Price fixing	<ul style="list-style-type: none"> • Competitors within an industry agree on raising or lowering prices rather than competing. 	<ul style="list-style-type: none"> • A large government contract has come up and multiple potential competitors secretly agree to offer inflated quotes.
Insider trading / Confidentiality breach	<ul style="list-style-type: none"> • Internal users may have access to information the general public does not. • This information could be used for personal advantage. 	<ul style="list-style-type: none"> • A manager is aware a positive business performance announcement will be made and invests in the company prior to the announcement.
Employee exploitation	<ul style="list-style-type: none"> • Businesses treating employees poorly. 	<ul style="list-style-type: none"> • Unsafe working conditions. • Unpaid staff overtime.
Exploitation of overseas workers	<ul style="list-style-type: none"> • A business uses offshore supply chain processes where workers have little welfare support. 	Overseas workers who experience: <ul style="list-style-type: none"> • Low wages. • Unsafe working conditions.

Note: Know any three ethical issues and how to describe them with examples. You can be creative here in thinking of behaviour which may be unethical. You may be asked to refer to a specific case study when identifying ethical issues that have or could occur.



Ciutadella Park, Barcelona.

Practice Questions

Questions 1-14: Corporate Social Responsibility.

Exam Questions

See 'Corporate Social Responsibility' chapter of the Exam Guide for practice exam questions. The Exam Guide can be found by navigating to the Resource Hub link on the front page.

Question 1

Which of the following is not a cost of engaging in corporate social responsibility?

- a. Staff recruitment costs.
- b. Costs of purchasing environmentally friendly assets.
- c. Attraction of investors.
- d. Maintenance costs of environmentally friendly assets.

Question 2

Which of the following is an example of a benefit of engaging in corporate social responsibility?

- a. Diversion of resources from main business activities.
- b. Attracting employees.
- c. Attracting lawsuits.
- d. Protests from far right extremists.

Question 3

Which of the following is an example of unethical practice?

- a. Supporting local charities for advertising opportunities.
- b. Insider trading.
- c. Providing great conditions for employees so they never want to quit.
- d. Paying full company tax rates.

Question 4

An example of an ethical issue is:

- a. Employing overseas workers and paying them a fair wage with good working conditions.
- b. Hiring an accountant to make sure the business is not paying too much tax.
- c. Negotiating with suppliers to get the cheapest possible price.
- d. Meeting with competitors to agree to raise prices for customers.

Question 5

Which of the following would not be a benefit of engaging in corporate social responsibility?

- a. A positive news article enhancing the businesses reputation.
- b. Attract employees who value CSR.
- c. Potentially to attract investors.
- d. Decreased competitive advantage.

Question 6

Qualitative factors that should be considered when making CSR decisions do not include:

- a. Customer perception of the business.
- b. Impact to the environment.
- c. Loss of revenue due to customers shopping elsewhere.
- d. Competitors gaining a competitive advantage.



Environmental Accounting

Climate Change Warrior

Embrace your inner financial eco-warrior, armed with the power of data collection and number-crunching. Your mission? Uncover the environmental impact of business decisions, share your findings, and make epic things happen for our planet.

Is it a good match for me?

If you are passionate about the environment, are on a mission to rescue our planet, or you're head over heels for science and maths, while rocking stellar communication and problem-solving skills, then you're a match.

Where could I work?

Any company who report on their environmental impact, from engineering and manufacturing firms to large corporates or government departments who manage a nation's natural resources.

How do I get there?

You don't need to study anything specific in high school, but business and science-related subjects can help you get a head start.

Ability to work overseas



Graduate salary*



*Hays Salary Guide FY23/24 Accounting and Finance

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8. Cost Accounting

Cost Accounting – Syllabus

Syllabus – Unit 3	
Cost Accounting	Financial institutions and systems: Financial systems and fundamental principles <ul style="list-style-type: none">• the nature of cost concepts for materials, labour and overheads• classification of cost<ul style="list-style-type: none">▪ behaviours: fixed, variable and mixed costs▪ relationships to cost objects: direct and indirect costs▪ treatment of costs: product and period▪ time orientation of costs: past and future• the concept of mark up and the calculation of the unit price of a product Recording, using and evaluating financial information: Recording, processing and communicating financial information <ul style="list-style-type: none">• cost accounting limited to calculation of the unit price of a product/service using only job order costing processes<ul style="list-style-type: none">▪ calculation of direct materials, direct labour and overhead costs▪ calculation and application of predetermined overhead recovery rates only using normal capacity▪ calculation of unit cost and the setting of selling/quotation prices for a job costing product/service▪ use of standard costing and variance analysis for:<ul style="list-style-type: none">○ materials price and usage○ labour rate and efficiency

Cost Accounting – Introduction

During this chapter you will cover a series of processes useful for internal decision making. Calculations and evaluations covered in this chapter are completed in the below steps.

1. Classification of costs based on the:
 - Behaviour of the cost object.
 - Relationship to the cost object.
 - Treatment of the cost object.
 - Time of the cost object.
2. Once costs have been identified, formulas can be applied to calculate things such as:
 - The cost of a job.
 - How much to sell a product for to achieve a desired level of profit.
3. Once a job has been completed, analysis can take place:
 - Calculation of variances between the budgeted costs and actual costs.
 - Reasons for variances identified.



Alhambra, Granada.

Cost classification – Nature, examples

Cost classification		Nature / Definition	Examples
Behaviour of cost object:	Fixed	Costs that do not change with varied numbers of products produced.	<ul style="list-style-type: none"> • Office rent. • Depreciation of NCAs. • Advertising. • Loan interest.
	Variable	Costs that change relative to the number of products manufactured.	<ul style="list-style-type: none"> • Materials used in production. • Factory labour hours.
	Mixed	Costs that contain both a fixed and a variable component.	Usually, expenses with usage that increases when production cost increases but has a service setup cost. <ul style="list-style-type: none"> • Internet. • Electricity. • Phone plan.
Relationship to cost object:	Direct	Costs that are easily related to cost object.	<ul style="list-style-type: none"> • Materials used in production. • Factory labour hours.
	Indirect	Costs that are not easily related to cost object (Manufacturing overheads): <ul style="list-style-type: none"> • These are allocated to cost objects via direct or machine hours. 	<ul style="list-style-type: none"> • Advertising. • Insurance. • Office supplies. • Materials used in small portions such as paint, staples, glue.
Treatment of cost object:	Product	Costs that are directly related to products produced: <ul style="list-style-type: none"> • Direct materials. • Direct labour. • Factory/manufacturing overhead. 	<ul style="list-style-type: none"> • Materials used in production. • Wages of factory workers. • Factory electricity.
	Period	Costs that are related to a period but not related to any specific product: <ul style="list-style-type: none"> • Can be fixed or variable. 	<ul style="list-style-type: none"> • Insurance. • Advertising. • Electricity.
Time of cost object:	Past (Sunk) costs	Costs that have occurred previously and cannot be changed.	<ul style="list-style-type: none"> • Costs from the past that are not related to future investments.
	Future (Relevant) costs	Costs that are related to a future investment proposal.	<ul style="list-style-type: none"> • Costs related to the maintenance, security, or storage a future investment.

Notes:

- Calculations in Specification book.
- Future costs are relevant for managerial decision making as they are required for expense control, decisions on new projects and pricing.



Mer de Glace, Chamonix.

Product costs – Nature, examples

Cost classification		Nature / Definition	Examples
Product costs	Direct material	Materials used and able to be linked to a final product.	<ul style="list-style-type: none"> Fabric. Timber.
	Direct labour	Employee wages required to produce a good or service.	<ul style="list-style-type: none"> Factory worker wages. Painter's wages. Seamstress wages.
	Factory/ manufacturing overhead	<ul style="list-style-type: none"> All the costs incurred during the manufacturing process, not including the costs of direct materials or direct labour. Overheads can include period costs that are linked to product manufacture. Overheads are assigned to the cost of a product using machine hours or labour hours. 	Indirect material: <ul style="list-style-type: none"> Disposable gloves. Machine petrol. Indirect labour: <ul style="list-style-type: none"> Supervisor wages. Cleaning of factory. Other overheads: <ul style="list-style-type: none"> NCA Depreciation and repairs. Factory rent. Factory electricity.

Notes:

- Product costs are one component of treatment classification (product and period costs).
- Some period costs may not be considered manufacturing overheads e.g. advertising, office rent, office staff wages.

Cost object, cost centre, cost unit

	Define
Cost object	Anything which costs can be assigned to. E.g., products, departments, locations, processes, projects, customers, locations etc.
Cost centre (Broader object)	Costs allocated to an overhead process not related to a product, but still requires cash flows. E.g., cost centres may be the advertising department, administration department.
Cost unit (More specific object)	Costs allocated to produce one unit of a product.

Job order costing - Nature

- Used to calculate the cost of a specific job.
- Often used to cost a unique item or small quantities.
- E.g., Quotes for photographer, plumber, dress maker, baker.

Pricing strategy – How cost accounting techniques helps develop a pricing strategy

- Calculation of product costs.
- Calculation of selling price necessary to reflect changes to costs or target profit.
- Selling price set to cover costs plus mark up.

Mark Up – Summary Table

		Mark Up
Nature / Concept		<ul style="list-style-type: none"> • The increase in cost to determine selling price. • Calculated as percentage or in dollars. • Different entities are influenced by varied influences when determining mark up.
Calculation	Formula	Selling price (of good or service) = cost + (mark-up % x cost)
	Calculation / Determination considerations	<ul style="list-style-type: none"> • Achievement of target investment return. • Consumers perception of appropriate selling price. • Competitor selling prices – for both cost leadership and differentiation strategy (see business planning chapter). • If cost leadership strategy chosen – selling price should be less than competitors. • All product costs must be covered. • Some period costs may be covered if they are factory/manufacturing overheads. • If markup is too low, business may experience a loss.

Standard Costing

Standard costing builds on job order costing through the process of:

- Calculation of the standard (estimated) cost of producing a good or service (similar to job order costing).
- Comparison of the standard costs with actual costs.
- Evaluation of the variance between standard costs and actual costs.
- Identification of reasons for these variances.

Standard cost of a product

Standard costing questions begin with calculation of the estimated cost of a good or service. This is the same process of job order costing problems. Standard costing questions will usually break down direct material and direct labour into the components that make up the final cost figure.

The factors that make up direct material and direct labour are analysed for variances.

- Direct material is made up of the following.
 - Material price.
 - Material usage.
- Direct labour is made up of:
 - Labour rate.
 - Labour efficiency.

Note: Variances can also be analysed for overheads but is not included in the syllabus. Some standard cost questions may include a component to calculate the overheads or the predetermined overhead rate. This will be the same process as in job order costing.



Arashiyama Park Observation Deck, Kyoto.

Variance analysis – Nature

Comparison of variances of actual price and usage relative to benchmark price and usage.

- Identifies production area variances as either favourable (positive) or unfavourable (negative).
- Internal control can be applied to remedy unfavourable variances and continue favourable variances.

Variance analysis – Category nature, causes and strategies

Variance		Material variance		Labour variance	
		Material price variances	Material usage variances	Labour rate variances	Labour efficiency variances
Definition / Nature		Difference in the price of material relative to a benchmark.	Difference in the quantity of materials used relative to a benchmark.	Difference in the labour cost per hour relative to a benchmark.	Difference in the labour hours used to produce an item compared to a benchmark.
Causes / Strategies	Favourable More Efficient due to: <i>Note: favourable and unfavourable causes / strategies are opposites</i>	<ul style="list-style-type: none"> • Supplier price decrease through negotiation. • Use of a cheaper supplier. • Cheaper material used that may be lower quality. • Market price of material decreased. 	<ul style="list-style-type: none"> • Improvement in production processes. • Training of staff. • Recruitment of skilled staff. • Higher quality materials used leading to increased usage efficiency. 	<ul style="list-style-type: none"> • Outsourcing to cheaper labour. • Entity negotiates lower wages. • Minimum wage decreases. • Unskilled workers hired and are paid less per hour. 	<ul style="list-style-type: none"> • Higher quality materials used decreases wastage. • Improvement in production processes. • Hiring skilled workers reduces wastage. • Training of workers reduces wastage.
	Unfavourable More inefficient due to:	<ul style="list-style-type: none"> • Supplier negotiates higher price. • Use of a more expensive supplier. • More expensive material used that may be higher quality. • Market price of material increased. 	<ul style="list-style-type: none"> • Production process setback (increase in waste). • Poor training of staff. • Hire of unskilled staff. • Lower quality materials leading to decreased usage efficiency. 	<ul style="list-style-type: none"> • Insourcing to more expensive labour • Staff negotiate pay rise. • Minimum wage increases. • Skilled workers hired are paid more per hour. 	<ul style="list-style-type: none"> • Low quality materials used increases wastage. • Production process setback (waste). • Hiring unskilled workers increases wastage. • Poor training of workers increases wastage.

Note: The 'Favourable' row also represents strategies to improve variances.

Note: Calculations are in the Specification book.

Tip	<u>Practical Guide</u>
	You may find it useful for the practical chapters to work through the Essential Insight Practical Guide textbooks. The Course Guide textbook only contains key summary information from the practically focused chapters. The Essential Insight Practical Guide textbooks contain step-by-step worked examples and practice questions to scaffold students from initial concept attainment to exam level for practically focused chapters. The Practical Guides can be found by navigating to the Resource Hub link on the front page.



Taxation

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Make epic things happen working in taxation. You'll ensure businesses stay on the right side of the law, and be their tax-savvy sidekick, providing guidance on strategic business choices, asset acquisitions and operational matters.

Is it a good match for me?

If you are a master of both people and numbers, an excellent listener, and possess an eagle-eyed attention to detail, then you're a seamless fit.

Where could I work?

Accounting firms of every size, whether they are big players, small teams, or even if you are the mastermind behind your very own business.

How do I get there?

You don't need to study anything specific in high school, but business-related subjects can help you get a head start.

Ability to work overseas

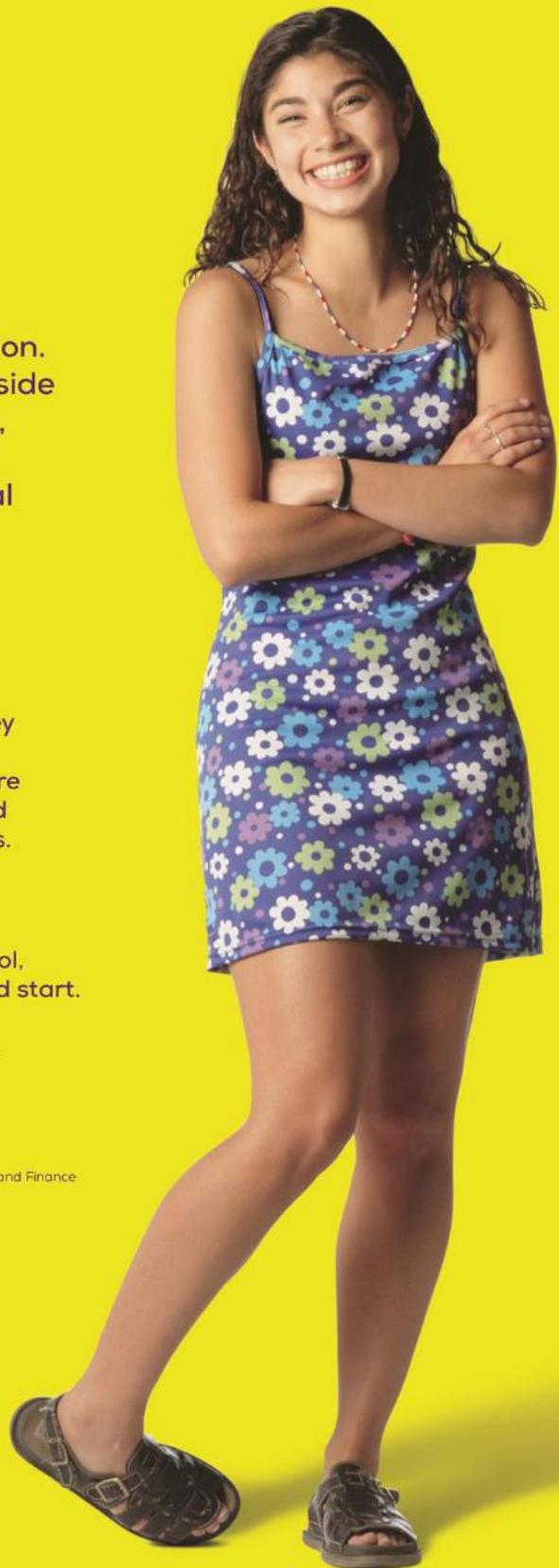


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*Hays Salary Guide FY23/24 Accounting and Finance

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9. Cost Volume Profit (CVP)

CVP – Syllabus

Syllabus – Unit 3	
Cost Volume Profit (CVP)	<p>Financial institutions and systems: Financial systems and fundamental principles</p> <ul style="list-style-type: none"> • explain the relationship between volume of activity, costs and profit <p>Recording, using and evaluating financial information: Evaluating financial information for planning, coordinating, controlling and investing</p> <ul style="list-style-type: none"> • cost-volume-profit (CVP) analysis for decision making purposes <ul style="list-style-type: none"> ▪ cost behaviour ▪ contribution margin ▪ break-even point ▪ margin of safety • interpretation of CVP results and testing of sensitivity to changing decisions about: <ul style="list-style-type: none"> ▪ volumes, product mixes, pricing and costs and the impact of capacity constraints ▪ make or buy decisions ▪ close down product/business unit decisions ▪ accept or reject special orders decisions <p>Recording, using and evaluating financial information: Recording, processing and communicating financial information</p> <ul style="list-style-type: none"> • cost-volume-profit (CVP) processing for a single and multi-product (maximum three products) business <ul style="list-style-type: none"> ▪ calculation of contribution margin ▪ calculation of contribution margin per unit ▪ calculation of weighted average contribution per unit ▪ calculation of margin of safety ▪ calculation of selling price, variable cost, fixed cost, profit or sales volume ▪ calculation of break-even point ▪ calculation of the effect on profit/loss of make or buy decisions ▪ calculation of the effect on profit/loss of closing a department/dropping a segment product decision ▪ calculation of the gain or loss on special order decisions

CVP – Introduction

CVP is a managerial accounting technique that calculates and analyses the relationship between costs, sales volume and profit. CVP is a useful tool for businesses to make informed decisions such as pricing strategies, production levels, and overall business planning.

Below is a theory summary for CVP that will be important to revise for assessments/exams. This theory is covered throughout this chapter and will make more sense once the entire chapter has been covered. For now, this reads as an overview of what will be covered during this chapter.

CVP – Summary Table

CVP	
Nature	Evaluates how changes in selling prices, costs and volume impact entity profit.
Assists in decision making / calculation of	<ul style="list-style-type: none"> • Estimate future profits. • Selling price of products. • Break-even point in units (of production) and dollars. • Capacity constraint decisions – prioritising high contribution margin production. • Whether to accept a special order or not. • Shut down (or Stay Open) decisions. • Make or buy decisions.
	<i>Note: Make sure you can describe these too.</i>
Calculations	See Specification Booklet for calculations.

CVP – Processes and how they assist in decision making

List	Define / Formula / Calculation	Importance / Assists decision making through
Break-even point	<ul style="list-style-type: none"> Where revenue equals costs. 	<ul style="list-style-type: none"> Calculation of unit sales required to cover costs. Evaluation of alternative options. Setting sales KPIs which can motivate employees.
Margin of safety	<ul style="list-style-type: none"> Value of sales over break-even point 	<ul style="list-style-type: none"> Calculation of level that sales can decrease before the entity: <ul style="list-style-type: none"> Operates at a loss. Revenue does not cover costs. Assessment of risk level: <ul style="list-style-type: none"> Lower margin of safety equals higher risk. Calculation of discounts that can be given to customers.
Contribution margin	<ul style="list-style-type: none"> Revenue remaining after variable costs are subtracted from sales 	Evaluation of: <ul style="list-style-type: none"> Profitability/losses of product lines. Appropriate sales prices. Product mix changes. Revenue that covers fixed costs and contributing to profit.

CVP – Components affecting break-even

- Sales price.
- Number of sales.
- Fixed costs.
- Variable costs.

CVP – How to tell which product will maximize profit

CVP can calculate:

- Product sales mix to maximises profit.
- Weighted average contribution margin.
 - This helps calculate break-even unit sales – portion of products to produce to maximize profit.
 - This is done by adding together each products contribution margin multiplied by each products sales mix percentage.

Other Business Decisions related to CVP

Other business decisions that are assisted by CVP analysis include:

- Special order decisions.
- Shut down (or stay open) decisions.
- Make or buy decisions.



View from Aiguille du Midi gondola, Chamonix.

Special order decisions

Special orders are usually once off orders with pricing that varies compared to the regular pricing. For example, a customer may make a large order and ask for a discount. The business must decide whether it is profitable to accept this decision using analysis of costs, volume and profit.

Special order	
Gain/Loss	= $(SP \times QS) - (VC \times QS) - \text{new FC} - OC$ i.e., Special order income – Special order variable costs – New or additional fixed costs – Opportunity costs
where OC	= Units forgone in usual production x Usual contribution margin

CVP – Qualitative factors to consider when making special order decisions

List	Describe
Price competition	Price relative to competitor prices.
Future business	Special order might attract repeat business in future.
Customer loyalty – reduced price	Customer loyalty may be impacted if customers hear about the reduced selling price another customer receives for their special order.
Customer loyalty – current orders	Customer loyalty may be impacted if the business ceases production of current customer orders to fulfil special order. I.e., delayed order fulfilment.
Quality changes	Price reduction may be linked to quality changes causing customers to be unhappy.
Shareholder demands	Shareholders may have expectations of returns that are required to be met.

Note: Know any two list and describe.

Shut down (or stay open) decisions

Businesses often have several departments as part of a larger business structure. Businesses reflect on the profit of each these departments and make decisions as to whether these varied departments should stay open or shut down. Examples of business departments:

- Stores in different areas.
- Varied products.
- Varied opening hours.

Tips	Decision making pattern for shut down (or stay open) decisions
	The main pattern in these questions to look for is whether the department that is being considered for shut down has a positive contribution margin. If the CM is positive, then the department should stay open, even if the fixed expenses allocated to the period result in a loss. This is because the positive contribution margin helps pay for the unavoidable fixed expenses.

CVP – Qualitative factors to consider when making shut down decisions

List	Describe
Investor interest	<ul style="list-style-type: none"> • Investors may view the shut down as a sign business is contracting, not expanding. • This reduces investor perception of future growth and therefore share price.
Existing customers	<ul style="list-style-type: none"> • Shutdown of a store or product may reduce customers loyalty. • Loyalty may be lost due to customers inability to access previously available product.
Employee impact	<ul style="list-style-type: none"> • Store closure may result in employee redundancy or relocation. • This could negatively impact company morale and culture, reducing productivity.
Competition	<ul style="list-style-type: none"> • Shut down could give competitors increased competitive advantage. • This competitor competitive advantage could lead to future losses.

Make or buy decisions

Businesses have the choice to make products, or components of products themselves or buy these from a supplier. This decision is based on both price and qualitative considerations.

Cost of making	=	Variable expense per unit + Fixed expense per unit
Cost of buying	=	Purchase price + Unavoidable fixed expenses
Unavoidable fixed expenses	=	Fixed expenses – Avoidable fixed expenses

Note: the formulas for calculating make or buy decisions are not included in the specification booklet.

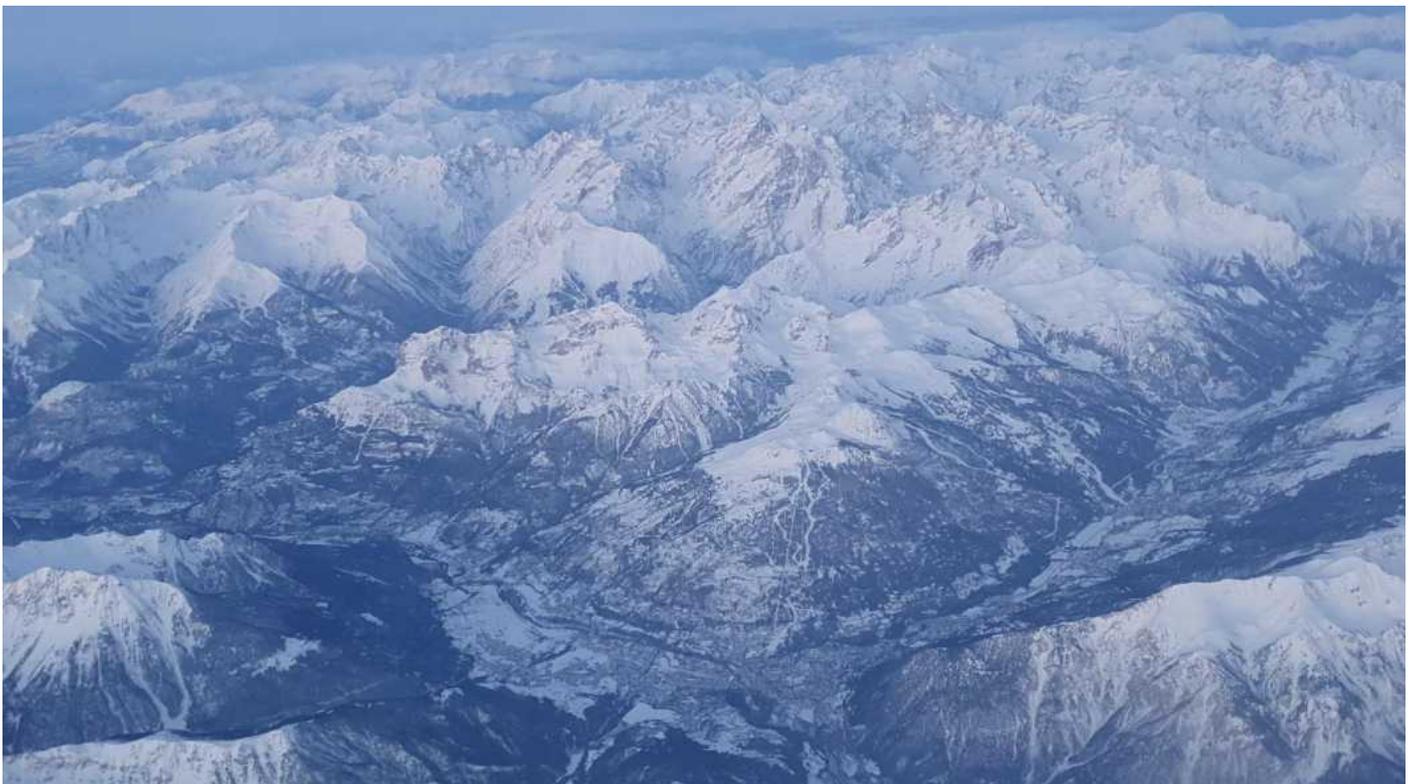
CVP – Make or buy qualitative considerations

	Make	Buy
Reasons for	<ul style="list-style-type: none"> • Lower shipping times. • Better quality oversight. • Can market as 'locally manufactured'. • Use of NCAs already purchased. 	<ul style="list-style-type: none"> • Cost control. • Lower labour costs. • Lower production costs.
Reasons against	<ul style="list-style-type: none"> • Higher labour costs. • Higher production costs. 	<ul style="list-style-type: none"> • Increased shipping times. • Lower quality oversight. • Cannot market as 'locally manufactured'. • NCA's already owned not utilized.

Notes:

- A question could be worded as 'Reasons for/against making product when buying is cheaper' or vice versa.
- These considerations have only been listed and not described. If a question asks you to describe these considerations, make sure you can provide an elaborated description of these reasons.
- If a make or buy decision question is given as part of a case study, reference details from case study.

Tip	<p><u>Practical Guide</u></p> <p>You may find it useful for the practical chapters to work through the Essential Insight Practical Guide textbooks. The Course Guide textbook only contains key summary information from the practically focused chapters. The Essential Insight Practical Guide textbooks contain step-by-step worked examples and practice questions to scaffold students from initial concept attainment to exam level for practically focused chapters. The Practical Guides can be found by navigating to the Resource Hub link on the front page.</p>
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Flight from Nice to Geneva.

10. Budgets

Budgets – Syllabus

Syllabus – Unit 3	
Budgets	<p>Financial institutions and systems: Financial systems and fundamental principles</p> <ul style="list-style-type: none"> • the nature and importance of the master budget • the components of the master budget <ul style="list-style-type: none"> ▪ operating ▪ capital expenditure ▪ financial <p>Recording, using and evaluating financial information: Evaluating financial information for planning, coordinating, controlling and investing</p> <ul style="list-style-type: none"> • purpose and function of cash budgets <ul style="list-style-type: none"> ▪ importance of cash to business viability ▪ interpretation of cash budgets • purpose and function of budgeted income statement • interpretation of budgeted income statement • difference between cash and accrual performance • purpose and function of performance reports • interpretation of performance reports for cash budgets and budgeted income statements <p>Recording, using and evaluating financial information: Recording, processing and communicating financial information</p> <ul style="list-style-type: none"> • preparation of cash budgets, including debtors' and creditors' schedules • preparation of budgeted income statements • preparation of performance reports for cash budgets and budgeted income statement <p><i>Note: The below syllabus section is in both 'capital investment' and 'budgets' given the overlap in syllabus but distinctly different content/examination questions.</i></p> <p>Evaluating financial information for planning, coordinating, controlling and investing</p> <ul style="list-style-type: none"> • interpretation of capital investment/budgeting techniques to evaluate capital expenditure



Mer de Glace, Chamonix.

Budgets – Introduction

Budgets are management’s financial record of goals for a period. The diagram below shows that the master budget has two main subcomponents, the operating and financial budget. These two subcomponents have many subcomponents again. This course only requires practical preparation for the Cash Budget and Budgeted Income Statement. However, you must understand the theory of the budget components outlined on the following table. A performance report is prepared for the Cash Budget and Budgeted Income Statement to evaluate business performance estimates (budgets) to actual results and analyse the reasons for variances.

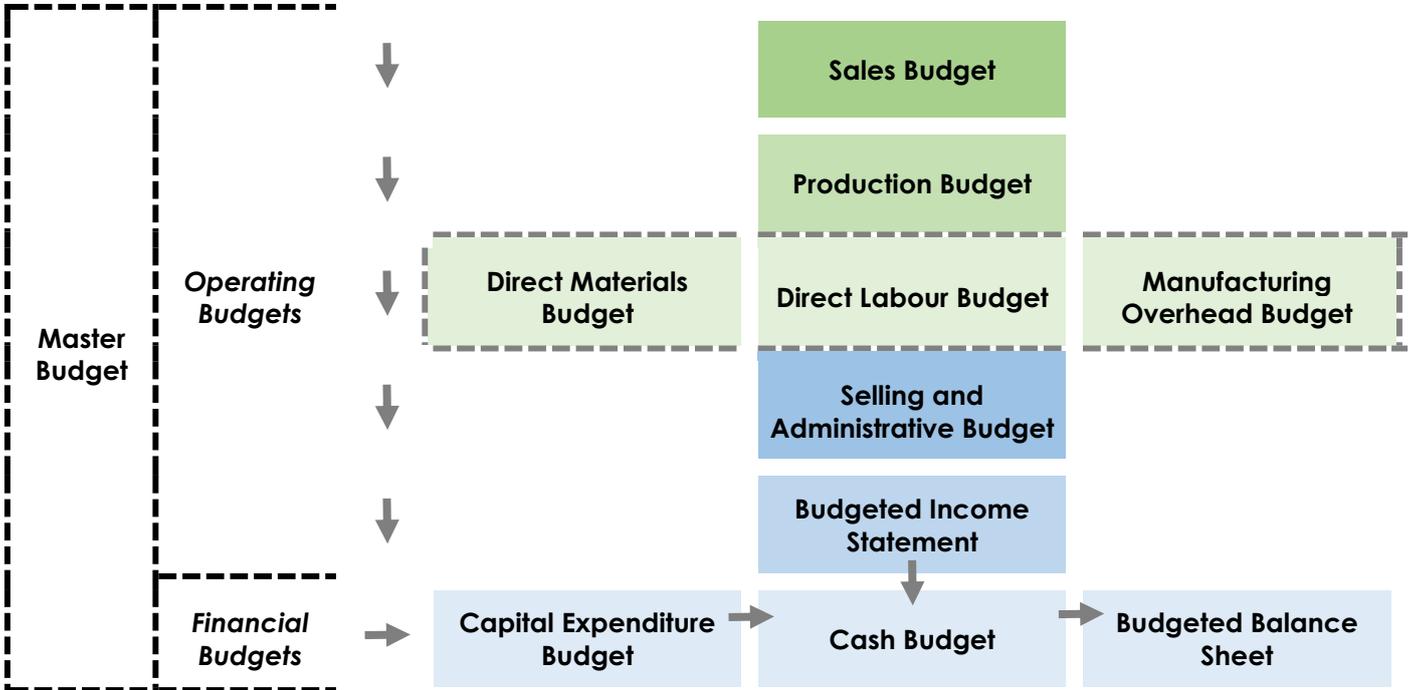


Diagram: Master budget components.



Annecy, France.

Budgets – Nature

Management's financial record of goals for a period.

Budgets – Types

Identify / List	Nature / Explain	Purpose / Importance <i>Know any 2 for each</i>	Includes
Master budget	Manages future entity activities.	<ul style="list-style-type: none"> Used to set KPIs. Allows management of activities to accomplish KPIs. Employees can be motivated to achieve KPIs. Assess performance. Identify areas for improvement. 	<ul style="list-style-type: none"> Operating budget. Capital expenditure budget. Financial budget.
Operating budget	Estimates future income and expenses based on projected sales.	<ul style="list-style-type: none"> Estimate operating profit for period. Sales budget is most significant and is prepared first. 	<ul style="list-style-type: none"> Sales Budget. Production Budget. Selling and administrative budget. <p>These contribute to Budgeted Income statement.</p>
Financial budget	Estimates future assets, liabilities and equity.	<ul style="list-style-type: none"> Highlights required funding for operations to achieve predicted financial position. Identify ability to pay debts as they fall due. 	<ul style="list-style-type: none"> Capital expenditure budget. Cash budget. Budgeted balance sheet.
Capital expenditure budget	Estimates future NCA purchases and sales.	<ul style="list-style-type: none"> Management of NCA's allows a business to: Produce future income. Achieve business growth. 	<ul style="list-style-type: none"> Planned NCA purchases and sales.
Budgeted Income Statement	Estimates income and expenses.	<ul style="list-style-type: none"> Estimate and assess profit for the period. Assist in decision making. Develop internal control strategies regarding income and expenses. 	<ul style="list-style-type: none"> Estimated income, expenses and profit.
Cash Budget	Estimates future cash inflows and outflows for any point in future.	<ul style="list-style-type: none"> Used to set KPIs. Allows management of activities to accomplish KPIs. Employees can be motivated to achieve KPIs. Assess performance. Identify areas for improvement. 	<ul style="list-style-type: none"> Estimated cash inflows and cash outflows.

Cash Budget – Advantages

- Identify cash that could be invested.
- Anticipate liquidity issues and develop prevention strategies.
- Variance analysis can be used to improve future performance.
- Can be used as a supporting document for loan applications.

Note: This could be asked as cash budget - 'functions', 'advantages', 'how it assists in management of business cash needs.' Talk about the nature and purpose of the budget first before discussion of these advantages.

Cash – Importance to business viability

Cash reflects ability of a business to:

- Pay current liabilities.
- Pay debts earlier for discounts.
- Pass credit checks for new suppliers / creditors.
- Manage unexpected expenses.
- Prevent insolvency.
- Invest.
- Pay dividends.

Cash – Measures to ensure balance increases

- Internal control of debt collection.
- Budget management i.e., keep expenses low.
- Negotiate lower prices with suppliers.
- Acquire a loan.
- Negotiate favourable loan terms (keep interest rates low, defer payment).
- Sell unproductive assets.
- Defer unproductive purchases.

Hint: Think of cash flows/internal control and what movements are desirable.

Examples of cash movements not recorded as income in the Budgeted Income Statement

List	Describe
Share issues	This increases the cash at bank (asset) and the equity of a business. There is no income or expense that takes place.
Loan funds	This increases cash at bank (asset) and liabilities (loan from bank) of a business. There is no income or expense that takes place.
Loan repayment	This decreases cash at bank (asset) and decreases the loan (liability) there is a movement of cash but no income or expense. The relevant expense is any interest expense paid.
Proceeds of sale of asset	This increases cash at bank (asset) and decreases the relevant non-current asset (asset) account of a business but there is no income or expense takes place. Instead, the budgeted income statement will record the gain or loss on sale of an asset which is the income or expense. The gain or loss on sale is the difference in the carrying value (historical cost subtract accumulated depreciation) and the amount received for the NCA.
Purchase of NCAs	This decreases cash (asset) or increases in accounts payable (liability) and increases the relevant NCA account (asset). There is no income or expense that takes place.
Drawings	Drawings involve equity and a decrease in cash (asset). There is no income or expense involved.

Performance report – Summary Table

	Performance Reports
Purpose	Evaluate variances regarding budgeted and actual financial performance.
Function / Allows users to <i>Know any 3</i>	<ul style="list-style-type: none"> • Analyse variances. • Reflect on negative variances. • Develop internal control strategies for negative variances. • Reward employees responsible for positive variances. • Manage the entity efficiently. <p><i>Note: If given a case study, discuss any relevant examples from exam question here.</i></p>
Example Reports <i>Know any 2</i>	<ul style="list-style-type: none"> • Cash budget performance report. • Budgeted income statement performance report. • Sales budget performance report. • Production Budget. • Ratio analysis of GPFRs.

Performance Report Examples – Purpose, function

		Cash budget performance report	Budgeted Income Statement Performance Report
Purpose	Purpose	Evaluate the actual and budgeted cash flows during a period.	Evaluate the actual and budgeted income, expenses, and profit during a period.
	Function	<ul style="list-style-type: none"> • Detect and measure variances. • Evaluate variances as favourable or unfavourable. • Develop internal control for negative variances. • Confirm cash available for future investments and current liabilities. • Adjust future planning and budgets with insight from past performance. 	<ul style="list-style-type: none"> • Detect and measure variances. • Evaluate variances as favourable or unfavourable. • Develop internal control for negative variances. • Confirm profit generation ability. • Adjust future planning and budgets with insight from past performance.

Note: if a question asks for purpose but is worth more than 1 mark, write about the function as well.

Cash and accrual – Accounting and Performance Reporting

	Cash	Accrual
Explain difference in accounting	<ul style="list-style-type: none"> Income recognised when the cash is received. Expenses recognised when the cash is paid. 	<ul style="list-style-type: none"> Income recognised when the transaction occurs (income earned). The cash may or may not have been received yet. Expenses recognised when the transaction occurs (expense incurred). The cash may or may not have been paid yet.
Explain difference in performance reporting	<ul style="list-style-type: none"> Evaluates the budgeted and actual cash inflows and outflows to identify variances. This is evaluated through comparison of budgeted cash received and cash paid with actual cash received and cash paid. 	<ul style="list-style-type: none"> Evaluates the budgeted and actual income and expense variances. This is evaluated through comparison of budgeted income earned and expenses incurred with actual income earned and expenses incurred.
Is useful to	<ul style="list-style-type: none"> Evaluate the liquidity and cash flows. 	<ul style="list-style-type: none"> Evaluate business performance and position. This is possible because accrual accounting aligns income and expenses to the year a transaction took place.
Example of difference between cash and accrual accounting – Sales	<ul style="list-style-type: none"> Cash Budget (CB) records sales when cash sales occur or when debtors pay. 	<ul style="list-style-type: none"> Budgeted Income Statement (BIS) records sales when sales made.
Example of difference between cash and accrual accounting – Prepaid advertising	<ul style="list-style-type: none"> CB records the prepaid advertising when the cash is paid 12 months in advance. 	<ul style="list-style-type: none"> BIS records prepaid advertising only when the expense used.

Note: Questions may ask for specific reference to a question with regards to how BIS and BCS account for income and expenses differently. The examples in the above table are for sales and advertising expense.



Monte Carlo, Monaco.

Budget performance report – Reasons for variances

Variance area	Reasons for variances in budget performance report	
	Favourable	Unfavourable
Cash sales	<ul style="list-style-type: none"> • Increased sales. • Increased selling prices. • Increased consumer demand for Inventory. • Decreased competition. • Upswing in economic cycle. 	<ul style="list-style-type: none"> • Decreased sales. • Decreased selling prices. • Decreased consumer demand for inventory. • Increased competition. • Downturn in economic cycle.
Cost of sales	<ul style="list-style-type: none"> • Increased sales leading to an increased cost of sales. • Decrease in cost of inventory relative to budgeted cost of inventory. 	<ul style="list-style-type: none"> • Decreased sales leading to a decreased cost of sales. • Increased cost of inventory relative to budgeted cost of inventory.
Inventory	<ul style="list-style-type: none"> • Decreased inventory purchased due to higher supplier prices. • Decreased cost of inventory relative to budgeted cost. 	<ul style="list-style-type: none"> • Increased inventory purchased due to lower supplier prices. • Increased cost of inventory relative to budgeted cost.
Proceeds of sale of NCA	<ul style="list-style-type: none"> • Increased equipment prices relative to when equipment was purchased. • Favourable exchange rate with overseas equipment sale. 	<ul style="list-style-type: none"> • Decreased equipment prices relative to when equipment was purchased. • Unfavourable exchange rate with overseas equipment sale.
Purchase of NCA	<ul style="list-style-type: none"> • Decreased equipment prices when equipment purchased. • Favourable exchange rate with overseas equipment purchase. 	<ul style="list-style-type: none"> • Increased equipment prices when equipment purchased. • Unfavourable exchange rate with overseas equipment purchase.
Collections from debtors	<ul style="list-style-type: none"> • Increased credit sales. • Increased selling prices. • Improved debt management. • Debtors paying earlier. 	<ul style="list-style-type: none"> • Decreased credit sales. • Decreased selling prices. • Poor debt management. • Debtors paying later.
Payments to creditors	<ul style="list-style-type: none"> • Decreased supplier prices. • Decreased credit purchases. • Poor credit management. • Payment of debts later. 	<ul style="list-style-type: none"> • Increased supplier prices. • Increased credit purchases. • Improved credit management. • Payment of debts earlier.
Wages	<ul style="list-style-type: none"> • Decreased staff wages. • Decreased use of overtime by slow workers • Improved staff management. • Firing of staff. 	<ul style="list-style-type: none"> • Increased staff wages. • Increased use of overtime by slow workers. • Poor staff management. • Hiring of staff.
Gross Profit	<ul style="list-style-type: none"> • Increased sales relative to cost of sales - due to decrease in price or volume of inventory, shipping or discounts allowed. 	<ul style="list-style-type: none"> • Decreased sales relative to cost of sales - due to increase in price or volume of inventory, shipping or discounts allowed.

Note: For strategies to manage these variances, refer to internal control strategies.

Tip	<p><u>Practical Guide</u></p> <p>You may find it useful for the practical chapters to work through the Essential Insight Practical Guide textbooks. The Course Guide textbook only contains key summary information from the practically focused chapters. The Essential Insight Practical Guide textbooks contain step-by-step worked examples and practice questions to scaffold students from initial concept attainment to exam level for practically focused chapters. The Practical Guides can be found by navigating to the Resource Hub link on the front page.</p>
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Cash Budget – Statement Preparation

Key:	<ul style="list-style-type: none"> • Green = positive figure. • Red = negative figure. • Blue = Positive or negative figure.
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Business Name Cash budget For the [number of month(s)] ended X Month 20XX			
Description	Month 1	Month 2	Month 3
Opening bank balance	X	From end of Month 1	From end of Month 2
Estimated receipts			
Cash sales	X	X	X
Collections from debtors/ accounts receivable	X	X	X
Interest on investments	X	X	X
Proceeds from sale of equipment		X	
Total Receipts	Total	Total	Total
Estimated Payments			
Payments to creditors/ accounts payable	X	X	X
Wages	X	X	X
Commission paid	X	X	X
Purchase of NCA: motor vehicle			X
Rent	X	X	X
Interest on loan	X	X	X
Other expenses	X	X	X
Total payments	Total	Total	Total
Cash Surplus or Deficit	Receipts – Payments	Receipts – Payments	Receipts – Payments
Closing bank balance	O Bal plus Cash surplus or subtract Cash deficit	O Bal plus Cash surplus or subtract Cash deficit	O Bal plus Cash surplus or subtract Cash deficit

Budgeted Income Statement – Statement Preparation

Key:	<ul style="list-style-type: none"> • Green = positive figure. • Red = negative figure. • Blue = Total sum.
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Business Name Budgeted Income Statement For the month ended X Month 20XX		
	\$	\$
Sales		X
Less discount allowed		X
Net sales		Sales – discount allowed
Less cost of sales		X
Gross Profit		Net sales – cost of sales
Add other income		
Gain on sale of equipment		X
Interest income		X
Total Income		Gross Profit + Other Income
Less other expenses		
Interest expense	X	
Telephone	X	
Wages	X	
Insurance	X	
Depreciation of motor vehicle	X	Total other expenses
Budgeted profit before tax		Total
Less income tax		X
Budgeted profit after tax		X

Tips	<ul style="list-style-type: none"> • If there is no discount allowed, do not have an entry in the statement for less discount allowed and net sales. • If there was a loss on sale of a non-current asset, this would appear under 'Less other expenses.' • If income tax is not relevant, then the budgeted profit before tax, less income tax and budgeted profit after tax are replaced by just one entry of 'Budgeted Profit'. • If the budgeted income statement is for multiple months, each month only has one column. Rather than being spread over two like in this example.
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11. Business Planning



Activate Prior Knowledge

Respond to the following questions. Discuss your answers with a peer or the class.

<p>What do you think a 'business plan' is? What kind of information would it include?</p>	
<p>How could a business sell a product at a cheaper price than competitors? Why would a business want to sell a product at a lower price?</p>	
<p>In what ways is a phone from twenty years ago different to a phone today?</p>	

Business Planning – Syllabus

Syllabus – Unit 3	
Business Planning	<p><i>Note: Some of the below syllabus sections are in both 'business planning' and 'capital investment' given the overlap in syllabus but distinctly different content/ examination questions.</i></p> <p>Recording, using and evaluating financial information: Evaluating financial information for planning, coordinating, controlling and investing</p> <ul style="list-style-type: none"> • importance of business planning, including a consideration of: <ul style="list-style-type: none"> ▪ goals, objectives and generic business strategies: cost leadership versus differentiation, strategic initiatives and performance management ▪ reducing costs and risk

Business Planning – Introduction

To help ensure business success, business leadership should establish goals to work towards, specific objectives which measure the goals are being reached, and strategies to achieve these goals and objectives. Business planning helps to mitigate risks and costs and enables the establishment of processes to manage business performance.

Also in this chapter is discussion of two common over-arching marketing strategies that may be used by business to gain a competitive advantage. These are cost leadership and differentiation strategies. Cost leadership focuses on a business reducing costs and providing goods and services at a lower cost to competitors to attract customers. Differentiation focuses on business providing goods or services that are innovative or different to competitors attract customers.

Business planning – Summary table

		Business planning
Importance	Overview	<p>The process of:</p> <ul style="list-style-type: none"> • Setting goals, objectives and business strategies. • Establishing performance management processes. <ul style="list-style-type: none"> ○ E.g. Key performance indicators (KPIs), asset management, internal control etc.) • Reducing costs: <ul style="list-style-type: none"> ○ A business must comprehend the types and value of the costs to run the business. ○ Once business costs are understood, the business can investigate ways to reduce costs to ensure positive business performance. • Reducing risks: <ul style="list-style-type: none"> ○ Business planning assists in the identification of potential future risks. ○ A business can make plans to reduce these risks once they have been identified.
How goals, objectives and strategies help plan for a successful business (Importance in detail)	Setting goals	<ul style="list-style-type: none"> • Develop vision for short term and long term business activity. • This process improves decision making through: <ul style="list-style-type: none"> ○ Refined future decision leadership focus. ○ Prioritized allocation of economic resources. ○ Creation of a precedent for future spending approval if spending aligns with business goals.
	Setting objectives	<ul style="list-style-type: none"> • Setting KPIs to evaluate performance: <ul style="list-style-type: none"> ○ Motivates internal users to meet KPIs. ○ Aligns departments processes / priorities with KPIs. • Reviewing performance relative to KPI targets: <ul style="list-style-type: none"> ○ Reduces costs and risks through identification of targets / strategies that require performance improvement.
	Strategic / Generic Business Strategies	<p>Strategies are developed to meet objectives.</p> <ul style="list-style-type: none"> • Cost leadership or differentiation (see table below): <ul style="list-style-type: none"> ○ KPIs can be set to align with chosen business strategy. ○ KPIs regarding business strategy performance reviewed to ensure achievement.
<i>For each subsection, describe any two dot points.</i>		

Note: KPIs stands for 'Key Performance Indicators'. KPIs are covered in more detail in Unit 4.

Marketing strategies – Cost leadership vs. Differentiation

	Cost leadership	Differentiation
Describe / Explain	Lowering costs and price paid by consumers to gain a competitive advantage.	Provide a good or service that is innovative or different from competitors to gain a competitive advantage.
Achieved by	<ul style="list-style-type: none"> • Minimisation and internal control of costs through: <p><i>Note: be creative as to how you can reduce and manage costs. Ideas below.</i></p> <ul style="list-style-type: none"> ○ Reduction of wastage and inefficiencies in all areas. ○ Automation of processes. ○ Direct purchase from source rather than third parties in supply chain. 	<p><i>Note: Think of ways you can appear to be different to existing products.</i></p> <ul style="list-style-type: none"> • New features. • Different origin. • Branding. • Quality. • Service and interactions. • Performing functions competitors do not. • Design. • Advertising. • Pricing model e.g., subscription, freemium.

Note: These strategies to achieve cost leadership and differentiation have only been listed not described. You need to be able to describe these strategies. This is one of the research tasks in the practice questions.

Marketing strategies – Business considerations

When choosing between differentiation and cost leadership:

- Choose:
 - A type of product to offer to the marketplace.
 - A defined customer base (market segmentation).
- Identify a market need (consumer demand).
 - Meet this need by delivering a good or service to meet consumer demand.



Nice, France.

Practice Questions

Questions 1-13: Business Planning.

Exam Questions

See 'Business Planning' chapter of the Exam Guide for practice exam questions. The Exam Guide can be found by navigating to the Resource Hub link on the front page.

Question 1

One of the ways settings goals improves decision making does not include:

- a. Prioritize allocation of economic resources.
- b. Increased customer demand.
- c. Refined future decision leadership focus.
- d. Precedent for future spending approval if aligns with business goals.

Question 2

Identify which of the following will allow a business to achieve cost leadership.

- a. Enhancing the quality of products.
- b. Offering a subscription based pricing model.
- c. Automating production processes.
- d. Setting KPIs to engage in corporate social responsibility.

Question 3

A business has recently invested \$2,500,000 on research and development of a e-hoverboard. This hoverboard is the first product of its kind to allow users to transport on a hovering skateboard with no greenhouse gas emissions. This is an example of which business marketing strategy.

- a. Cost leadership.
- b. New product features.
- c. Corporate social responsibility
- d. Differentiation.

Question 4

Identify which of the following is not an example of the differentiation marketing strategy.

- a. A phone with a new state of the art camera.
- b. Recycling metal off cuts to reduce the money spent on inputs.
- c. A tea towel being advertised with a celebrity endorsement.
- d. A mobile game allowing users to play for free but offering paid content.

Question 5

The importance of business planning does not include:

- a. Establish performance management processes.
- b. Review the strategies of competing businesses.
- c. Setting goals, objectives and business strategies.
- d. Mitigating risks and costs.

Question 6

Business considerations when choosing a marketing strategy include:

- a. The design of the product.
- b. Mitigating costs and risks.
- c. Defining a customer base.
- d. Review of performance relative to KPI targets.

Question 7

A coffee pod manufacturer has recently made a deal with a coffee farm in Nicaragua to supply coffee beans directly, thus reducing costs. Which marketing strategy is this an example of?

- a. Corporate social responsibility.
- b. Differentiation.
- c. Mitigating costs.
- d. Cost leadership.

Question 8

Outline what a business should consider when choosing a business strategy.

Question 9

Compare the business strategies of cost leadership and differentiation. For each strategy describe how this strategy can be achieved.

Question 10

Discuss the importance of business planning. Outline how goals, objectives and strategies help plan for a successful business.



Management Consulting

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12. Capital Investment

Capital Investment – Syllabus

Syllabus – Unit 3	
Capital Investment	<p>Recording, using and evaluating financial information: Recording, processing and communicating financial information</p> <ul style="list-style-type: none"> • capital investment/budgeting techniques for capital expenditure, limited to calculations for cash flows using straight-line depreciation method only and net of taxation <ul style="list-style-type: none"> ▪ discounted cash flows [net present value (NPV) only] ▪ payback period <p>Financial institutions and systems: Financial systems and fundamental principles</p> <ul style="list-style-type: none"> • nature and importance of capital investment decisions • concept of the time value of money • factors affecting capital investment decisions, including: <ul style="list-style-type: none"> ▪ consumer preferences ▪ competition ▪ government regulation <p><i>Note: Some of the below syllabus sections are in both 'business planning' and 'capital investment' given the overlap in syllabus but distinctly different content/ examination questions.</i></p> <p>Recording, using and evaluating financial information: Evaluating financial information for planning, coordinating, controlling and investing</p> <ul style="list-style-type: none"> • interpretation of capital investment/budgeting techniques to evaluate capital expenditure <ul style="list-style-type: none"> ▪ reducing costs and risks <p><i>Note: The below syllabus section is in both 'capital investment' and 'budgets' given the overlap in syllabus but distinctly different content/examination questions.</i></p> <p>Evaluating financial information for planning, coordinating, controlling and investing</p> <ul style="list-style-type: none"> • interpretation of capital investment/budgeting techniques to evaluate capital expenditure

Capital Investment – Introduction

Capital investment refers to the financial commitment made by a company to acquire, upgrade, or maintain physical assets or long-term investments with the expectation of generating returns over an extended period. Long-term investments have long term results and as such, careful review of capital investment decisions occurs to analyse predicted benefits and risks. Capital investment should take into account financial and non-financial (qualitative) considerations.

There are several possible methods to analyse the financial impact of capital investment decisions. The Year 12 syllabus focuses on the Payback Method and Net Present Value Method. Both of these methods have their own advantages and disadvantages which should be considered by businesses when making capital investment decisions.

Capital Investment – Introduction and Summary Table

		Capital Investment
Nature	Overview	<ul style="list-style-type: none"> The review of the viability of long term decisions with long term results. The results of this review impact future: <ul style="list-style-type: none"> Cash flow. Growth. Investor returns.
	Importance / Characteristics	<ul style="list-style-type: none"> High costs, due to NCAs often being expensive to purchase and maintain. High risk, due to uncertain future. Difficult to reverse capital investment decisions. Requirement for careful planning.
Examples		Purchase of NCAs such as: <ul style="list-style-type: none"> Motor vehicle. Machinery. Land. Shares in another entity.

There are two methods used to evaluate capital investment decisions that will be explored in this chapter:

- Payback Period Method.
- Net Present Value (NPV) Method.

Capital Investment – Important concepts

Concept	Nature
Time value of money	<ul style="list-style-type: none"> Future money is worth less than the same amount of money today. Money value changes as a result of: <ul style="list-style-type: none"> Inflation. Interest that is able to be earned on the original money value.
Present values	<ul style="list-style-type: none"> Present value of a set amount decreases over time. If interest rates increase, future money decreases in value. Similar calculation results obtained with either individual discount factor or annuity factor (see specification booklet tables).
Opportunity cost	The loss in benefit from one option when choosing an alternate option. <ul style="list-style-type: none"> Relevant during: <ul style="list-style-type: none"> Capital investment decisions. Asset management.

Capital Investment – Non-financial (Qualitative) considerations

The payback period and NPV method calculate numerical (quantitative) results. However, it is still important to consider qualitative factors when evaluating capital investment decisions.

Identify / List	Explain / Discuss
Government regulation	<ul style="list-style-type: none"> Current and future legislation may impact entity e.g., future CSR regulation.
Consumer preferences	<ul style="list-style-type: none"> Some industries have rapidly changing trends which may decrease confidence of long term investment success.
Competition	<ul style="list-style-type: none"> Number of competitors increases difficulty to compete. An entity with competitive advantages usually outcompetes competitors.

Capital investment – Decision Evaluation Methods

	Payback Method	Net Present Value (NPV)
Considers time value of money	No	Yes
Nature / Explain / Calculation process	<p>Calculation of the time required for revenue produced by investment to reimburse investment cost.</p> <p>Information required for calculation:</p> <ul style="list-style-type: none"> • Original project cost. • Predicted net cash flows produced by project over first few years until investment costs covered (additional revenue less additional expenses). 	<p>Calculation of net cash flows for each year of the useful life of an investment with consideration of discounted cash flows (time value of money).</p> <p>Net flows are added together and result is the 'Net Present Value' of the investment.</p> <p>Information required for calculation:</p> <ul style="list-style-type: none"> • Original project cost. • Predicted net cash flows. • Revenue and expenses recorded as present day dollars using formula or discount rate table.
Investment decision (Project) acceptable when	<p>Payback period compared to entity's benchmark payback period (e.g., investments must be repaid within 3 years or less).</p> <ul style="list-style-type: none"> • If not within benchmark, investment not accepted. • If within benchmark, investment accepted. <ul style="list-style-type: none"> ◦ As payback period decreases, risk decreases. 	<p>NPV compared to entity's expected investment return.</p> <ul style="list-style-type: none"> • If negative value, investment is not accepted. • If positive value, investment is accepted. <ul style="list-style-type: none"> ◦ As NPV increases, investment risk decreases.
Comparing two investments	<ul style="list-style-type: none"> • Payback period compared between investments. • The investment paid back sooner is better. 	<ul style="list-style-type: none"> • NPV of investments can be compared. • The investment with a higher NPV is the better option.
Advantages	<ul style="list-style-type: none"> • Ease of understandability. • Simple calculation. • Provides indication of risk. • Does not require calculation of target rate of return. • Allows estimate calculation of Return on Investment. 	<ul style="list-style-type: none"> • More accurate than Payback method. • Considers the time value of money. • Straight forward decision making, when NPV is zero or more, target return is achieved and vice versa. • Calculates target return/investment yield.
Disadvantages	<ul style="list-style-type: none"> • Less accurate than NPV method. • Time value of money not considered. • No measurement of whether target investment return is achieved. • Cash flows not evaluated once payback achieved. 	<ul style="list-style-type: none"> • Complex calculation. • Complex to understand compared to Payback method. • Estimates later in investments useful life become increasingly approximate. • Difficult to calculate target rate of return and discount rate.

Notes:

- Original cost of the project is usually not hard to estimate quite accurately.
- The NPV method is more accurate than the payback period method due to consideration of time value of money and other advantages outlined in table.
- Calculations for each method are in the Specification book.

Tip	<p><u>Practical Guide</u></p> <p>You may find it useful for the practical chapters to work through the Essential Insight Practical Guide textbooks. The Course Guide textbook only contains key summary information from the practically focused chapters. The Essential Insight Practical Guide textbooks contain step-by-step worked examples and practice questions to scaffold students from initial concept attainment to exam level for practically focused chapters. The Practical Guides can be found by navigating to the Resource Hub link on the front page.</p>
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Agricultural Accounting

Financial Harvester

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Is it a good match for me?

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Where could I work?

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How do I get there?

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Ability to work overseas



Graduate salary*



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13. Accounting Standards



Activate Prior Knowledge

Respond to the following questions. Discuss your answers with a peer or the class.

<p>Why is it important to have consistent account standards?</p>	
<p>Which users of financial information would benefit from accounting standards? Why?</p>	
<p>What would happen if investors lacked confidence in the financial reports of businesses due to poor accounting standards?</p>	

Accounting Standards – Syllabus

Syllabus – Unit 4	
Accounting Standards	Financial institutions and systems: Financial systems and fundamental principles <ul style="list-style-type: none"> • the purpose of accounting standards in: <ul style="list-style-type: none"> ▪ protecting external users ▪ assisting directors in discharging their obligations ▪ providing confidence to investors in Australian capital markets

Accounting Standards – Nature and Purpose

		Describe
		<i>By complying with accounting standards...</i>
Nature		<ul style="list-style-type: none"> • Regulate GPFs content and structure. • Assure stakeholders that GPFs are a relevant and faithful representation of entity's financial performance and position.
Purpose in the context of GPFs	Protect external users	<ul style="list-style-type: none"> • Fair presentation of financial position, performance and cash flows. • Assists stakeholders decision making.
	Provide investors' confidence	<ul style="list-style-type: none"> • Investors' confident GPFs are reliable due to standard compliance.
	Ensure comparability	<ul style="list-style-type: none"> • GPFs are comparable between entities.
	Assists directors to discharge obligations	<ul style="list-style-type: none"> • Directors responsible for the audit of GPFs to ensure reports measure the accountability of the director managing entity resources. • Directors are liable for false, misleading or fraudulent information that arise through lack of compliance with accounting standards. <ul style="list-style-type: none"> ◦ Director liability ensures accountability and promotes reliable GPFs. <p><i>(Note: Directors have accountability in other ways beyond GPFs)</i></p>

Stakeholders that benefit from Accounting Standards

Existing and potential:

- Shareholders / investors.
- Creditors (lenders).
- Government agencies (ATO, ASIC).
- Lobby groups.
- Employees.
- Suppliers.
- Customers.

Accounting Standards – Protection of external users of GPFs

List	Explain the impact on protecting external users when Accounting Standards followed	Explain the impact on protecting external users when Accounting Standards not followed
Rules governing GPF structure	<ul style="list-style-type: none"> • GPFs are prepared with same AAS across entities. • Financial reports are accurate. • Consistent structure helps comparable and informed investor decisions. 	<ul style="list-style-type: none"> • GPFs are not prepared with same standards across entities. • Financial reports are inaccurate. • False image of company financial position makes it difficult to make informed investor decisions.
Report comparability	<ul style="list-style-type: none"> • GPFs comparable between entities and across years due to AAS. 	<ul style="list-style-type: none"> • Difficult to compare financial reports of different entities across years.
Stakeholders ability to make informed decisions	GPF information relevant and faithfully represented: <ul style="list-style-type: none"> • Allowing stakeholders to make informed decisions due to AAS. 	GPF information not relevant and faithfully represented: <ul style="list-style-type: none"> • This creates investment risk for shareholders in the form of lower share price or lower dividends.

Note: AAS stands for Australian Accounting Standards.

Accounting Standards – Impact of investor confidence in GPFs

	If GPFs are poor quality due to a lack of accounting standards	If GPFs are good quality due to good accounting standards
Impact of investor confidence	Less investor confidence in ASX leads to: <ul style="list-style-type: none">• Less investment in companies on share market.• Less incentive for companies to list on ASX.• Entity comparability difficult.• Less capital investment in companies through ASX means less money flowing through economy.	Increased investor confidence in ASX leads to: <ul style="list-style-type: none">• Increased investment in companies on share market.• Increased incentive for companies to list on the ASX.• Entity comparability possible.• Increased capital investment in companies through ASX means more money flowing through the economy.

Practice Questions

Questions 1-10: Accounting Standards.

Exam Questions

See 'Accounting Standards' chapter of the Exam Guide for practice exam questions. The Exam Guide can be found by navigating to the Resource Hub link on the front page.

Question 1

Identify which of the following is not a stakeholder that benefits from the Australian Accounting Standards.

- a. Suppliers.
- b. Employees.
- c. Creditors.
- d. Competitors.

Question 2

Which of the following is not a purpose of Accounting Standards.

- a. Ensure GPFs are comparable between entities.
- b. Allow directors to not be liable for misleading information.
- c. Assist suppliers to a business to make decisions.
- d. Provide confidence to investors.

Question 3

Accounting Standards provide confidence to investors in the Australia stock market. If GPFs are good quality which of the following is likely to occur.

- a. Less money flowing through the Australian economy.
- b. Comparability between entities is difficult.
- c. Higher incentive for companies to list on the ASX.
- d. Investment risk for shareholders.

Question 4

Identify which of the following is not one of the ways that Accounting Standards help protect external users of GPFs.

- a. Increased director accountability.
- b. Allows GPFs to be comparable between entities.
- c. GPFs are prepared the same across
- d. Information in GPFs is faithfully represented.

Question 5

Which of the following is not an impact on external users if accounting standards are not applied.

- a. A false image of the company is portrayed.
- b. Financial reports are inaccurate.
- c. Increased investment risk for investors.
- d. Increased incentive for companies to list on the ASX.

Question 6

Describe the nature of accounting standards.

Question 7

Explain how Australian Accounting Standards can influence investor decisions and discuss the broader impact of investor confidence.

Question 8

Explain how the Australian Accounting Standards influence protect external users of General Purpose Financial Reports.

14. AASB Conceptual Framework for Financial Reporting



Activate Prior Knowledge

Respond to the following questions. Discuss your answers with a peer or the class.

<p>What type of information is found in financial statements?</p>	
<p>Would cash owned by a business be categorised in the same way as money that the business owes? Why?</p>	
<p>How would the Conceptual Framework help the preparers of financial statements?</p>	

AASB Conceptual Framework for Financial Reporting – Syllabus

Syllabus – Unit 4	
AASB Conceptual Framework for Financial Reporting	Financial institutions and systems: Financial systems and fundamental principles <ul style="list-style-type: none"> • the purpose of the <i>Conceptual Framework</i> and its key elements <ul style="list-style-type: none"> ▪ the nature of the reporting entity ▪ the objective of general purpose financial reports ▪ evaluation and application of the fundamental and enhancing qualitative characteristics of financial information ▪ evaluation and application of asset, liability, income and expense recognition criteria

AASB Conceptual Framework – Introduction

The AASB (Australian Accounting Standards Board) Conceptual Framework refers to the set of principles and guidelines that underlie the development and application of accounting standards in Australia. The conceptual framework provides a foundation for the creation of consistent and coherent accounting standards, enhancing the quality and transparency of financial reporting.

Reporting entity – Conceptual Framework Nature / Definition

Adapted from Conceptual Framework 3.10: An entity that is required, or chooses, to prepare financial statements. A reporting entity is not necessarily a legal entity. A reporting entity can be:

- A single entity.
- A portion of an entity.
- Can comprise more than one entity.

GPFR – Objective

Adapted from Conceptual Framework 1.2: To provide financial information about the reporting entity that is useful to existing and potential external stakeholders (investors, lenders and other creditors) in making investing decisions (providing resources to the entity).

GPFR's – Information provided about an entity

GPFRs provide information about reporting entity's	Discuss <i>(Information about the entities...)</i>	This information is found in
Financial position	<ul style="list-style-type: none"> • Assets, liabilities, and equity (economic resources). 	<ul style="list-style-type: none"> • Statement of Financial Position.
Financial performance	<ul style="list-style-type: none"> • Ability to use economic resources to generate profit. 	<ul style="list-style-type: none"> • Statement of Comprehensive Income.
Liquidity / cash flows	<ul style="list-style-type: none"> • Ability to pay debts as they fall due i.e., liquidity and solvency. • Amount of cash inflows and outflows. • Ability to generate future new cash inflows. • Evaluate cash flows from operating, investing and financing activities. 	<ul style="list-style-type: none"> • Statement of Financial Position. • Statement of Cash Flows.

Conceptual Framework – Role

Adapted from SP1.5: Provides the foundation for financial statement preparation and presentation standards that:

- Contribute to transparent by enhancing international comparability and quality financial information. Enables external users to make informed decisions.
- Strengthen accountability by reducing information gap between providers of capital and entities.
- Contribute to economic efficiency by helping investors identify opportunities and risks.

Conceptual Framework – Elements

- Provide definitions for key terms such as assets, liabilities, equity, income and expenses.
- Outlines Qualitative Characteristics of financial statements.
- Objective of GPFRs.

Conceptual Framework – Purpose

Purpose	Describe (Assists 'X' to...)
Assist AASB	<ul style="list-style-type: none"> Develop AAS based on consistent concepts.
Assist preparers of financial statements	<ul style="list-style-type: none"> Develop consistent accounting processes when: <ul style="list-style-type: none"> No standard applies to a given event, or A standard allows choice.
Assist users of financial statements	<ul style="list-style-type: none"> Increase confidence and transparency. Understand standards which guide the preparation of financial statements.
Assist auditors	<ul style="list-style-type: none"> Determine whether GFR's align with AAS.

AASB stands for: Australian Accounting Standards Board. AAS stands for: Australian Accounting Standards.

Elements of Financial Statements – Summary Table

	Asset	Liability	Equity	Income	Expense
Definition	<p>A present economic resource controlled by the entity as a result of past events.</p> <p>An economic resource is a right that has the potential to produce economic benefits.</p>	<p>A present obligation of the entity to transfer an economic resource as a result of past events.</p>	<p>The residual interest in the assets after deducting all its liabilities.</p>	<p>Income is increases in assets, or decreases in liabilities, that result in increases in equity, other than those relating to contributions from holders of equity claims.</p>	<p>Expenses are decreases in assets, or increases in liabilities, that result in decreases in equity, other than those relating to distributions to holders of equity claims.</p>
Aspects of definition	<ul style="list-style-type: none"> Right. Potential to produce economic benefits. Control. 	<ul style="list-style-type: none"> Obligation. Entity to transfer an economic resource. Present obligation as a result of past events. 	N/A		
Recognition Criteria	<p>An element is only recognized in financial statements if it:</p> <ul style="list-style-type: none"> Meets aspects of the definition. Provides users of financial statements with information that is useful, i.e., with: <ul style="list-style-type: none"> Relevant information. Faithful representation. 				

Conceptual Framework – Qualitative Characteristics of Financial Information

- Fundamental Qualitative Characteristics of Financial Information.
- Enhancing Qualitative Characteristics of Financial Information.

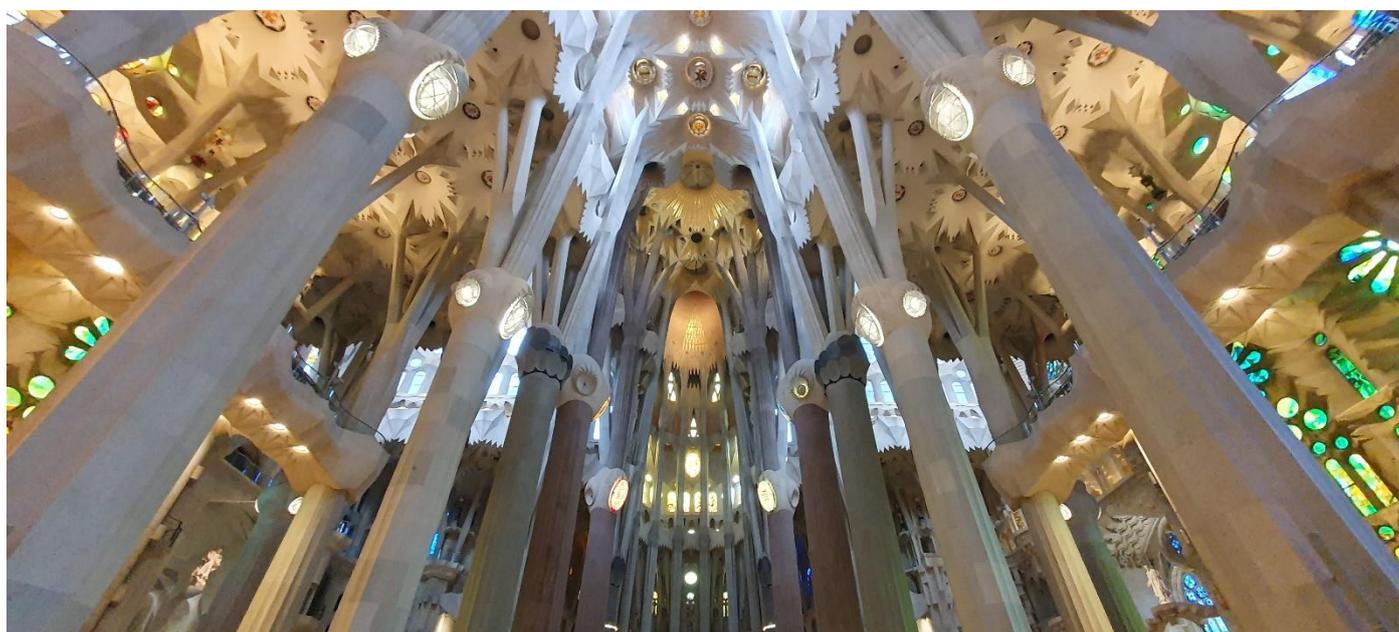
Fundamental Qualitative Characteristics of financial information

Fundamental	Definition
Relevance	Adapted from 2.6: Information that can make a difference in the decisions made by users. Information could make a difference if it has: <ul style="list-style-type: none"> • Predictive value: information can be used to predict future outcomes. • Confirmatory value: information provides feedback about (confirms or changes) previous evaluations
Faithful Representation	Adapted from 2.12-2.18: To be perfectly faithful, information is complete, neutral, and free from error. <ul style="list-style-type: none"> • Complete: includes all information necessary for a user to understand events depicted, including all necessary descriptions and explanations. • Neutral: no bias in financial information selection or presentation. • Free from error: no errors or omissions in the description of the events, and the process used to produce the reported information has been selected and applied with no errors in the process. Perfection is rarely (if ever) achievable. Above qualities should be maximized as much as possible.

Tip	When answering a question asking why an item is an asset, liability etc., refer to: <ul style="list-style-type: none"> • How the item meets the aspects of definition. • Fundamental Qualitative Characteristics: <ul style="list-style-type: none"> ○ Why is the item relevant? ○ Why is it faithful representation to include the item?
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Enhancing qualitative characteristics of financial information

Enhancing	Describe
Understandability	Clear and concise information presentation assists understandability.
Timeliness	Information should be available to stakeholders in time to influence decisions. In general, the more recent information is, the more useful it is. Except for comparison with previous information or trends.
Comparability	Information can be compared other entities and previous periods.
Verifiability	Verification of information provides a guarantee that information is faithfully represented.



Basilica de la Sagrada Família, Barcelona.

Aspects of the Conceptual Framework Definitions

	Aspect of definition	Description of aspect	Examples
Asset	Right	Rights that have the potential to produce economic benefits.	Rights that correspond to an obligation of another party: <ul style="list-style-type: none"> • Rights to receive cash. • Rights to receive goods or services. Rights that do not correspond to an obligation of another party: <ul style="list-style-type: none"> • Rights over physical objects, such as property, plant and equipment or inventories. • Rights to use intellectual property.
	Potential to produce economic benefits	An economic resource is a right that has the potential to produce economic benefits.	<ul style="list-style-type: none"> • Receive cash or other economic resources by selling the economic resource. • Produce goods or provide services. • Using the economic resource to enhance the value of other economic resources.
	Control	Control links an economic resource to an entity.	An entity controls an economic resource if it has the present ability to: <ul style="list-style-type: none"> • Direct the use of the economic resource and • Obtain the economic benefits that may flow from it.
Liability	Obligation	An obligation is a duty or responsibility that an entity has no practical ability to avoid.	<ul style="list-style-type: none"> • Many obligations are established by contract, legislation or similar means and are legally enforceable by the party (or parties) to whom they are owed.
	Entity to transfer an economic resource	The obligation must have the potential to require the entity to transfer an economic resource to another party (or parties).	<ul style="list-style-type: none"> • Obligations to pay cash. • Obligations to deliver goods or provide services.
	Result of past events	A present obligation exists as a result of past events only if: <ul style="list-style-type: none"> • The entity has already obtained economic benefits; and • As a consequence, the entity will or may have to transfer an economic resource that it would not otherwise have had to transfer. 	<ul style="list-style-type: none"> • The economic benefits obtained could include, for example, goods or services. • The economic resources the entity would have to transfer includes cash or goods and services.

Practice Questions

Questions 1-14: AASB Conceptual Framework for Financial Reporting.

Exam Questions

See 'AASB Conceptual Framework for Financial Reporting' chapter of the Exam Guide for practice exam questions. The Exam Guide can be found by navigating to the Resource Hub link on the front page.

Question 1

A purpose of the AASB Conceptual Framework for Financial Statements does not include:

- a. Assist auditors to assess whether reports are prepared in line with accounting standards.
- b. Assist the AASB develop accounting standards.
- c. Assist preparers of financial statements to mitigate tax responsibility.
- d. Assist users of financial statements to have confidence financial reports are comparable.

Question 2

The enhancing qualitative characteristics of financial information are:

- a. Timeliness, understandability, comparability.
- b. Relevance, comparability, verifiability, timeliness.
- c. Comparability, verifiability, timeliness, understandability.
- d. Verifiability, timeliness, relevance.

Question 3

To be perfectly faithful information must be:

- a. Free from error, complete, biased.
- b. Accurate, neutral, free from error.
- c. Accurate, complete, neutral.
- d. Complete, free from error, neutral.

Question 4

An element of the Conceptual Framework includes:

- a. Outlines the Qualitative Characteristics of financial statements.
- b. Provide details about an entities financial position.
- c. Outlines the Quantitative Characteristics of financial statements.
- d. Examples of businesses financial performance.

Question 5

The fundamental qualitative characteristics of financial information are:

- a. Faithful representation and relevance.
- b. Timeliness and comparability.
- c. Faithful representation and timeliness.
- d. Comparability and understandability.

Question 6

Describe the elements of the Conceptual Framework.

Question 7

Outline the information that financial statements provide about an entity. Include in your response the financial statements that this information can be found in.

Question 8

Describe three purposes of the AASB Conceptual Framework.

Question 9

Describe the role of the Conceptual Framework.

Question 10

A fundamental qualitative characteristic of financial information is relevance. Define relevance, predictive value and confirmatory value.

Question 11

A fundamental qualitative characteristic of financial information is faithful information. Describe information that is complete, neutral and free from error.

Question 12

A business is preparing financial statements for the first time. Explain the following qualitative characteristics.

- a. Relevance.
- b. Timeliness.
- c. Comparability.

15. Companies

Companies – Syllabus

Syllabus – Unit 4	
Companies	<p>Financial institutions and systems: Financial systems and fundamental principles</p> <ul style="list-style-type: none"> • characteristics of public and large proprietary companies <ul style="list-style-type: none"> ▪ liability of owners ▪ number of members and directors ▪ continuity of existence ▪ legal entity ▪ transferability of ownership ▪ separation of ownership and management <p>Government and the community: The role and influence of governments and other bodies</p> <ul style="list-style-type: none"> • the purpose and nature of the <i>Corporations Act 2001</i>, and its impact on company formation and operations <ul style="list-style-type: none"> ▪ powers and duties of directors ▪ a written constitution ▪ replaceable rules ▪ prospectus ▪ rights of shareholders <p>Recording, using and evaluating financial information: Recording, processing and communicating financial information</p> <ul style="list-style-type: none"> • preparation of the general journal and general ledger for the following: <ul style="list-style-type: none"> ▪ issue of ordinary shares payable in full on application ▪ bonus share issues ▪ interim and final dividends (recommended, declared or paid) ▪ share issue costs • preparation of the retained earnings ledger account, including: <ul style="list-style-type: none"> ▪ profit or loss ▪ dividends ▪ transfers to and from reserve accounts ▪ debit or credit opening balances <p>Recording, using and evaluating financial information: Recording, processing and communicating financial information</p> <ul style="list-style-type: none"> • preparation of financial statements in accordance with the <i>Conceptual Framework</i> and in accordance with the standards <ul style="list-style-type: none"> ▪ statement of comprehensive income (one statement version only) ▪ statement of financial position ▪ statement of changes in equity <ul style="list-style-type: none"> ○ retained earnings ○ equity ○ share capital ○ reserves • notes to financial statements/notes to accounts, limited only to: <ul style="list-style-type: none"> ▪ share capital ▪ other components of equity ▪ property, plant and equipment ▪ dividends <p>Note: preparation of the above financial statements is restricted to the following issues:</p> <ul style="list-style-type: none"> • revaluation of property, plant and equipment: non-depreciable assets only • cash dividends • bonus share issues • transfers to or from general reserve • preliminary expenses • issue of ordinary shares, including share issue costs • purpose and nature of the following balance day adjustments: <ul style="list-style-type: none"> ▪ accrued expenses ▪ prepaid expenses/stock of supplies ▪ accrued income ▪ income in advance ▪ doubtful debts ▪ depreciation • for the purpose of calculating income tax expense, profit before tax is deemed to equal taxable income

Companies – Introduction

Companies are a form of business ownership in Australia which are governed by the Corporations Act 2001. The practical skills regarding this companies chapter primarily focuses on the accounting processes required to prepare General Purpose Financial Reports (GPFs) for use by external users.

Structure of this chapter

- Company Theory.
- Company Practical – Preparation of GPFs:
 - General journal and general ledger entries required to prepare GPFs.
 - Statement of Changes in Equity.
 - Statement of Comprehensive Income.
 - Statement of Financial Position.
 - Note: The Statement of Cash Flows is a GPF but is covered in its own chapter due to the more complex nature of preparing this report.

Corporations Act 2001 – Nature, purpose

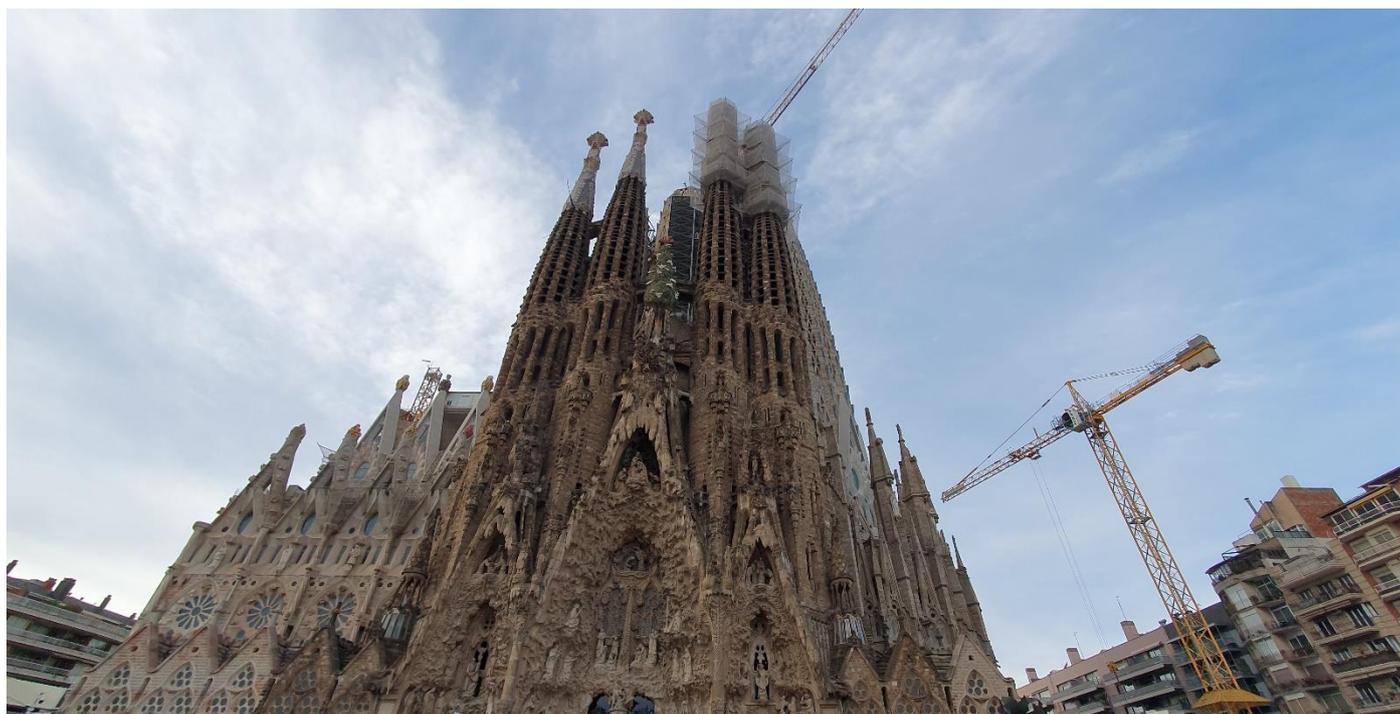
Corporations Act 2001	
Nature	Federal Australian legislation for business entities.
Purpose	<ul style="list-style-type: none">● Primarily legislation is about companies.● Administered by ASIC. <p><i>The purpose of the Act includes company:</i></p> <ul style="list-style-type: none">● Company types.● Legal existence.● Director duties.● External audit requirements. <p><i>Hint: think of things included in the company characteristics comparison table.</i></p>

Note: Corporations Act questions may ask about restrictions on company structures. This type of question is referring to the restrictions as per the company characteristics tables.

Companies – Public vs Private

- Public company – Open to investment from the public.
- Private company – Not open to investment from the public.
 - Small proprietary company.
 - Large proprietary company.

Note: More detailed comparison in following summary tables.



Basílica de la Sagrada Família, Barcelona.

Characteristics of Small and Large Proprietary Companies

	Small Proprietary Companies	Large Proprietary Company
Employees	Fewer than 100 employees	If a proprietary company exceeds any two of the three criteria for small proprietary companies.
Consolidated revenue at the end of the financial year	Less than \$50 million	
Value of consolidated gross assets at the end of the financial year	Less than \$25 million	

Company characteristics comparison

Key	
	• Green = Two match.
	• 3 yellow = All Same.
	• 3 no colour = All different.

	Small Proprietary Companies (SPC)	Large Proprietary Companies (LPC)	Public Companies (PC)
Separate legal entity	Yes.	Yes.	Yes.
Limited liability (Main advantage)	Yes. Limited only to unpaid amounts owing on shares.	Yes. Same as SPC.	Yes. Same as SPC.
Continuity of existence	Yes.	Yes.	Yes.
Separation of ownership and members	Company is run by board of directors. Shareholders elect directors at annual general meeting.	Same as SPC.	Same as SPC.
Transferable ownership	Yes. Shares can be sold as per company constitution.	Yes. Same as SPC.	Yes. Shares can be sold without restriction.
Director(s)	At least one director who lives in Australia.	Same as SPC.	Minimum 3 directors, at least two must live in Australia.
Number of shareholders (members)	Minimum of 1 shareholder and a maximum 50 non-employee shareholders.	Same as SPC.	Minimum of 1 shareholder and no maximum shareholders.
Employees, revenue and gross profit	See table above.	See table above.	No restrictions.

Notes:

- The syllabus only requires characteristics of public and large proprietary companies regarding: 'liability of owners', 'number of members and directors', 'continuity of existence', 'legal entity', 'transferability of ownership', 'separation of ownership and management'.
- Further company characteristic comparison is on the following page and may fall under other syllabus dot points either directly or loosely.
- The above legislation is found in the Corporations Act.

Company characteristics – Further comparison

	Small Proprietary Companies (SPC)	Large Proprietary Companies (LPC)	Public Companies (PC)
Name	Requires "Proprietary Limited" or "Pty Ltd".	Same as SPC.	Requires "Limited" or "Ltd".
ASX Listed	No.	No.	Yes, optionally listed on ASX. Can either be listed or unlisted.
Access to capital / Issue of securities (shares or debentures)	Can raise funds from employees and existing shareholders.	Same as SPC.	Can raise funds from the public by issuing shares or debentures.
Annual General Meeting (AGM)	Not required.	Not required.	Required to hold AGM.
Constitution	Required to have a Constitution. ASIC lodgment of Constitution not required. Copy of Constitution must be kept in company's records.	Same as SPC.	Required. ASIC lodgment of Constitution required.
Financial statements audit	Only lodged or audited if requested by ASIC.	Required to prepare, audit and lodge GPFs with ASIC.	Same as LPC.
Director's report	Not required.	Required for ASIC and shareholders.	Same as LPC.
Shareholders dividends	Receive profits if dividend declared.	Same as SPC.	Same as SPC.
Tax rate	Flat tax rate.	Flat tax rate.	Flat tax rate.
Regulation / Legislative interference	Less than LPC and public companies.	More than SPC, less than PC. GPFs submitted to ASIC and shareholders.	More than LPC. GPFs submitted to ASIC and shareholders. Must comply with ASX listing rules.

Notes:

- The syllabus only requires characteristics of public and large proprietary companies regarding: 'liability of owners', 'number of members and directors', 'continuity of existence', 'legal entity', 'transferability of ownership', 'separation of ownership and management'.
- This table of company characteristic comparison may fall under other syllabus dot points either directly or loosely.
- The above legislation is found in the Corporations Act.

Share issue price

Public company shares are issued at:

- A price per share determined by directors.

Shareholder rights

Right	Ordinary Shareholders	Preference Shareholders
Dividends	No specific dividend rights.	Dividends paid before ordinary shareholders at a fixed rate.
Voting rights	Voting rights at AGM.	No right to attend or vote at AGM.
Liquidation repayment order	Last to receive liquidation payment.	Repayment may occur before ordinary shareholders during liquidation based on Constitution.
Share sale	Can sell shares without restriction.	Can sell shares without restriction.
Receive Annual Report	Yes.	Yes.

Company constitution – Summary Table

	Company Constitution
Nature	Rules to define internal management processes.
Purpose	<ul style="list-style-type: none"> • Is not compulsory, 'replaceable rules' can be used instead of a company constitution. • Company constitution replaces the 'replaceable rules'. • Can modify the 'replaceable rules'. • Company constitution must be submitted to ASIC.
Covers / Function / Deals with	<ul style="list-style-type: none"> • Shareholder rights. • Director powers. • AGM voting procedures.

Replaceable Rules – Summary Table

	Replaceable Rules
Nature / Purpose	<ul style="list-style-type: none"> • Basic rules outlining internal management processes of businesses. • Included in Corporations Act. • These are the default rules of a business if no custom company constitution has been created.
Deal with / Functions	<ul style="list-style-type: none"> • Director appointment. • Director powers. • AGM processes. • AGM voting. • Shares. • Director salaries.

Prospectus – Summary Table

	Prospectus
Nature	Prospectus of public company invites members of the public to purchase company shares or debentures.
Purpose / Function	<ul style="list-style-type: none"> • Includes information that investors require to decide whether to purchase shares or debentures. • Aligns with Corporations Law requirements when making information public. • Prospectus available to public and lodged with ASIC and ASX.
ASIC registration	Required when shares in public company are offered to the public.
Information includes <i>Know any 3</i>	<ul style="list-style-type: none"> • Where investor money will be spent specifically. • Future financial planning. • GPF information. • Directors and senior management details. • Company age. • Value and number of shares/debentures. • Minimum share subscription amount for security issue to proceed.

Directors – Duties

- Act in good faith.
- Act with care and diligence.
- Avoid improper use of information.
- Avoid improper use of position.
- Disclose personal interests.
- Management of a public company.
- Dividend recommendation and approval.
- Awareness of company's position and performance.
- Not trade while insolvent.
- Ensure legislation compliance.

Note: Know any 4.

Annual General Meeting (AGM) – Purpose

- Review performance.
- Shareholders can ask questions.
- Voting on key issues, such as:
 - Approval of GPFs.
 - Director election/re-election.
- AGM formally resolved with director preparation and acceptance of Annual Report.

Impact of proprietary limited company becoming public company on manager's control

Changes managers control in the form of:

- Directors are now required to act in interest of all shareholders, not just themselves.
- Director ability to influence decisions is based on the number of shares owned.
- Control could be lost due to separation of owners and management.

Negative aspects of company characteristics

Negative aspect	Explain
Separation of ownership and management	<ul style="list-style-type: none">• Shareholders have ownership portion with no day-to-day management capacity.• GPFs are the only insight into an entity before directors are elected.• Self-interest of directors or management could negatively impact shareholders.
Continuity of existence	<ul style="list-style-type: none">• Company survival depends on director ability to manage entity.• Insolvency can disrupt operations.• Liquidation ceases to operations.
Costs	<ul style="list-style-type: none">• High start up and running costs.
Regulation	<ul style="list-style-type: none">• Legislation influences operations and is expensive to comply with.



Casa Batlló, Barcelona.

Annual report – Additional items included, other than GPFs and notes to the accounts

Identify	Describe
External audit report	<ul style="list-style-type: none"> Independent assessment of GPFs. Concludes whether GPFs: <ul style="list-style-type: none"> Are a true and fair presentation of company. Comply with legislation.
Director's report	Provides review of company: <ul style="list-style-type: none"> Financial position. List of directors and their remuneration. Board of directors' changes. Core goals. Business strategies. Review of previous year(s). Future goals. <i>(Hint: think of Business Planning chapter.)</i>
CSD report	<ul style="list-style-type: none"> Provides information regarding CSR obligations, goals and progress.
KPI report	<ul style="list-style-type: none"> Reflects on performance relative to KPIs.
Corporate Governance report	<ul style="list-style-type: none"> Must be produced by all companies listed on the ASX. Report includes policies and processes that the entity follows and maintains.
A directors' declaration	States that financial statements and notes to the accounts represent: <ul style="list-style-type: none"> A fair and true presentation of company. Accurate preparation as per Australian Accounting Standards. The company is solvent.

Note: This additional information is required for full disclosure. Know how to identify and describe any three. For each of those three any two description dot points is usually enough.

General Purpose Financial Reports contained in the Annual Report

Annual reports include a series of General Purpose Financial Reports (GPFs) to provide information to stakeholders. These GPFs include:

- Statement of Comprehensive Income.
- Statement of Changes in Equity.
- Statement of Financial Position.
- Statement of Cash Flows.

Note: While the statement of cash flows is also a GPF, this is covered in its own chapter due to the many steps involved relative to other GPFs.

General Purpose Financial Reports – Summary Table

Statement	Financial Position	Comprehensive Income	Cash Flows	Changes in Equity
Accrual or cash accounting	Accrual	Accrual	Cash	Accrual
Enables users to evaluate the company's	<ul style="list-style-type: none"> Financial position. Liquidity. 	<ul style="list-style-type: none"> Performance. 	<ul style="list-style-type: none"> Cash-related activities impact on cash position. 	Changes in equity during the period.
Discloses / Measures and reports	<ul style="list-style-type: none"> Assets. Liabilities. Shareholders' equity. 	<ul style="list-style-type: none"> Profit or loss. Other comprehensive income. Comprehensive income. 	Cash related activities classified as: <ul style="list-style-type: none"> Operating. Investing. Financing. 	<ul style="list-style-type: none"> Total comprehensive income. Equity reconciliation of carrying amount between at the start an end of period for: <ul style="list-style-type: none"> Profit or loss. Other comprehensive income. Owner contributions and distributions to owners.

Tip	<p><u>Practical Guide</u></p> <p>You may find it useful for the practical chapters to work through the Essential Insight Practical Guide textbooks. The Course Guide textbook only contains key summary information from the practically focused chapters. The Essential Insight Practical Guide textbooks contain step-by-step worked examples and practice questions to scaffold students from initial concept attainment to exam level for practically focused chapters. The Practical Guides can be found by navigating to the Resource Hub link on the front page.</p>
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Reserves

During this chapter, reserves are introduced. Reserves are equity items other than share capital. The three types of reserves covered in this course are:

- Retained Earnings.
 - Profits are transferred to retained earnings at the end of the financial year.
 - Dividends are paid from retained earnings.
 - These are covered in more detail in another section.
- General Reserve.
 - A general reserve is created by a company to set aside funds for future use. Funds can be transferred to or from the general reserve from retained earnings.
- Asset Revaluation Reserve.
 - An asset revaluation is created when the value of a non-current asset increases above the historical cost of the asset recorded on the balance sheet.

General journal and ledger entries for GPFR preparation

Share issue and share issue costs

Companies issue shares to raise capital. There are a series of general ledger and journal entries required to record the issue of shares and the costs of issuing shares.

Issue of Ordinary share payable in full on application

Step	General Journal Entry	General Ledger Entry																																																
1. Application money received.	<table border="1"> <thead> <tr> <th>Date</th> <th>Details</th> <th>D</th> <th>C</th> </tr> </thead> <tbody> <tr> <td></td> <td>Cash at Bank Application Application money received for (number of shares), \$X.XX shares</td> <td style="text-align: center;">X</td> <td style="text-align: center;">X</td> </tr> </tbody> </table>	Date	Details	D	C		Cash at Bank Application Application money received for (number of shares), \$X.XX shares	X	X	<table border="1"> <thead> <tr> <th colspan="5">Cash at Bank</th> </tr> <tr> <th>D</th> <th>Desc.</th> <th>\$</th> <th>D</th> <th>Desc.</th> </tr> </thead> <tbody> <tr> <td></td> <td>Application</td> <td style="text-align: center;">X</td> <td></td> <td></td> </tr> </tbody> </table> <table border="1"> <thead> <tr> <th colspan="5">Application</th> </tr> <tr> <th>D</th> <th>Desc.</th> <th>\$</th> <th>D</th> <th>Desc.</th> </tr> </thead> <tbody> <tr> <td></td> <td></td> <td></td> <td></td> <td>Cash at Bank</td> </tr> <tr> <td></td> <td></td> <td></td> <td></td> <td style="text-align: right;">X</td> </tr> </tbody> </table>	Cash at Bank					D	Desc.	\$	D	Desc.		Application	X			Application					D	Desc.	\$	D	Desc.					Cash at Bank					X					
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2. Share allotment, application transfer	<table border="1"> <thead> <tr> <th>Date</th> <th>Details</th> <th>D</th> <th>C</th> </tr> </thead> <tbody> <tr> <td></td> <td>Application Ordinary share capital Allotment of (number of shares), \$X.XX shares</td> <td style="text-align: center;">X</td> <td style="text-align: center;">X</td> </tr> </tbody> </table>	Date	Details	D	C		Application Ordinary share capital Allotment of (number of shares), \$X.XX shares	X	X	<table border="1"> <thead> <tr> <th colspan="5">Application</th> </tr> <tr> <th>D</th> <th>Desc.</th> <th>\$</th> <th>D</th> <th>Desc.</th> </tr> </thead> <tbody> <tr> <td></td> <td>Ordinary share capital</td> <td style="text-align: center;">X</td> <td></td> <td>Cash at Bank</td> </tr> <tr> <td></td> <td></td> <td></td> <td></td> <td style="text-align: right;">X</td> </tr> </tbody> </table> <table border="1"> <thead> <tr> <th colspan="5">Ordinary share capital</th> </tr> <tr> <th>D</th> <th>Desc.</th> <th>\$</th> <th>D</th> <th>Desc.</th> </tr> </thead> <tbody> <tr> <td></td> <td></td> <td></td> <td></td> <td>Application</td> </tr> <tr> <td></td> <td></td> <td></td> <td></td> <td style="text-align: right;">X</td> </tr> </tbody> </table>	Application					D	Desc.	\$	D	Desc.		Ordinary share capital	X		Cash at Bank					X	Ordinary share capital					D	Desc.	\$	D	Desc.					Application					X
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Share issue costs

Step	General Journal Entry	General Ledger Entry																																											
1. Share issue cost payment	<table border="1"> <thead> <tr> <th>Date</th> <th>Details</th> <th>D</th> <th>C</th> </tr> </thead> <tbody> <tr> <td></td> <td>Share Issue Costs Cash at Bank Share issue cost payment</td> <td style="text-align: center;">X</td> <td style="text-align: center;">X</td> </tr> </tbody> </table>	Date	Details	D	C		Share Issue Costs Cash at Bank Share issue cost payment	X	X	<table border="1"> <thead> <tr> <th colspan="5">Share Issue Costs</th> </tr> <tr> <th>D</th> <th>Desc.</th> <th>\$</th> <th>D</th> <th>Desc.</th> </tr> </thead> <tbody> <tr> <td></td> <td>Cash at Bank</td> <td style="text-align: center;">X</td> <td></td> <td></td> </tr> </tbody> </table> <table border="1"> <thead> <tr> <th colspan="5">Cash at Bank</th> </tr> <tr> <th>D</th> <th>Desc.</th> <th>\$</th> <th>D</th> <th>Desc.</th> </tr> </thead> <tbody> <tr> <td></td> <td></td> <td></td> <td></td> <td>Share Issue Costs</td> </tr> <tr> <td></td> <td></td> <td></td> <td></td> <td style="text-align: right;">X</td> </tr> </tbody> </table>	Share Issue Costs					D	Desc.	\$	D	Desc.		Cash at Bank	X			Cash at Bank					D	Desc.	\$	D	Desc.					Share Issue Costs					X
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2. Transfer of share issue costs	<table border="1"> <thead> <tr> <th>Date</th> <th>Details</th> <th>D</th> <th>C</th> </tr> </thead> <tbody> <tr> <td></td> <td>Ordinary share capital Share issue costs Transfer of share issue costs</td> <td style="text-align: center;">X</td> <td style="text-align: center;">X</td> </tr> </tbody> </table> <p><i>Note: Share issue costs are not an expense, this reduces equity instead.</i></p>	Date	Details	D	C		Ordinary share capital Share issue costs Transfer of share issue costs	X	X	<table border="1"> <thead> <tr> <th colspan="5">Ordinary share capital</th> </tr> <tr> <th>D</th> <th>Desc.</th> <th>\$</th> <th>D</th> <th>Desc.</th> </tr> </thead> <tbody> <tr> <td></td> <td>Cash at Bank OR Accounts Payable</td> <td style="text-align: center;">X</td> <td></td> <td></td> </tr> </tbody> </table> <table border="1"> <thead> <tr> <th colspan="5">Share Issue Costs</th> </tr> <tr> <th>D</th> <th>Desc.</th> <th>\$</th> <th>D</th> <th>Desc.</th> </tr> </thead> <tbody> <tr> <td></td> <td></td> <td></td> <td></td> <td>Ordinary share capital</td> </tr> <tr> <td></td> <td></td> <td></td> <td></td> <td style="text-align: right;">X</td> </tr> </tbody> </table>	Ordinary share capital					D	Desc.	\$	D	Desc.		Cash at Bank OR Accounts Payable	X			Share Issue Costs					D	Desc.	\$	D	Desc.					Ordinary share capital					X
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Bonus share issue

A company may choose to issue bonus shares to existing shareholders. The benefit of issuing bonus shares is the ability to compensate shareholders, without a cash outflow taking place. I.e., issuing dividends would be an outflow of cash, whereas when issuing bonus shares no cash outflow takes place. Bonus share issues may take place when an entity is short on cash, but investors still demand regular income. Investors can sell bonus shares for income.

The issue of bonus shares can take place out of retained earnings, general reserve or asset revaluation reserve.

Step	General Journal Entry				General Ledger Entry					
1. Issue of bonus shares from retained earnings or reserves.	Date	Details	D	C	Retained Earnings OR GR or ARR					
		Retained Earnings or GR or ARR Ordinary share capital Issue of (number of shares), \$X.XX, bonus shares, from reserves OR retained earnings.	X	X	D	Desc.	\$	D	Desc.	\$
<i>Note: Bonus share issue can come from general reserve, asset revaluation reserve or retained earnings. This would require swapping retained earnings account for either the General Reserve or Asset Revaluation Reserve.</i>					Ordinary share capital					
					D	Desc.	\$	D	Desc.	\$
								Retained Earnings or GR or ARR	X	

Interim and final dividends (recommended, declared or paid)

Retained Earnings

Retained earnings are the remaining profits after dividends have been paid. Retained earnings is a capital account used to withhold profits for future use. The retained earnings account is also used to distribute profits of the company to shareholders in the form of dividends.

Dividends

Dividends are either final dividends or interim dividends. The general journal and general ledger entries record both the approval of the dividend and the payment of the dividend.

Final dividend

- The directors of a company can recommend a final dividend at the end of a financial year. This recommended dividend is discussed at the annual general meeting for shareholder approval before being paid.

Interim dividend

- An interim dividend takes place mid financial year and is declared and paid by directors, without the approval of (being declared by) shareholders. The ability for directors to approve (declare) and pay interim dividends must be outlined in the company's constitution.

Step	General Journal Entry				General Ledger Entry					
1. Dividend approved by the directors.	Date	Details	D	C	Retained Earnings					
		Retained Earnings Dividend payable – Final OR Interim Dividend approved by the (directors or shareholders).	X	X	D	Desc.	\$	D	Desc.	\$
<i>Note: The final dividend is approved by shareholders. The interim dividend is approved by directors.</i>					Dividend payable – Final OR Interim					
					D	Desc.	\$	D	Desc.	\$
								Retained Earnings	X	
2. Payment of dividend.	Date	Details	D	C	Dividend payable – Final OR Interim					
		Dividend payable – Final OR Interim Cash at Bank Payment of (Final OR Interim) dividend.	X	X	D	Desc.	\$	D	Desc.	\$
					Cash at Bank					
					D	Desc.	\$	D	Desc.	\$
								Dividend payable – Final/Interim	X	

General Reserve and Retained Earnings

A general reserve is created by a company to set aside funds for future use. Funds can be transferred to or from the general reserve from retained earnings.

Transfer to general reserve to retained earnings

Step	General Journal Entry				General Ledger Entry					
1. Transfer to general reserve from retained earnings	Date	Details	D	C	Retained Earnings					
		Retained Earnings General Reserve Transfer to general reserve	X	X	D	Desc.	\$	D	Desc.	\$
						General Reserve	X			
					General Reserve					
					D	Desc.	\$	D	Desc.	\$
								Retained Earnings	X	

Transfer from general reserve to retained earnings

Step	General Journal Entry				General Ledger Entry					
1. Transfer from general reserve to retained earnings	Date	Details	D	C	General Reserve					
		General Reserve Retained Earnings Transfer from general reserve	X	X	D	Desc.	\$	D	Desc.	\$
						Retained Earnings	X			
					Retained Earnings					
					D	Desc.	\$	D	Desc.	\$
								General Reserve	X	

Asset Revaluation Reserve

An asset revaluation is created when the value of a non-current asset increases above the historical cost of the asset recorded on the balance sheet. For example, the value of land purchased for \$250,000 five years ago is revalued today at \$300,000. For the accounting records to accurately portray the financial position of the company, the asset must be revalued at an increased price. This is done through the asset revaluation reserve.

Step	General Journal Entry				General Ledger Entry					
1. Revaluation of land	Date	Details	D	C	Land					
		Land Asset Revaluation Reserve Revaluation of Land	X	X	D	Desc.	\$	D	Desc.	\$
						Asset Revaluation Reserve	X			
					Asset Revaluation Reserve					
					D	Desc.	\$	D	Desc.	\$
								Land	X	

Statement of Changes in Equity – Statement Preparation

Key	<ul style="list-style-type: none"> • Green = positive figure. • Red = negative figure. • Blue = no net change in equity.
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Company Name Statement of Changes in Equity For the year ended 30 June 20XX					
	Ordinary share capital	Retained earnings	Asset revaluation reserve	General reserve	Total equity
Balance at beginning	X	X	X	X	\$TOTAL
Issue of share capital	X				X
Share issue costs	(X)				(X)
Issue of bonus shares	X	(X)	(X)	(X)	0
Dividends		(X)			(X)
Total comprehensive income for the period		X	X		X
Transfer to OR from reserves		X Or (X)		(X) or X	0
Balance as at 30 June 20XX	\$TOTAL	\$TOTAL	\$TOTAL	\$TOTAL	\$TOTAL

Company Name Statement of Changes in Equity For the year ended 30 June 20XX	
Profit for the period	X
Changes in Revaluation reserve during period	X
Total recognised income and expenses for the period	\$TOTAL
Ordinary share capital	
Balance at start of period	Opening Balance
Issue of share capital	X
Share issue costs	(X)
Bonus share issue	X
Total share capital	\$TOTAL
Reserves	
Asset revaluation reserve	
Balance at start of the period	Opening Balance
Gain on revaluation	X
Balance at end of period	Closing Balance
General reserve	
Balance at start of period	Opening Balance
Bonus share issue	(X)
Transfer to OR from retained earnings	Positive figure if to reserve OR Negative figure if from reserve
Balance at end of period	Closing Balance
Total Reserves	General reserve + Asset Revaluation Reserve
Retained earnings	
Balance at start of period	Opening Balance
Profit for the period	X
Total for the period	\$TOTAL of above two entries
Transfer to OR from general reserve	Negative figure if to reserve OR Positive figure if from reserve
Dividends	(X)
Bonus share issue	(X)
Balance at end of the period	Previous \$TOTAL + above two entries

Tips	<ul style="list-style-type: none"> • The transfer to/from reserves will either be positive or negative whether it is to OR from. • Issue of bonus shares comes from either retained earnings, general reserve or A.R.R.
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Statement of Comprehensive Income – Statement Preparation

Key:	<ul style="list-style-type: none"> • Green = positive figure. • Red = negative figure. • Blue = Total sum.
-------------	---

Company Name Statement of Comprehensive Income For the year ended 30 June 20XX	
Revenue	X
Less Cost of Sales	(X)
Gross Profit	X
Add Other Income	X
Less Finance Expenses	(X)
Less Operating Expenses (includes Other expenses)	(X)
Profit before Tax	\$TOTAL
Less Income Tax Expense	(X)
Profit after Tax	\$TOTAL
Add Other Comprehensive Income	
Gain on Asset Revaluation	X
Total Comprehensive Income for the Period	\$TOTAL

Tips	<ul style="list-style-type: none"> • If the question does not include 'Cost of Sales,' do not include 'Cost of Sales' and 'Gross Profit' entries. • If other individual entries are not present in question, do not include that specific individual entry. • To find 'income tax expense' – multiply Profit before tax by the tax rate given in question.
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Calculation of entries for the Statement of Comprehensive Income

Entry	Examples
Revenue	<ul style="list-style-type: none"> • Sales. • (Less Discount Allowed). • (Less Sales returns).
Cost of Sales	<ul style="list-style-type: none"> • Cost of sales. • Cartage inwards. • (Less discount received).
Other income	<ul style="list-style-type: none"> • Gain on sale of NCA. • Interest received. • Dividends received.
Finance expenses	<ul style="list-style-type: none"> • Interest expense. • Loan interest.
Operating Expenses	<ul style="list-style-type: none"> • Preliminary expenses. • Doubtful debts. • Wages. <p>Other expenses:</p> <ul style="list-style-type: none"> • Rent. • Insurance. • Electricity. • Repairs and maintenance. • Cleaning fees. • Telephone. • Preliminary expenses. • Cartage outwards. • Depreciation of NCA's. • Loss on sale of NCA.

Balance Day Adjustments – Practical Summary

Adjustment	Account to adjust	What to do	Workings	Account	Where adjustment goes
Prepaid Expense or Stock of Supplies	Prepaid Expense or Stock of Supplies Current Asset ↓ Expense	Reduce the amount of prepaid expense that was used.	C Bal = O Bal – Total Expense OR Total Expense = O Bal + Expense Paid – C Bal OR Expense Paid = C Bal + Total Expense – O Bal	Prepaid Expense O Bal Total Expense Expense paid (CAB) Closing Prepaid	Closing Balance • Statement of FP. Total Expense: • Income budget. • Statement of Comprehensive Income. Expense Paid: • Cash budget. • Statement of CF.
Accrued Expense	Expense Account Current Liability ↓ Expense	Add expense owing to expense account.	Total Expense = Expense Paid + C Bal OR Total Expense = Expense Paid + C Bal – Opening Accrued OR Expense Paid = Total Expense – C Bal OR Expense Paid = Opening Accrued + Total Expense – C Bal	Accrued Expense Expense Paid (CAB) O Bal C Bal Total Expense	Closing Balance • Statement of FP. Total Expense: • Income budget. • Statement of Comprehensive Income. Expense Paid: • Cash budget. • Statement of CF.
Unearned Income / Income Received in Advance	Income Received in Advance Current Liability ↓ Income	Reduce the Income Received in Advance by the amount earned.	C Bal = O Bal – Total Income OR Total Income = O Bal + Income Received – C Bal OR Income Received = C Bal + Total Income – O Bal	Income Received in Advance Total Income O Bal C Bal Income Received (CAB)	Closing Balance • Statement of FP. Total Income: • Income budget. • Statement of Comprehensive Income. Income Received: • Cash budget. • Statement of CF.
Accrued Income	Income Account Current Asset ↓ Income	Add income earned but not yet received to income account.	Total Income = Income Received + C Bal OR Total Income = Income received + C Bal – O Bal OR Income Received = Total Income – C Bal OR Income Received = O Bal + Total Income – C Bal	Accrued Income O Bal Income Received (CAB) Total Income C Bal	Closing Balance • Statement of FP. Total Income: • Income budget. • Statement of Comprehensive Income. Income Received: • Cash budget. • Statement of CF.
Depreciation	Acc Dep Acc Dep ↓ Expense	Add this year's depreciation expense to Accumulated Depreciation.	C Bal Acc Dep = O Bal + Depreciation OR Depreciation = Sale of Asset + C Bal – O Bal <u>Straight-line method:</u> Depreciation Per Annum = (Historical Cost – Residual Value) / Estimated Life <u>Reducing Balance method:</u> Depreciation Per Annum = Carrying Value x Depreciation Rate	Accumulated Depreciation Sale of Asset O Bal C Bal Depreciation	Closing Balance • Statement of FP. Depreciation: • Income Budget. • Statement of Comprehensive Income.
Doubtful Debts	Allowance for D.D. A.D.D. ↓ Expense	Transfer doubtful debts that have become bad debts. Adjust doubtful debts and bad debts.	Doubtful debts = Bad debts + C Bal – O Bal Bad debts = O Bal + Doubtful Debts – C Bal = Bad Debts	Allowance for Doubtful Debts Bad Debts O Bal C Bal Doubtful Debts	Closing Balance • Statement of FP. Doubtful debts / Bad Debts: • Income budget. • Statement of Comprehensive Income.

Balance Day Adjustments – Theory Summary

Theory		Prepaid expenses / Stock of Supplies	Accrued expense	Unearned Income / Income Received in Advance	Accrued income (Income earned but not received)	Depreciation	Doubtful debts
Nature	Conceptual Framework category of original account	Current Asset	Current Liability	Current Liability	Current Asset	Expense	Expense
	<p>How this account meets the conceptual framework definition?</p> <p><i>Note: in exam write the conceptual framework definition and then explain how each aspect of the definition is met.</i></p>	<p>“A present economic resource, controlled by the entity as a result of past events.”</p> <p>Right. The business has the right to use the prepaid expense.</p> <p>Economic resource. The use of this prepaid expense / supplies will generate economic benefit e.g., increase sales, provide electricity etc.</p> <p>Control. The use of the prepaid expense is only by the business.</p>	<p>“A present obligation of the entity to transfer an economic resource as a result of past events.”</p> <p>Obligation. The business has an obligation to pay for the expense.</p> <p>Entity to transfer an economic resource. The business must transfer money to pay for the expense.</p> <p>Result of past events. The expense incurred as a result of past events.</p>	<p>“A present obligation of the entity to transfer an economic resource as a result of past events.”</p> <p>Obligation. The business has an obligation to provide the good or service to the customer to earn income received.</p> <p>Entity to transfer an economic resource. The business must provide the economic resource to the customer.</p> <p>Result of past events. Income received in advance.</p>	<p>“A present economic resource, controlled by the entity as a result of past events.”</p> <p>Right. The business has the right to receive the income in the future.</p> <p>Economic resource. The business will receive income in the future.</p> <p>Control. The accrued income is earned by the business.</p>	<p>“decreases in assets, or increases in liabilities, that result in decreases in equity, other than those relating to distributions to holders of equity claims.”</p> <p>Derecognition of asset. Asset’s historical cost is derecognised due to usage, wear & tear and obsolescence.</p> <p>Depreciation reduces the carrying value of assets and equity and does not increase liabilities.</p>	<p>“decreases in assets, or increases in liabilities, that result in decreases in equity, other than those relating to distributions to holders of equity claims.”</p> <p>Derecognition of asset. An asset is derecognised due to customers identified as being at risk of becoming bad debtors.</p>
Accounts Created	Accounts created	Expense	Expense	Income	Income	Expense	Expense
	Recognition process that creates the account	Derecognition of current asset.	Recognition of current liability.	Derecognition of current liability.	Recognition of the current asset.	Derecognition of depreciable non-current asset.	Derecognition of current asset (accounts receivable).
Purpose (of the adjusting entry)	Purpose overview	To record expenses consumed at balance date.	To record expenses incurred but not yet paid as at balance date	To record income earned at balance date.	To record income earned but not yet received at balance date.	To record the decline in the future economic benefit of asset.	To record debtors who are unlikely to pay their accounts.
	Effect on Balance Sheet	•Current assets decreased.	•Current liabilities increased.	•Current liabilities decreased.	•Current assets increased.	•Non-current assets decreased.	•Current asset decreased.
	Effect on Income Statement	•Expenses increased. •Profit decreased.	•Expenses increased. •Profit decreased.	•Income increased. •Profit increased.	•Income increased. •Profit increased.	•Expenses increased. •Profit decreased.	•Expenses increased. •Profit decreased.
	Effect on balance sheet if not accounted for	•Current assets overstated.	•Current liabilities understated.	•Current liabilities overstated.	•Current assets understated.	•Non-current assets overstated.	•Current assets (debtors) over-estimated.
Effect on income statement if not adjusted on balance day	•Expense understated. •Profit overstated.	•Expenses understated. •Profit overstated.	•Income understated. •Profits understated.	•Income understated. •Profit understated.	•Expenses understated. •Profits overstated.	•Expenses under-estimated. •Profit over-estimated.	

Statement of Financial Position – Statement Preparation

Key	<ul style="list-style-type: none"> • Green = assets. • Red = liabilities. • Blue = equity.
------------	---

Company Name Statement of Financial Position As at 30 June 20XX	
Current Assets	
Cash and Cash Equivalents	
Trade and other receivables	
Inventories	
Financial assets	
Other current assets	
Total Current Assets	\$TOTAL
Non-Current Assets	
Property, Plant and Equipment	
Investments	
Goodwill	
Total Non-Current Assets	\$TOTAL
Total Assets	CA + NCA
Current Liabilities	
Trade and other payables	
Short term borrowings	
Tax payable	
Total Current Liabilities	\$TOTAL
Non-Current Liabilities	
Long-term borrowings	
Total Non-Current Liabilities	\$TOTAL
Total Liabilities	CL + NCL
Net Assets	TA – TL
Equity	
Share Capital	
Retained Earnings	
Other reserves	
Total Equity	\$TOTAL

Calculation of entries for the Statement of Financial Position

Category	Entry	Examples
Current Assets	Cash and cash equivalents	If the question contains cash as well as cash equivalents these would need to be added together. See the Cash and cash equivalents summary table that follows this table for definitions and examples. Cash and cash equivalents are explained in detail during the Cash Flows chapter.
	Trade and other receivables	<ul style="list-style-type: none"> • Accounts receivable. • Less allowance for doubtful debts.
	Inventories	<ul style="list-style-type: none"> • Inventory of the company.
	Financial assets	Current Assets that arise due to future cash flows outlined in contractual agreements or from owning equity instruments of another entity. <ul style="list-style-type: none"> • Term deposits. • Cash management trusts. • Money markets. <i>Tip: Think of Current Asset examples from the investment options chapter.</i>
	Other current assets	Contains less important current assets such as: <ul style="list-style-type: none"> • Prepaid expenses. • Accrued income.
Non-Current Assets	Property, Plant and Equipment	<ul style="list-style-type: none"> • Non-Current Assets added together. • Less the accumulated depreciation of these NCAs. • Add any asset revaluation increase.
	Investments	<ul style="list-style-type: none"> • Shares. • Term deposits. • Debentures. • Unsecured notes. • Trusts. <i>Tip: Think of Non-Current Asset examples from the investment options chapter.</i>
	Goodwill	An intangible asset of a business. It is the value of a business beyond the value of its assets less liabilities. This is made up of the value created by loyal customers, brand awareness, management excellence etc.
Current Liabilities	Trade and other payables	<ul style="list-style-type: none"> • Accounts payable. • Accrued expenses. • Unearned income received within 12 months.
	Short term borrowings	Borrowings due for payments within 12 months. <ul style="list-style-type: none"> • Short term loan. • Bank overdraft. • Credit from suppliers. • Commercial bills. • Debt factoring. <i>Tip: Think of Current Liability examples from the sources of finance chapter.</i>
Non-Current Liabilities	Long-term borrowings	Borrowings due for payments within more than 12 months, such as: <ul style="list-style-type: none"> • Loans. • Mortgage. • Leasing. • Debentures. • Unsecured notes. • Commercial bills. <i>Tip: Think of Non-Current Liability examples from the sources of finance chapter.</i>
Equity	Share Capital	<ul style="list-style-type: none"> • Share capital. • Less share issue costs.
	Retained Earnings	The profit remaining once dividends have been paid.
	Other reserves	<ul style="list-style-type: none"> • General reserve. • Asset revaluation reserve.

Note: There is no prescribed AASB format for SFP presentation. The AASB states that the SFP should detail a company's assets, liabilities and equity.

Cash and cash equivalents – Summary Table

	Cash	Cash equivalents
Define	<ul style="list-style-type: none"> Cash on hand and demand deposits. 	<ul style="list-style-type: none"> Short term highly liquid investments (less than 3 months). Readily convertible into cash of known amounts. Low risk of value change.
Examples	<ul style="list-style-type: none"> Cash on hand (notes and coins). Demand deposit: Money held in financial institutions that a business can withdraw without constraint on demand. 	<ul style="list-style-type: none"> Term deposit with 3 months maturity (90 days). Bank bills. Commercial bills. Money market deposits. Bank overdraft.

Notes to the Statement of Financial Position

Key	
	• Green = positive figure.
	• Red = negative figure.
	• Blue = Total sum.

Description of note	Notes to the Account																						
Property, plant and equipment Non-current asset changes	<table border="1"> <thead> <tr> <th colspan="2">Property, plant and equipment</th> </tr> </thead> <tbody> <tr> <td>Land (at cost)</td> <td>X</td> </tr> <tr> <td>Add asset revaluation</td> <td>X</td> </tr> <tr> <td></td> <td>\$TOTAL</td> </tr> <tr> <td>Furniture and fittings (at cost)</td> <td>X</td> </tr> <tr> <td>Less Accumulated depreciation of furniture and fittings</td> <td>(X)</td> </tr> <tr> <td></td> <td>\$TOTAL</td> </tr> <tr> <td>Plant and equipment (at cost)</td> <td>X</td> </tr> <tr> <td>Less Accumulated depreciation of plant and equipment</td> <td>(X)</td> </tr> <tr> <td></td> <td>\$TOTAL</td> </tr> <tr> <td>Total property, plant and equipment</td> <td>\$TOTAL</td> </tr> </tbody> </table>	Property, plant and equipment		Land (at cost)	X	Add asset revaluation	X		\$TOTAL	Furniture and fittings (at cost)	X	Less Accumulated depreciation of furniture and fittings	(X)		\$TOTAL	Plant and equipment (at cost)	X	Less Accumulated depreciation of plant and equipment	(X)		\$TOTAL	Total property, plant and equipment	\$TOTAL
Property, plant and equipment																							
Land (at cost)	X																						
Add asset revaluation	X																						
	\$TOTAL																						
Furniture and fittings (at cost)	X																						
Less Accumulated depreciation of furniture and fittings	(X)																						
	\$TOTAL																						
Plant and equipment (at cost)	X																						
Less Accumulated depreciation of plant and equipment	(X)																						
	\$TOTAL																						
Total property, plant and equipment	\$TOTAL																						
Share Capital Details the number of shares and the changes in shares	<table border="1"> <thead> <tr> <th colspan="2">Share Capital</th> </tr> </thead> <tbody> <tr> <td>(Number of) ordinary shares @ (price) each, fully paid</td> <td>X</td> </tr> <tr> <td>(Number of) ordinary shares @ (price) each, fully paid less share issue costs</td> <td>X</td> </tr> <tr> <td>Total share capital</td> <td>\$TOTAL</td> </tr> </tbody> </table>	Share Capital		(Number of) ordinary shares @ (price) each, fully paid	X	(Number of) ordinary shares @ (price) each, fully paid less share issue costs	X	Total share capital	\$TOTAL														
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(Number of) ordinary shares @ (price) each, fully paid less share issue costs	X																						
Total share capital	\$TOTAL																						
Other components of equity (Reserves) Includes general reserve and asset revaluation reserve.	<table border="1"> <thead> <tr> <th colspan="2">Other components of equity (Reserves)</th> </tr> </thead> <tbody> <tr> <td>General reserve</td> <td>X</td> </tr> <tr> <td>Asset revaluation reserve</td> <td>X</td> </tr> <tr> <td>Total reserves</td> <td>\$TOTAL</td> </tr> </tbody> </table>	Other components of equity (Reserves)		General reserve	X	Asset revaluation reserve	X	Total reserves	\$TOTAL														
Other components of equity (Reserves)																							
General reserve	X																						
Asset revaluation reserve	X																						
Total reserves	\$TOTAL																						
Dividends Details all recognized and unrecognized dividends.	<table border="1"> <thead> <tr> <th colspan="2">Dividends</th> </tr> </thead> <tbody> <tr> <td colspan="2">Dividends paid as at 30 June 20XX:</td> </tr> <tr> <td>Final dividend as per 20XX AGM (Number) Ordinary shares @ (price) per share</td> <td>X</td> </tr> <tr> <td>Interim dividends (Number of) Ordinary shares @ (price) per share</td> <td>X</td> </tr> <tr> <td colspan="2">Dividends recommended by Directors:</td> </tr> <tr> <td>Final dividend (Number of) Ordinary shares @ (price) per share</td> <td>X</td> </tr> </tbody> </table>	Dividends		Dividends paid as at 30 June 20XX:		Final dividend as per 20XX AGM (Number) Ordinary shares @ (price) per share	X	Interim dividends (Number of) Ordinary shares @ (price) per share	X	Dividends recommended by Directors:		Final dividend (Number of) Ordinary shares @ (price) per share	X										
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Dividends recommended by Directors:																							
Final dividend (Number of) Ordinary shares @ (price) per share	X																						



Corporate Accounting

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16. Regulatory Bodies



Activate Prior Knowledge

Respond to the following questions. Discuss your answers with a peer or the class.

<p>How do you think multiple countries have come to develop similar accounting standards? Why would similar accounting standards between different countries be beneficial?</p>	
<p>Why do you think it would be important for regulatory bodies to monitor the regulatory compliance of companies?</p>	
<p>How do you think everyday accountants could influence the development of Accounting Standards?</p>	

Regulatory Bodies – Syllabus

Syllabus – Unit 4	
Regulatory Bodies	<p>Government and the community: The role and influence of governments and other bodies</p> <ul style="list-style-type: none"> the nature and importance of the following groups which regulate and influence the general purpose financial reporting of companies in Australia: <ul style="list-style-type: none"> the Financial Reporting Council (FRC) Australian Securities and Investments Commission (ASIC) International Accounting Standards Board (IASB) Australian Accounting Standards Board (AASB) Australian Securities Exchange (ASX) lobby groups

Regulatory Bodies – Introduction

There are several different regulatory bodies that influence the preparation of GPFs by companies in Australia. Each of these groups has different levels of authority and performs varied functions.

Regulatory Bodies that influence the preparation of the GPFs – Summary Table

Regulatory Body	Nature / Role	Importance / Functions
International Accounting Standards Board (IASB)	<ul style="list-style-type: none"> Independent private sector group. International Standards Committee Foundation member Funding provided to IASB by Australian government to produce global standards in co-operation with the AASB. 	<ul style="list-style-type: none"> Provides a consistent financial reporting language for global financial markets. Creation of consistent global accounting standards.
Australian Accounting Standards Board (AASB)	<ul style="list-style-type: none"> Regulated, independent Australian government body. Develops accounting standards in Australia with international comparability (IASB standards). 	<ul style="list-style-type: none"> Ensures Australian accounting standards are comparable and align with IASB standards. Requires public companies to apply accounting standards for GPFs through Corporations Law. No enforcement role.
Financial Reporting Council (FRC)	<ul style="list-style-type: none"> AFRC provides strategic direction for AASB. 	<ul style="list-style-type: none"> Influences processes for Accounting standards and auditing standards. Supervise audits conducted by auditors in Australia. Sets AASB budget and supervises AASB staff. Monitors development and promotion of international accounting and auditing standards, including use of these in Australia.
Australian Securities and Investments Commission (ASIC)	<ul style="list-style-type: none"> Regulated, independent Australian Government body. Administers the Corporation Act i.e. regulates the conduct of Australian companies. 	<ul style="list-style-type: none"> Stakeholders protected via Corporations Act, ASX Listing Rules and Accounting Standards Financial reports checked for Corporations Act compliance. Ensure performance of Australia's financial system.
Australian Stock Exchange (ASX)	<ul style="list-style-type: none"> A public company. Operates a marketplace for buying and selling public companies shares and other financial services. Has various regulatory obligations under the Corporations Act. 	<ul style="list-style-type: none"> Ensures ASX listing regulation requirements met by public companies. Support investor confidence and education. Can suspend trading of a company's shares if they do not comply with the Listing Rules.
Lobby Groups	<ul style="list-style-type: none"> Accounting bodies that influence AASB (e.g., CAANZ, CPA, IPA). 	<ul style="list-style-type: none"> Influence standard establishment. Discuss issues in accounting standards.

Note: Some questions will ask for "Nature" but the marking key also includes "Importance." In an extended writing question for a regulatory body, it is recommended to write both the nature and importance regardless of whether "Nature/Role" or "Importance/Function" is asked for.

Practice Questions

Questions 1-12: Regulatory Bodies.

Exam Questions

See 'Regulatory Bodies' chapter of the Exam Guide for practice exam questions. The Exam Guide can be found by navigating to the Resource Hub link on the front page.

Question 1

The Australian Securities and Investment Commission is responsible for:

- Influencing the establishment of Accounting Standards.
- Providing the AASB with strategic direction.
- Checking financial reports to ensure they are compliant with the Corporations Act.
- Providing a marketplace for buying and selling shares in public companies.

Question 2

Lobby groups are important as they:

- Pay money to politicians to influence accounting laws.
- Discuss issues in accounting standards.
- Create accounting standards.
- Audit Australian accounting standards.

Question 3

The role of the Financial Reporting Council includes:

- Provision of regulation for ASIC.
- Conduction of audits in Australia.
- Providing the strategic direction for AASB.
- Supervision of AASB staff.

Question 4

The nature of the International Accounting Standards Board does not include:

- The Australian government provides funding to IASB.
- This is an Independent private sector group.
- Is a member of the International Standards Committee Foundation.
- Dictates the accounting standards that all other countries must follow.

Question 5

Identify which of the following is not a function of the Australian Stock Exchange (ASX).

- Purchases shares in public companies.
- Can suspend trading of a company's shares if they do not comply with the Listing Rules.
- Support investor confidence and education.
- Ensures ASX listing regulation requirements met by public companies.

Question 6

The nature of the Australian Accounting Standards Board does not include:

- Develops accounting standards.
- Prepares financial statements for public companies.
- Accounting standards developed with international comparability.
- This is a regulated Australian government body.



Government Accounting

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How do I get there?

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Ability to work overseas



Graduate salary*



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17. Corporate Social Disclosure (CSD)



Activate Prior Knowledge

Respond to the following questions. Discuss your answers with a peer or the class.

<p>A business wants to disclose its environmental impact in its annual reports. What kind of information could the business report on?</p>	
<p>Which users of financial reports would want to know about the impact of a business on people and the environment? Why?</p>	
<p>What would make it difficult for a business to report about its corporate social responsibility?</p>	

Syllabus – Unit 4

Corporate Social Disclosure (CSD)	Government and the community: The influence of social, environmental and ethical factors <ul style="list-style-type: none"> • the extent and nature of corporate social disclosure • the difficulties faced by accountants in producing social and environmental information • the use made of corporate social disclosure by the company and other users • critical evaluation of corporate social disclosure as made by Australian companies
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CSD – Introduction

CSD builds on the CSR chapter covered previously in this course. This CSD chapter focuses on the disclosure of information regarding a business's CSR activities. CSD is a relatively contemporary and actively developing area of accounting compared with other components of this course. In the last few decades there has been an increasing global shift in the education of consumers and investors and the demand for company financial statements to be accompanied with high level CSD in the annual reports. This shift in CSR awareness and demand has been reflected in an increasing prevalence of company annual reports containing CSD information. This is in spite of the fact that in many cases, there is may be no exact government guidelines on how CSD should look or what it should include – which is far from the prescriptive nature of financial statements.

CSD is far less black and white than other areas of accounting. There are many difficulties faced by accountants in producing social and environmental information. For example, there is no single internationally recognised authority responsible for setting benchmarks or frameworks of what companies should do to minimise their impact upon climate change or how to measure and report business activities related to climate change. This means that CSR areas can be difficult to measure in terms which are comparable across businesses or industries. That being said, the credibility of CSD information can be enhanced with the recognition of CSR activities by government bodies or international groups. In the final research task of this chapter you will critically evaluate the corporate social disclosure made by two Australian companies. This research task is particularly important to address the syllabus and apply the content and skills from this chapter.

CSD – Duties of directors

Director duty linked to CSD	Explain link to CSD	Examples
Directors' report provided to external users included in Annual Report.	CSR activities could be included in the Annual report.	<ul style="list-style-type: none"> • Compare performance of business with current environmental regulation. • Planned future developments regarding CSR.
Director's actions should reflect shareholder interests.	Directors have duty disclose CSR activities as these can impact the share price.	<ul style="list-style-type: none"> • Negative CSR activity can create bad press lowering share price and vice versa. • Paying overseas workers fair wages creates positive image but negatively impacts costs.

Note: Duties of directors are in the Corporations Act.

CSD – Used by Directors to

CSD is used by directors to:

- Establish / shape corporate image.
- Develop strategies and objectives e.g., employee wellbeing, greenhouse gas emissions etc.
- Identify CSR areas:
 - For improvement or development.
 - Where the company is successfully meeting objectives.

CSD – Summary Table

		CSD
<p>Nature</p> <p>Check how many marks question is out of.</p> <p>Questions for 1-2 marks just want the overview.</p> <p>Questions for 3 or more marks want dot points from all three boxes.</p>	<p>Nature overview</p>	<p>Company reports on ethical actions regarding social and environmental impacts.</p> <ul style="list-style-type: none"> • CSD may include targets set by the company or external standards and progress. • CSD is voluntary. • Community concern about social and environmental issues drives CSD.
	<p>Possible uses</p>	<p>CSD is used by stakeholders to confirm and make decisions about a company's:</p> <ul style="list-style-type: none"> • Social and environmental regulation compliance management costs. <ul style="list-style-type: none"> ◦ Reduces possibility of adverse government actions or costs of complying with any regulation created in future. • Relationships with internal and external parties. • Performance and decision-making. I.e., reflecting on business performance and previous decisions.
	<p>Difficulties faced by accountants producing social and environmental information</p> <p>Know any 3, with description for 6 marks.</p>	<ul style="list-style-type: none"> • Lack of standards: lack of regulation that exists to inform CSD process. This results in different measurement of CSR, varied CSR information produced by businesses and varied presentation formats. • Audit difficulty: lack of standards makes verifying information and impacts of activities difficult in an audit. • Difficulty measuring: CSR impacts can be difficult to measure and quantify in financial terms. • Training cost: CSD is a relatively new form of disclosure which accountants will require training and support to carry out. • Cost: Producing CSD information is costly and management may see value to the profit or value of the business. This may lead to businesses not allocating sufficient funds to CSD. • Comparability: CSD is mostly voluntary and without standards so comparison of CSD between entities is difficult. • Location of reports: Different businesses may report CSR information in different locations. E.g. in GPFs, websites or media announcements etc. This may make it difficult to locate information produced by different businesses. • Styles of reports: Report information may be presented in different formats. E.g. written, in tables or in graphs. This makes comparing information difficult. • Qualitative nature: CSD can be qualitative (descriptive not quantitative) with information that changes between reporting cycles. • Long term issues, short period reports: Many CSR issues are long-term. Reports are short term. This creates difficulty in producing appropriate CSR progress assessment. • Company bias: Businesses may emphasize the positive CSR impacts of the business and understate/downplay negative CSR impacts. This may make it difficult to provide all information desired by end users.

Practice Questions

Questions 1-14: Corporate Social Disclosure (CSD).

Exam Questions

See 'Corporate Social Disclosure (CSD)' chapter of the Exam Guide for practice exam questions. The Exam Guide can be found by navigating to the Resource Hub link on the front page.

Question 1

A duty of directors with regards to corporate social disclosure is to:

- a. Disclose CSR as it could impact the share price.
- b. Mitigate publicity of any negative environmental impacts of business activity.
- c. Disclose CSR as a good community citizen.
- d. Mitigate publicity of any negative social impacts of business activity.

Question 2

Identify which of the following is not one of the ways corporate social disclosure is used by directors.

- a. Identify where the company can improve regarding CSR.
- b. Acquire government funding regarding CSR strategies.
- c. Establish / shape corporate image.
- d. Develop strategies and objectives regarding CSD areas.

Question 3

Identify which of the following is true regarding the nature of corporate social disclosure.

- a. Corporate social disclosure is only driven by targets set by the company.
- b. Corporate social disclosure is driven mainly by external standards.
- c. Corporate social disclosure is involuntary.
- d. Corporate social disclosure is driven by community concerns.

Question 4

A possible use of corporate social disclosure for a public company includes:

- a. Reduction in training costs.
- b. Reduction in taxation responsibility.
- c. Creation of relationships with internal and external stakeholders.
- d. Creation of financial reports which include qualitative information.

Question 5

Identify which of the following is not a difficulty faced by accountants when producing social and environmental information.

- a. CSD can be qualitative (descriptive not quantitative) with information that changes between reporting cycles.
- b. There is a lack of regulation that informs CSD process.
- c. CSR impacts can be difficult to measure and quantify in financial terms.
- d. Many CSR issues are quantitative in nature, making it difficult to report changes between reporting cycles.

Question 6

Identify which of the following is not an example of corporate social disclosure.

- a. A business reporting its greenhouse gas emissions.
- b. A company reporting on its employee wellbeing.
- c. Financial reports including information about a business's tree planting program.
- d. General purpose financial reports detailing a business's net assets.

Question 7

Which of the following is not an external user of statements made within corporate social disclosure.

- a. Government bodies.
- b. Managers.
- c. Investors.
- d. Creditors.

Question 8

Describe the nature of corporate social disclosure for public companies.

Question 9

Outline how corporate social disclosure is used by directors of a company.



Indigenous Tax and Advisory

Community Empowerer

Tell the story behind the numbers and drive transformation within the local community, supporting Aboriginal and Torres Strait Islander as well as Māori enterprises and local neighbourhoods. Make epic things happen, empowering the expansion of businesses, communities, and cultural richness.

Is it a good match for me?

If you're passionate about building family connections, creating a positive impact in your community, and have a knack for using your analytical and storytelling talents to support the growth of small businesses, this role offers an exciting chance to make a difference.

Where could I work?

Your own accounting firm, start-ups, community centres, government departments, banks supporting local communities, and not-for-profit organisations.

How do I get there?

You don't need to study anything specific in high school, but business-related subjects can help you get a head start.

Ability to work overseas



Graduate salary*



*Hays Salary Guide FY23/24 Accounting and Finance

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make epic things happen



18. Cash Flows

Cash Flows – Syllabus

Syllabus – Unit 4	
Cash Flows	<p>Financial institutions and systems: Financial systems and fundamental principles</p> <ul style="list-style-type: none"> • Statement of Cash Flows as per AASB 107, including: <ul style="list-style-type: none"> ▪ benefits of the cash flow statement information ▪ concepts of cash and cash equivalents <p>Recording, using and evaluating financial information: Recording, processing and communicating financial information</p> <ul style="list-style-type: none"> • cash flow statement from comparative balance sheets and income statements using the direct method only – notes not required and GST not included <p>Recording, using and evaluating financial information: Evaluating financial information for planning, coordinating, controlling and investing</p> <ul style="list-style-type: none"> • interpretation of the movements in cash flow items

Cash Flows – Introduction

The statement of cash flows is a financial statement that summarises a company's cash inflows and outflows over a specific period. It is a key component of a company's annual report and is one of the general purpose financial reports (GPFs). The creation of a statement of cash flows enables users to gain insights into the financial position of a company and enhances the comparison of the business with other entities.

The statement of cash flows analyses cash flows in three key areas; operating activities, investing activities and financing activities.

Some students may falsely assume that if a business is profitable that it may be free from any significant issues. The statement of cash flows can highlight cash flow problems that may be occurring in a business that is otherwise profitable which can then allow for the development of recommendations to remedy these issues.

To prepare a statement of cash flows, reconstructions of general ledgers are required. These reconstructions use information found in the statement of financial position and statement of comprehensive income to calculate varied specific cash flows that have taken place.

Statement of Cash Flows – Introduction and Summary Table

Statement of Cash Flows	
Nature / Define	Provides information about cash received and paid by the entity.
Purpose / Benefit of information (financial position insight gained) <i>(Know any 4)</i>	<ul style="list-style-type: none"> • Evaluates: <ul style="list-style-type: none"> ○ Cash in – ability to generate cash flows. ○ Cash out – entity's needs that use cash flows. ○ Entity's ability to generate positive future cash flows. ○ Financial position changes. ○ Liquidity / solvency changes – ability to pay debts. ○ Capacity to tweak timing and amounts of cash flows in response to changing circumstances. • Enhances comparison of: <ul style="list-style-type: none"> ○ Operating performance of varied entities. ○ Profitability and net cash flows. ○ Past assessment of cash flow accuracy.

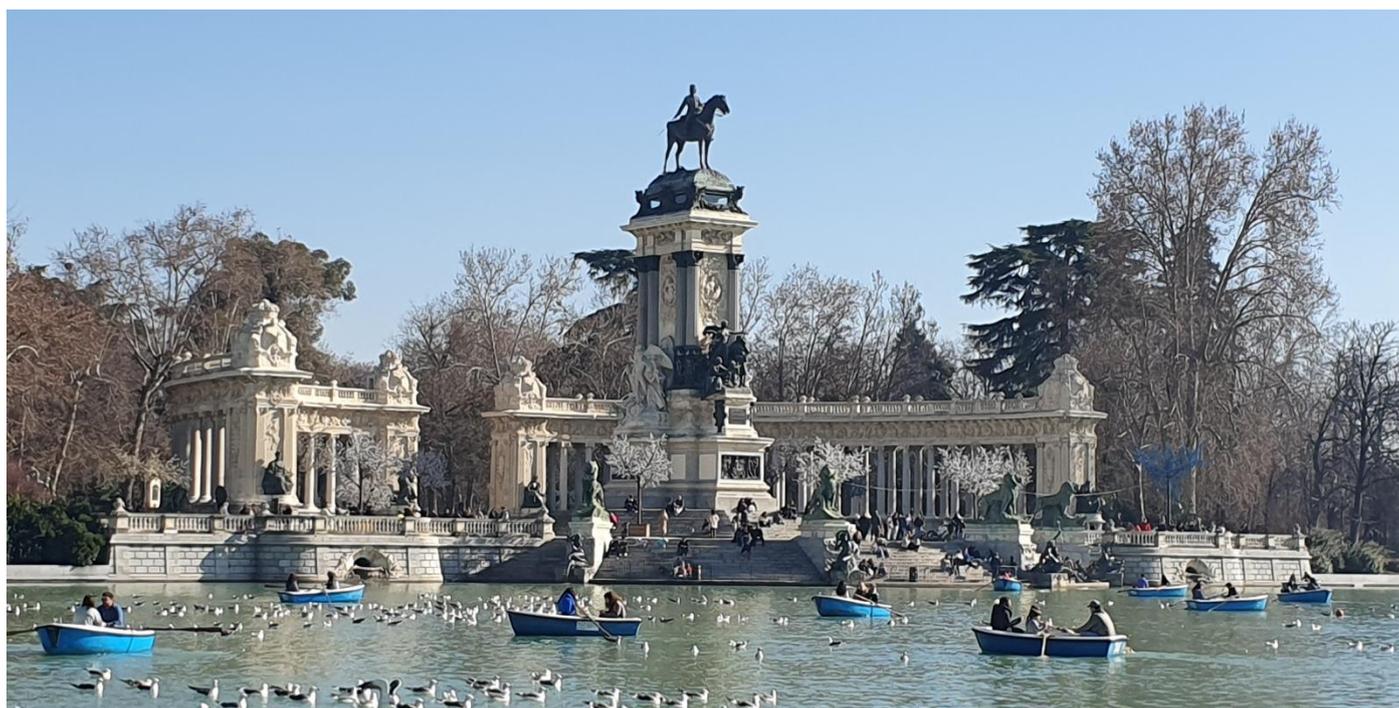
Cash and cash equivalents – Summary Table

	Cash	Cash equivalents
Define	<ul style="list-style-type: none"> Cash on hand and demand deposits. 	<ul style="list-style-type: none"> Short term highly liquid investments (less than 3 months). Readily convertible into cash of known amounts. Low risk of value change.
Examples	<ul style="list-style-type: none"> Cash on hand (notes and coins). Demand deposit: Money held in financial institutions that a business can withdraw without constraint on demand. 	<ul style="list-style-type: none"> Term deposit with 3 months maturity (90 days). Bank bills. Commercial bills. Money market deposits. Bank overdraft.

Cash flow problems occurring in a profitable businesses

	Cash flow problems may occur in profitable business
Reasons	<ul style="list-style-type: none"> Profit does not equal cash available e.g., payment for a non-current asset may reduce available cash but increase profit. There are several cash based entries that do not directly impact profit. E.g., excessive dividends, drawings, purchase of NCAs etc. Accounts receivable increases revenue/profit but do not have cash flow (yet). Accounts receivable may not be being managed effectively. NCAs may be purchased with current liabilities (instead these should be purchased with noncurrent liabilities). This is not related to profit but impacts cash available. Slow stock turnover reduces cash inflow; however, cash outflow may be present to repay creditors whom inventory was purchased from. This is not related to profit.
Recommendations	<ul style="list-style-type: none"> Internal control strategies for issue areas. E.g., Management of debtors if there are issues with accounts receivable. Management responses should be prepared alongside budgets and performance reports. E.g., cash budgets, stock and debtors.

Note: If asked this question related to a specific case study – give example reasons and recommendations that align with the case study.



El Retiro Park, Madrid.

Differences between the statement of comprehensive income and statement of cash flows

Exam tip: This could be asked as:

- Describe why net cash flow from operating activities and total comprehensive income can be different.
- Describe items dealt with differently by statement of comprehensive income and cash flows.
- Describe why the cash balance at the end of financial year is not a reliable indicator of profitability.
- Describe why net operating cash flows can be different from profit after tax.

Notes for table below:

- The first three rows give a general/core answer. The following rows give more specific examples.
- Use the number of marks in a question as a guide to your response level of detail.
- If given a specific case study, refer to items on financial statements with \$ figures.

Financial statement		Comprehensive Income	Cash Flows
		Entry recognized in statement when	
Core understanding	Accrual or cash accounting	Accrual.	Cash.
	Income / Sales revenue	Income / revenue earned.	As cash from income / revenue received (not including creditors who have not paid).
	Expenses	Expenses incurred and expenses paid.	Expenses paid.
Additional entry examples	Depreciation, profits or gain/loss of non-current assets	Recognized as an expense.	Not recognized at all. This is a non-cash expense or loss.
	Doubtful debts / Bad debts	Recognized as an expense.	Not recognized at all. This is a non-cash expense or loss.
	Cost of inventory	Inventory is acquired and sold.	Inventory purchased on credit that is actually paid for.
	Interest revenue	Interest receivable and received.	Interest received only.
	Interest expense	Interest paid and interest payable.	Interest paid only.
	Dividend revenue	Dividend receivable and received.	Dividends received only.
	Unearned Income	Not included in income figure affecting profit. Only shows income earned.	Unearned Income.
	Prepaid expenses	Not included in expenses amount. Only shows expenses incurred.	Prepaid expenses.
	Tax	Tax expense.	Taxes paid.
	Asset revaluation	Recognized as other comprehensive income.	Not recognized as it does not involve a cash flow.

Tip	<u>Practical Guide</u>
	You may find it useful for the practical chapters to work through the Essential Insight Practical Guide textbooks. The Course Guide textbook only contains key summary information from the practically focused chapters. The Essential Insight Practical Guide textbooks contain step-by-step worked examples and practice questions to scaffold students from initial concept attainment to exam level for practically focused chapters. The Practical Guides can be found by navigating to the Resource Hub link on the front page.

Statement of Cash Flows – Statement Preparation

Key	<ul style="list-style-type: none"> • Green = positive figure. • Red = negative figure. • Grey = positive or negative • Blue = heading.
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Company Name Statement of Cash Flows for the year ended 30 June 20XX	
Cash flows from operating activities	
Receipts from customers	X
Payments to suppliers and employees	(X)
Interest paid (if for current liability)	(X)
Income tax paid	(X)
<i>Net cash from operating activities</i>	\$TOTAL
Cash flows from investing activities	
Interest received	X
Dividend received	X
Proceeds of sale of investments	X
Proceeds of sale of plant and equipment	X
Payment for Investments	(X)
Payment for NCA's / Purchase of NCA's	(X)
<i>Net cash from investing activities</i>	\$TOTAL
Cash flows from financing activities	
Proceeds from borrowings / loan	X
Share capital proceeds / Additional share capital	X
Debentures issued	X
Repayment of borrowings / loan	(X)
Repayment of debentures	(X)
Interest paid (if for non-current liability)	(X)
Dividends paid	(X)
Share issue costs	(X)
<i>Net cash from financing activities</i>	\$TOTAL
Net increase/decrease in cash held	X or (X)
Cash and cash equivalents at start of period	START
Cash and cash equivalents at end of period	START + net in/decrease

Tips	<ul style="list-style-type: none"> • Interest paid will either be within operating or financing activities depending on if it is for a current liability (operating) or a non-current liability (financing). • Interest received only belongs in the investing activities section based on AASB 107. I.e. Interest received from current and non-current both belong in the investing activities section. • Each NCA purchased or sold should have its own corresponding entry. • Dividends paid may also be classified as cash flows from operating activities. • Some of the wording in the above may vary slightly during exam questions. Read the exam question carefully and use wording for the entries that matches the wording of these entries in the question.
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Cash Flows – Nature and reconstructions required for each section

Cash Flows	Nature	Reconstructions required to find cash flows
Operating activities	The principal revenue-producing activities of the entity and other activities that are not investing or financing activities.	Balance day adjustments for: <ul style="list-style-type: none"> • Income accounts. • Expense accounts.
Investing activities	The acquisition and disposal of long-term assets and other investments not included in cash equivalents.	<ul style="list-style-type: none"> • Non-Current Assets. • Accumulated Depreciation of Non-Current Assets. • Non-cash items are depreciation and carrying amount of non-current asset.
Financing activities	Activities that result in changes in the size and composition of the contributed equity and borrowings of the entity.	<ul style="list-style-type: none"> • Capital: transfers to/from reserves, capital increases/decreases, profit/loss. • Borrowings / loans.

Note: The nature of each activity section comes from AASB 107: Statement of Cash Flows.

Reconstructions

Reconstruction – Accounts Receivable and Allowance for Doubtful Debts

Solution

Step 1 – Reconstruction of Allowance for Doubtful Debts

Allowance for Doubtful Debts					
	Bad Debts	2,600		Opening Balance	500
	Closing Balance	400		Doubtful Debts	2,500
		3,000			3,000

Therefore, the bad debts figure was \$2,600 for the year ended 30 June 2035.

Reconstruction of allowance for doubtful debts account purpose: The bad debts figure calculated when reconstructing the allowance for doubtful debts is needed to reconstruct accounts receivable. The bad debts entry calculated is transferred to the accounts receivable account.

Note: If allowance for doubtful debts is not present on the balance sheet, this reconstruction is not required.

Step 2 – Reconstruction of Accounts Receivable

Accounts Receivable					
	Opening Balance	3,000		Sales Returns	5,000
	Sales	80,000		Bad Debts	2,600
				Discount Allowed	1,000
				Bank	70,400
				Closing Balance	4,000
		83,000			83,000

Therefore, the cash received from customers was \$71,500.

Reconstruction of accounts receivable account purpose: The bank figure calculated when reconstructing the accounts receivable account is the cash received from customers. This appears in the SCF is by being added to the "Receipts from Customers" in the 'Cash flows from operating activities' section.

Reconstructions – Inventory and Accounts Payable

Solution

Step 1 – Reconstruction of Inventory.

Inventory					
	Opening Balance	12,000		Cost of Sales	35,000
	Accounts Payable	39,000		Purchases	1,000
				Returns	
				Closing Balance	15,000
		51,000			51,000

Reconstruction of Inventory account purpose: The accounts payable that is calculated when reconstructing the inventory account is the amount of inventory purchased on credit which is necessary to reconstruct accounts payable. The accounts payable entry that is calculated is transferred to the accounts payable account.

Step 2 – Reconstruction of Accounts Payable.

Accounts Payable					
	Discount Received	2,500		Opening Balance	3,000
	Purchases Returns	1,000		Inventory	39,000
	Bank	33,500			
	Closing Balance	5,000			
		42,000			42,000

Therefore, the cash paid to creditors was \$33,500.

Reconstruction of Accounts Payable account purpose: The bank figure calculated when reconstructing the accounts payable account is the cash paid to creditors. This appears in the SCF by being added to 'Payments to suppliers and employees' in the 'Cash flows from operating activities' section.

Reconstructions – Income Tax Payable

Solution

Step 1 – Reconstruction of Tax Payable

Income Tax Payable					
	Bank	8,480		Opening Balance	4,000
	Closing Balance	5,000		Income tax expense	9,480
		13,480			13,480

Therefore, the income tax paid was \$8,480.

Reconstruction of Tax Payable account purpose: The bank figure calculated when reconstructing the income tax payable account is the income tax paid. This appears in the SCF as 'Income Tax Paid' in the 'Cash flows from operating activities' section.

Reconstructions – Retained Earnings

Solution

Step 1 – General Reserve increase or decrease

The General Reserve figure needed to reconstruct the retained earnings account is found by Year 2 subtract Year 1

- If the result is **positive**
 - This is a transfer of profits **from retained earnings to the general reserve**
 - Retained earnings is **debited**
- If the result is **negative**
 - This is a transfer of profits **to retained earnings from the general reserve**
 - Retained earnings is **credited**

Big Tings Ltd Unclassified Balance Sheets As at 30 June 2035		
	30 June 2034	30 June 2035
Equity		
General Reserve	40,000	55,000

In this example, General Reserve figure = 55,000 – 40,000 = **15,000**. Therefore, the result is debited to retained earnings.

Step 2 – Reconstruction of Retained Earnings

Retained Earnings					
	Dividend	38,720		Opening Balance	16,000
	Closing Balance	14,400		Profit and Loss	22,120
				General Reserve	15,000
		53,120			53,120

The Profit and Loss figure is Profit after tax from the income statement.

Therefore, the dividend paid was \$8,720 for the year ended 30 June 2035.

Note: Dividend appeared as an entry on the income statement within 'add other income'. This is the **dividend received**. This will appear separately on the statement of cash flows. The retained earnings reconstruction finds the **dividend paid**.

Reconstruction of Retained Earnings account purpose: The dividend figure found when reconstructing the retained earnings account is the dividend paid. This appears on the SCF as 'Dividend paid' in the 'Cash flows from financing activities' section.

Solution

Step 1 – Reconstruction of Share Capital.

Share Capital					
	Bank	4,000		Opening Share Capital	40,000
	Closing Share Capital	55,000		Bank	19,000
		59,000			59,000

Therefore, the Share Capital proceeds were \$19,000 for the year ended 30 June 2035.

The share issue costs are provided in the additional information in the question. This is the bank figure on the debit side of \$4,000. This appears in the SCF as 'Share issue costs' in the 'Cash flows from financing activities' section.

Note: Share issue costs does not appear on the income statement in the question as this account is closed during the period as the share issue costs are paid from Cash at Bank. This is why share issue costs were listed in the additional information.

Reconstruction of Share Capital account purpose: The bank figure on the credit side that is calculated when reconstructing the Share capital account is the cash received from the issue of shares. This appears in the SCF as 'Share issue proceeds' in the 'Cash flows from financing activities' section.

Reconstructions – Prepaid Expense

Solution

Step 1 – Reconstruction of Prepaid Expense

Prepaid Rent					
	Opening Balance	5,000		Rent (expense)	8,000
	Bank	6,000		Closing Balance	3,000
		11,000			11,000

Therefore, the cash paid for rent was \$6,000.

Reconstruction of prepaid expense account purpose: The bank figure calculated when reconstructing the prepaid expense account is the cash paid for the expense. This appears in the SCF by being added to 'Payments to suppliers and employees' in the 'Cash flows from operating activities' section.

Reconstructions – Accrued Expense

Solution 1

Step 1 – Reconstruction of expense inside the Accrued expense account

Accrued Wages Expense					
	Bank	1,100		Opening Accrued Expense	1,000
	Closing Accrued Expense	1,500		Wages Expense	1,600
		2,600			2,600

Therefore, the wages expense paid was \$1,100.

Reconstruction of accrued expense purpose: The bank figure calculated when reconstructing the accrued expenses in the expense account is the expense paid. This appears in the SCF by being added to 'Payments to suppliers and employees' in the 'Cash flows from operating activities' section.

Solution 2

Step 1 – Reconstruction of the accrued expense account

Accrued Wages					
	Bank	1,000		Opening Accrued Expense	1,000

Reconstruction of accrued expense account purpose: To find the accrued expense value. This is added to the expense account value to find the total expense paid. This appears in the SCF by being added to 'Payments to suppliers and employees' in the 'Cash flows from operating activities' section.

*Note: The bank figure in the accrued expense account reflects a **portion** of the expense paid. The entry on the credit side reflects the figure found in the balance sheet that opened the account.*

Step 2 – Reconstruction of the expense account

Wages					
	Closing Accrued Expense	1,500		Wages Expense	1,600
	Bank	100			
		1,600			1,600

$$\begin{aligned} \text{Expense paid} &= \text{Expense} + \text{Accrued expense} \\ &= 1,000 + 100 \\ &= 1,100 \end{aligned}$$

Therefore, the wages expense paid was \$1,100.

Reconstruction of expense account purpose: The bank figures calculated in the accrued expense and expense account are added together to find the total expense paid. This appears in the SCF by being added to 'Payments to suppliers and employees' in the 'Cash flows from operating activities' section.

Reconstructions – Accrued Income

Solution 1

Accrued Interest Income					
	Opening Accrued Interest Income	2,000		Bank	2,500
	Profit and Loss	1,000		Closing Accrued Interest Income	500
		3,000			3,000

Therefore, the interest income received was \$2,500.

Reconstruction of accrued income purpose: The bank figure calculated when reconstructing the accrued income account is the interest income received. This appears in the SCF as interest received in the “Cash flows from Investing Activities”.

Solution 2

Step 1 – Reconstruction of the Accrued Interest Income Account

Accrued Interest Income					
	Opening Accrued Interest Income	2,000		Bank	2,000

Reconstruction of accrued interest income account purpose: To find the accrued income value. This is added to the interest income account value to find the interest income received.

*Note: The bank figure in the accrued interest income account reflects a **portion** of the interest received. The entry on the credit side reflects the figure found in the balance sheet that closed the account.*

Step 2 – Reconstruction of the Interest Income Account

Interest Income					
	Profit and Loss	1,000		Closing Accrued Interest Income	500
				Bank	500
		1,000			1,000

$$\begin{aligned} \text{Income received} &= \text{Interest Income} + \text{Accrued Interest Income} \\ &= 500 + 2,000 \\ &= 2,500 \end{aligned}$$

Therefore, the interest income received was \$2,500.

Reconstruction of Expense account purpose: The bank figures calculated in the accrued interest income and interest income account are added together to find the total interest income received. This appears in the SCF as interest received in the “Cash flows from Investing Activities”.

Reconstructions – Sale and Purchase of Non-Current Assets

Solution

Step 1 – Reconstruction of the Accumulated Depreciation of NCA Account

Accumulated Depreciation of NCA					
	Sale of Asset	2,000		Opening Balance	8,000
	Closing Balance	10,000		Depreciation	4,000
		12,000			12,000

Reconstruction of Accumulated Depreciation of NCA account purpose: The sale of asset figure calculated when reconstructing the accumulated depreciation account is transferred to the sale of asset account.

Step 2 – Reconstruction of the Sale of Asset Account

Sale of Asset					
	Property, plant and equipment	9,000		Accumulated Depreciation	2,000
	Gain on sale	5,000		Bank	12,000
		14,000			14,000

The cash received from the sale is the bank figure.

Gain or loss on sale:

- Gain on sale = Debit side
- Loss on Sale = Credit side

Therefore, the proceeds of the sale of the non-current asset was \$12,000.

Reconstruction of Sale of Asset account purpose:

- The bank figure calculated when reconstructing the sale of asset account is cash received from the sale of the NCA. This appears in the SCF as "Proceeds of sale of plant and equipment" in the "Cash flows from investing activities" section.
- The Property, Plant and Equipment figure calculated when reconstructing the sale of asset account is the purchase price of the NCA that was sold. This is transferred to the Sale of Asset Account.

Step 3 – Reconstruction of the Non-Current Asset Account

Property, plant and equipment					
	Opening balance	50,000		Sale of Asset	9,000
	Bank	29,000		Closing balance	70,000
		79,000			79,000

Therefore, the cash paid for the non-current asset was \$29,000.

Reconstruction of Property, plant and equipment account purpose: The bank figure calculated when reconstructing the non-current asset account is the cash paid for the NCA. This appears in the SCF as "Payment for NCA" in the "Cash flows from investing activities" section.

Note: The reconstructions required for the "Hidden cash expenses relating to Sale and Purchase of Non-Current Assets" are demonstrated in the Practical Guide.

Reconstructions – Unearned Income / Income Received in Advance

Solution

Unearned Income					
	Fees Income	70,000		Opening Balance	12,000
	Closing Balance	14,000		Bank	72,000
		84,000			84,000

Therefore, the cash received from customers is \$72,000.

Reconstruction of unearned income purpose: The bank figure calculated when reconstructing the unearned income account is the cash received from customers. This appears in the SCF is by being added to the "Receipts from Customers" in the 'Cash flows from operating activities' section.



Medina Azahara, Córdoba.



Corporate Finance

Money Master

Make epic things happen as you rock the cash flow. You'll elevate, distribute, and skilfully manage business finances, all while being primed to seize investment opportunities that pop up.

Is it a good match for me?

If you have people skills, communication finesse, empathetic vibes, teamwork mojo, ability to problem-solve, and a love of understanding how businesses work – you're a tailor-made superstar for this career.

Where could I work?

Loads of large corporations like Disney, Sony, PepsiCo, and Kellogg's as well as financial services like HSBC and the biggest accounting firms.

How do I get there?

You don't need to study anything specific in high school, but business-related subjects can help you get a head start.

Ability to work overseas



Graduate salary*



*Hays Salary Guide FY23/24 Accounting and Finance

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19. Key Performance Indicators (KPIs)



Activate Prior Knowledge

Respond to the following questions. Discuss your answers with a peer or the class.

<p>Why would a business want to set and track the achievement of goals?</p>	
<p>You are the manager of a fast food restaurant. What non-financial outcomes could be measured to quantify how well the business is performing?</p>	
<p>You are the manager of a sales team. What financial outcomes could be measured to quantify how well the business is performing?</p>	

KPIs – Syllabus

Syllabus – Unit 4	
Key Performance Indicators (KPIs)	<p><i>Note: The below syllabus sections are in both the 'Ratios' chapter and 'Key Performance Indicators' chapter given the overlap in syllabus but distinctly different content/examination questions.</i></p> <p>Recording, using and evaluating financial information: Evaluating financial information for planning, coordinating, controlling and investing</p> <ul style="list-style-type: none"> • examination and interpretation of annual reports, financial statements and stock exchange data to assess the position and performance of a public company • purpose of annual reporting and the use of key performance indicators by directors for accountability and decision-making purposes

KPIs – Introduction

KPIs are measures that a business can use to assess their success in achieving specific business objectives. KPIs provide an objective way to monitor progress, make informed decisions, and measure effectiveness across various aspects of the organization. KPIs range from financial metrics such as sales growth to non-financial metrics including customer satisfaction.

KPIs – Summary Table

	KPIs
Define / Nature	<ul style="list-style-type: none"> • Financial or non-financial measures that are quantifiable and allow a businesses to assess: <ul style="list-style-type: none"> ◦ Performance of business processes. ◦ Achievement of goals.
Useful because KPIs	<ul style="list-style-type: none"> • Define business success and encourage movement toward this success. • Assist in management of business processes. • Help reduce costs. • Motivate employees towards KPI achievement. • Identify potential trends through comparison of target KPIs with actual results. • Identify target areas where KPI targets are surpassed or underperformed.

Financial and Non-financial KPIs – that could be included in annual reports

	Financial KPIs	Non-financial KPIs
Examples	<p>Customer success examples:</p> <ul style="list-style-type: none"> • Sales per salesperson. • Sales per franchise. • Sales per product line. • Average sales per salesperson. • Average customer spending. <p>Operational performance examples:</p> <ul style="list-style-type: none"> • Variances in production operations. • Market ratios analysis. • Performance reports. <ul style="list-style-type: none"> ◦ Operating forecast. ◦ Sales forecast. ◦ Production forecast. 	<ul style="list-style-type: none"> • Human resources: <ul style="list-style-type: none"> ◦ Employee turnover. ◦ Sick days taken. ◦ Time to fill open positions. ◦ Applications received for openings. • Corporate Social Responsibility: <ul style="list-style-type: none"> ◦ Employee treatment. ◦ Greenhouse gas emissions. ◦ Workplace conditions. • Customer satisfaction: <ul style="list-style-type: none"> ◦ Customer surveys of customer service. ◦ Customer surveys of item satisfaction. • Timeliness: <ul style="list-style-type: none"> ◦ Deliveries sent to customers on time. ◦ Deliveries from suppliers being received on time. • Company reputation: <ul style="list-style-type: none"> ◦ Perception of company CSR. ◦ Perception of product quality.

Note: there are near infinite KPIs that could be used across various business areas. Be creative and think of anything a business may want to track to ensure performance. Some examples are listed above. You may need to describe these. A research task has been included in the practice tasks to describe KPIs. You may also need to describe these relevant a case study if the question asks. Read the question/case study and answer the specific question being asked.

Practice Questions

Questions 1-10: Key Performance Indicators.

Exam Questions

See 'Key Performance Indicators' chapter of the Exam Guide for practice exam questions. The Exam Guide can be found by navigating to the Resource Hub link on the front page.

Question 1

Key performance indicators allow a company to assess:

- a. Competitor performance.
- b. Government regulation.
- c. Achievement of business goals.
- d. Competitor ASX share price.

Question 2

Identify which of the following is not a financial key performance indicator.

- a. Average customer spending.
- b. Sales per franchise
- c. Analysis of market ratios.
- d. Percentage of deliveries sent to customers on time.

Question 3

Identify which of the following is a non-financial key performance indicator.

- a. Average sales per salesperson.
- b. Greenhouse gas emissions.
- c. Production forecast.
- d. Average cost to recruit new employees.

Question 4

A reason key performance indicators are useful does not include:

- a. Identifies potential trends through comparison of actual results with target KPIs.
- b. Helps to reduce costs.
- c. Defines business success and encourages movement towards this success.
- d. Reduces competitive advantage of competitors.

Question 5

A company is interested in aligning its business activities with its strategic objectives. One of the company's recent strategic objectives is to demonstrate increased corporate social responsibility. Which of the following would not be a useful key performance indicator for this strategic objective?

- a. Average product lifespan.
- b. Employee satisfaction survey results.
- c. Tonnes of waste generated per year.
- d. Average sales per salesperson.

Question 6

Describe the nature of key performance indicators.

20. Ratios

Ratios – Syllabus

Syllabus – Unit 4	
Ratios	<p>Recording, using and evaluating financial information: Recording, processing and communicating financial information</p> <ul style="list-style-type: none"> • preparation of the following ratios – application of GST not required <ul style="list-style-type: none"> ▪ liquidity ratios <ul style="list-style-type: none"> ○ working capital/current ○ quick asset ▪ efficiency ratios <ul style="list-style-type: none"> ○ debtor's collection ○ inventory/stock turnover ▪ profitability ratios <ul style="list-style-type: none"> ○ profit ○ rate of return on assets ○ times interest earned ▪ leverage ratio <ul style="list-style-type: none"> ○ debt to equity ▪ market ratios <ul style="list-style-type: none"> ○ earnings per share ○ price/earnings ○ dividend yield <p><i>Note: Some of the below syllabus sections are in both the 'Ratios' chapter and 'Key Performance Indicators' chapter given the overlap in syllabus but distinctly different content/ examination questions.</i></p> <p>Recording, using and evaluating financial information: Evaluating financial information for planning, coordinating, controlling and investing</p> <ul style="list-style-type: none"> • examination and interpretation of annual reports, financial statements and stock exchange data to assess the position and performance of a public company • purpose of annual reporting and the use of key performance indicators by directors for accountability and decision-making purposes • interpretation of the following ratios: <ul style="list-style-type: none"> ▪ liquidity ratios <ul style="list-style-type: none"> ○ working capital/current ○ quick asset ▪ efficiency ratios <ul style="list-style-type: none"> ○ debtor's collection ○ inventory/stock turnover ▪ profitability ratios <ul style="list-style-type: none"> ○ profit ○ rate of return on assets ○ times interest earned ▪ leverage ratio <ul style="list-style-type: none"> ○ debt to equity ▪ market ratios <ul style="list-style-type: none"> ○ earnings per share ○ price/earnings ○ dividend yield • limitations in assessing performance from financial statement analysis and from traditional financial accounting <ul style="list-style-type: none"> ▪ historical cost accounting ▪ lack of comparability between entities ▪ lack of disclosure

Ratios – Introduction

Ratios analyse various areas of a business to assess the performance of a company. Different ratios will measure different areas of performance. Once ratios have been calculated they can be compared with other information such as, budgeted ratio results, the ratio results of previous years, industry ratio averages or other businesses ratios. This chapter also discusses some of the possible limitations in assessing performance from ratios and traditional financial accounting.

Ratios – Summary Table

Area	Definition	Ratio	Ratio definition	Calculation	Interpretation – increasing	Interpretation – decreasing
Efficiency	Ability to manage inventory and accounts receivable.	Debtor's Collection	Ability to collect accounts receivable from sales on credit.	$\frac{\text{Average Debtors}}{\text{Net Credit Sales}} \times 365$	<ul style="list-style-type: none"> Decreased net credit sales. Debts owed to business paid slower. Accounts receivable should be managed better. Need to develop internal control strategies for accounts receivable. 	<ul style="list-style-type: none"> Increased net credit sales. Debts owed to business paid sooner. Accounts receivable is being managed better. Internal control strategies for accounts receivable are more effective.
				Inventory / Stock Turnover	Number of times inventory replaced each period.	$\frac{\text{Cost of Sales}}{\text{Cost of Average Inventory}}$
Gearing / Leverage / Stability	Ability of a business to survive long term - comparison of internal debt (equity) with the external debt (liabilities).	Debt to Equity Ratio	Ability of a business to survive long term.			$\frac{\text{Total Liabilities}}{\text{Equity (End)}}$

Note for ratio interpretations: Increasing/decreasing columns on far right list a range of possible **potential** interpretations.

Note: 'Ratios – Summary Table' continues on the following pages.

Area	Definition	Ratio	Ratio definition	Calculation	Interpretation – increasing	Interpretation – decreasing				
Liquidity	Ability of a business to pay due debts.	Working Capital Ratio / Current Ratio	Ability to pay short-term debts.	Current Assets	<ul style="list-style-type: none"> • Between 100-200% or 1.0-2.0:1.0 ideal – Indicates capacity to pay short term debts. • Current assets increasing relative to current liabilities. • Decreased creditors or current liabilities. • Cash may be idle that could be invested. • Slower debtor receipts. 	<ul style="list-style-type: none"> • Less than 100% or 1.0:1.0 not ideal – Indicates possible short term debt repayment issues. • Decreasing current assets relative to current liabilities. • Increased creditors or current liabilities. • Cash has been invested rather than sitting idle. • Fast debtor receipts 				
				Current Liabilities						
		Quick Asset Ratio / Acid Test Ratio	Ability to use highly liquid assets to pay urgent short term debts.	Current Assets (excluding inventory and prepayments)			<ul style="list-style-type: none"> • Ideally above 100% or 1.0:1.0 implies short term debt is payable. • Increasing current assets such as cash. • Increasing debtors. • Decreasing creditors. 	<ul style="list-style-type: none"> • Below 100% or 1.0:1.0 implies short term debt might not be payable. • Decreasing current assets such as cash. • Decreasing debtors. • Increasing creditors. 		
				Current Liabilities (except for Bank Overdraft)						
Profitability	Ability to create profits from investment in assets or equity.	Profit Ratio	Profit percentage within each sale.	Profit (after income tax)	<ul style="list-style-type: none"> • Increasing profit relative to sales/fees • Decreasing expenses. • Sale of more high profit stock relative to low profit stock. • Less depreciation of NCAs due to less capital investment. • More accrued income received. 	<ul style="list-style-type: none"> • Decreasing profit relative to sales/fees. • Increasing expenses. • Sale of less high profit stock relative to low profit stock. • More depreciation of NCAs via recent capital investment. • Less accrued income received. 				
				Total revenue (or Net Sales or Fees)						
		Rate of Return on Assets Ratio	The efficiency of using assets to generate profit.	Profit before income tax + Interest expense			<ul style="list-style-type: none"> • Increasing profit relative to assets. • More efficient asset use to generate higher returns. 	<ul style="list-style-type: none"> • Decreasing profit relative to assets. • Less efficient asset use to generate returns. 		
				Average total assets						
		Times Interest Earned	How many times business interest is covered by profit before tax.	Profit before income tax + interest expense					<ul style="list-style-type: none"> • Interest payments able to be made. • Low leverage (indicated by low interest expense from loans). • Investment should be considered if very high (due to high profit relative to interest expense). 	<ul style="list-style-type: none"> • Interest payments may be difficult to make. • High leverage (indicated by high interest expense from loans). • Investment should not be considered if low (due to low profit relative to interest expense).
				Interest expense						

Note for ratio interpretations: Increasing/decreasing columns on far right list a range of possible **potential** interpretations.

Area	Definition	Ratio	Ratio definition	Calculation	Interpretation – increasing	Interpretation – decreasing	
Market	Review of the ASX performance of public companies.	Earnings Per Share	Amount of profit after tax a company earns relative to the number of ordinary shares.	Profit (after income tax)	<ul style="list-style-type: none"> Higher return for shareholders. Higher profit per share. 	<ul style="list-style-type: none"> Lower return for shareholders. Lower profit per share. 	
				Weighted average number of ordinary shares issued			
		Price / Earnings	Market price per ordinary share compared to earnings per share.	Market price per ordinary share	Earnings per share	<ul style="list-style-type: none"> Higher valuation of shares by current investors. Higher valuation of shares by market. 	<ul style="list-style-type: none"> Lower valuation of shares by current investors. Lower valuation of shares by market.
		Dividend Yield	Dividends paid compared to share price.	Annual dividend per ordinary share	Market price per ordinary share	<ul style="list-style-type: none"> Perception by the market that the company is a valuable investment. 	<ul style="list-style-type: none"> Perception by the market that the company is a less valuable investment.

Note for ratio interpretations: Increasing/decreasing columns on far right list a range of possible **potential** interpretations.

Tip	<u>Practical Guide</u>
	You may find it useful for the practical chapters to work through the Essential Insight Practical Guide textbooks. The Course Guide textbook only contains key summary information from the practically focused chapters. The Essential Insight Practical Guide textbooks contain step-by-step worked examples and practice questions to scaffold students from initial concept attainment to exam level for practically focused chapters. The Practical Guides can be found by navigating to the Resource Hub link on the front page.



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Ratio comparisons

Ratios may be calculated and then compared with:

- Budgeted / predicted results.
- Previous year's results.
- Industry averages.
- Other businesses.

Limitations in assessing performance from ratios and traditional financial accounting

List	Describe
Historic focus not future focus	Ratios reflect historic performance and do not predict future performance.
Need for comparison	Ratios need to be compared with other information to be most useful. See Ratio comparisons section above.
Timeliness	Financial reports are produced after a financial period and company position will have changed by the time GPFs are able to be analysed.
External influences on market ratios	Market ratios are heavily influenced by external factors such as speculation, political events, news stories etc. These external influences are not always related to company's performance.
Historical figures ignore inflation	Data used to calculate ratios uses historical figures which are not adjusted for inflation (present value).
Accounting methods between entities	Different businesses use varied methods to apply accounting standards. Especially for qualitative information. This makes comparability between entities difficult.
Lack of disclosure	Full disclosure is impossible. Confidentiality required to retain confidential company trade secrets which generate competitive advantage.
Data manipulation	Data could be manipulated to make data appear more desirable. This will impact ratio calculation and comparisons.
Only a guide, not a reason	Ratios may highlight positive and or negative areas but will not identify causes. Especially qualitative causes e.g., non-financial KPIs such as culture, high staff turnover etc. do not appear on GPFs or ratios.

Note: Know any 3.

How it is possible to have high profitability but poor liquidity

- Possible because income can be earned with customers paying on credit rather than cash.
- Internal control over accounts receivable required to collect cash from debtors quickly / efficiently.
- Poor internal control negatively impacts cash flow.

Note: Provide definitions of profitability and liquidity before describing above dot points.



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