

# **BSBFIA402**

# **Report on financial activity**

**Release 1**

**Learner guide**

# **BSBFIA402**

# **Report on financial activity**

Release 1

**Learner guide**

Aspire Version 1.1

## Copyright Warning

**This product is copyrighted to Aspire Training & Consulting  
(ABN 51 054 306 428).**

Aspire Training & Consulting owns all copyright to its products. Except as permitted by the *Copyright Act 1968* (Cth) or unless you have obtained the specific written permission of Aspire Training & Consulting, you must not:

- reproduce or photocopy this product in whole or in part
- publish this product in whole or in part
- cause this product in whole or in part to be transmitted
- store this product in whole or in part in a retrieval system including a computer
- record this product in whole or in part either electronically or mechanically
- resell this product in whole or in part.

Aspire Training & Consulting:

- invests significant time and resources in creating its original products
- protects its copyright material
- will enforce its rights in copyright material
- reserves its legal rights to claim its loss and damage or an account of profits made resulting from infringements of its copyright.

Aspire is committed to developing quality resources that meet the needs of our customers. However, occasionally Aspire finds, or is notified of, errors. Please refer to our website at [www.aspirelr.com.au](http://www.aspirelr.com.au) to see if there are any updates that may be relevant to you.

Every effort has been made to ensure the information in this book is accurate; however, the author and publisher accept no responsibility for any loss, damage or injury arising from such information.

Except where an information source is acknowledged, the names and details of individuals and organisations used in examples are fictitious and have been devised for learning purposes only. Any similarity to actual people or organisations is unintentional.

All websites referred to in this unit were accessed and deemed appropriate at time of publication.

Aspire Training & Consulting apologises unreservedly for any copyright infringement that may have occurred and invites copyright owners to contact Aspire so any violation may be rectified.

BSBFIA402 Report on financial activity Release 1

© 2017 Aspire Training & Consulting  
Level 1, 464 St Kilda Road  
MELBOURNE VIC 3004 AUSTRALIA  
Phone: (03) 9820 1300

First published April 2017

Cover design: Rewind Creative  
Printer: Doculink Australia Pty Ltd, 1d/28 Rogers Street, Port Melbourne VIC 3207

e-ISBN 978-1-76059-360-5 (PDF version)  
ISBN 978-1-76059-359-9

## Contact details

<b>Participant</b>
Name:
Start date:
Phone number:
Email:
<b>Work location</b>
Name:
Address:
Postal address:
Workplace supervisor name:
Phone number:
Fax:
Email:
<b>Registered Training Organisation (RTO)</b>
Name:
Address:
Postal address (if different):
Phone number:
Fax:
RTO contact name:
Mobile:
Email:



---

# Contents

<b>Before you begin</b>	<b>vii</b>
<b>Topic 1: Compile financial information and data</b>	<b>1</b>
1A Collect, evaluate and code financial data	2
1B Convert and consolidate financial data	16
1C Make and record asset and liability valuations	18
1D Identify and resolve discrepancies and errors	23
Summary	26
Learning checkpoint 1: Compile financial information and data	27
<b>Topic 2: Prepare statutory requirement reports</b>	<b>33</b>
2A Record income and expenditure to meet statutory requirements	34
2B Calculate taxation liabilities	44
2C Identify relevant receipts, revenue documentation and payments	51
2D Claim available benefits and allowances	52
2E Submit statutory reports within stated time lines	54
Summary	56
Learning checkpoint 2: Prepare statutory requirement reports	57
<b>Topic 3: Provide financial business recommendations</b>	<b>61</b>
3A Derive recommendations supported by evidence	62
3B Propose effective and concise recommendations	75
3C Identify significant issues in financial statements	76
3D Ensure structure and report formats comply with requirements	80
Summary	82
Learning checkpoint 3: Provide financial business recommendations	83



# Before you begin

This learner guide is based on the unit of competency *BSBFIA402 Report on financial activity*, Release 1. Your trainer or training organisation must give you information about this unit of competency as part of your training program. You can access the unit of competency and assessment requirements at: [www.training.gov.au](http://www.training.gov.au).

## How to work through this learner guide

This learner guide contains a number of features that will assist you in your learning. Your trainer will advise which parts of the learner guide you need to read, and which practice tasks and learning checkpoints you need to complete. The features of this learner guide are detailed in the following table.

Feature of the learner guide	How you can use each feature
Learning content	Read each topic in this learner guide. If you come across content that is confusing, make a note and discuss it with your trainer. Your trainer is in the best position to offer assistance. It is very important that you take on some of the responsibility for the learning you will undertake.
Examples and case studies	Examples of completed documents that may be used in a workplace are included in this learner guide. You can use these examples as models to help you complete practice tasks and learning checkpoints. Case studies highlight learning points and provide realistic examples of workplace situations.
Practice tasks	Practice tasks give you the opportunity to put your skills and knowledge into action. Your trainer will tell you which practice tasks to complete.
Video clips	Where QR codes appear, learners can use smartphones and other devices to access video clips relating to the content. For information about how to download a QR reader app or accessing video on your device, please visit our website: <a href="http://www.aspirelr.com.au/help">www.aspirelr.com.au/help</a>
Summary	Key learning points are provided at the end of each topic.
Learning checkpoints	There is a learning checkpoint at the end of each topic. Your trainer will tell you which learning checkpoints to complete. These checkpoints give you an opportunity to check your progress and apply the skills and knowledge you have learnt.



## Foundation skills

As you complete learning using this guide, you will be developing the foundation skills relevant for this unit. Foundation skills are the language, literacy and numeracy (LLN) skills and the employability skills required for participation in modern workplaces and contemporary life.

The following table outlines specific foundation skills noted for your learning in this learner guide.

Foundation skill area	Foundation skill description
Reading	<ul style="list-style-type: none"> <li>Compares and analyses information from a range of sources varying in complexity to determine and complete financial requirements</li> </ul>
Writing	<ul style="list-style-type: none"> <li>Records numerical and textual information incorporating required financial language organising data in a manner that supports the format and purpose of the document</li> </ul>
Oral communication	<ul style="list-style-type: none"> <li>Presents financial issues and requirements clearly, succinctly and based on own findings using language appropriate to audience and environment</li> <li>Exchanges and obtains information from others by listening and questioning</li> </ul>
Numeracy	<ul style="list-style-type: none"> <li>Establishes criteria and categories for financial management purposes and monitors activities on a regular basis</li> <li>Uses a wide range of mathematical calculations to interpret and arrange/compare numerical information in order to comply with requirements</li> </ul>
Navigate the world of work	<ul style="list-style-type: none"> <li>Recognises, understands and applies applicable legislation, industry standards and organisational policies and procedures in the conduct of own work</li> </ul>
Interact with others	<ul style="list-style-type: none"> <li>Selects and uses appropriate conventions and protocols when communicating with external stakeholders to supply required information</li> </ul>
Get the work done	<ul style="list-style-type: none"> <li>Uses formal and logical processes to plan and complete tasks, achieving timelines and organisational requirements</li> <li>Uses analytical skills to identify discrepancies, attempts to resolve the issues within the context of own responsibilities and, where appropriate, consults with more experienced colleagues for assistance</li> <li>Uses a range of digital technologies to access, record, store, organise, compile, analyse and present complex data from multiple sources of information</li> </ul>

## What do you already know?

Use the following table to identify what you may already know. This may assist you to work out what to focus on in your learning.

Topic	Key outcome	Rate your confidence in each section
Topic 1 Compile financial information and data	1A Collect, evaluate and code financial data	<input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident
	1B Convert and consolidate financial data	<input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident
	1C Make and record asset and liability valuations	<input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident
	1D Identify and resolve discrepancies and errors	<input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident
Topic 2 Prepare statutory requirement reports	2A Record income and expenditure to meet statutory requirements	<input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident
	2B Calculate taxation liabilities	<input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident
	2C Identify relevant receipts, revenue documentation and payments	<input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident
	2D Claim available benefits and allowances	<input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident
	2E Submit statutory reports within stated time lines	<input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident

Topic	Key outcome	Rate your confidence in each section
Topic 3 Provide financial business recommendations	3A Derive recommendations supported by evidence	<input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident
	3B Propose effective and concise recommendations	<input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident
	3C Identify significant issues in financial statements	<input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident
	3D Ensure structure and report formats comply with requirements	<input type="checkbox"/> Confident <input type="checkbox"/> Basic understanding <input type="checkbox"/> Not confident

---

# Topic 1

## Compile financial information and data

A key responsibility of an organisation is to ensure that data from its financial activities is systematically collected, coded, analysed, presented and recorded so that management can plan and control the organisation's financial performance effectively.

Financial information and data include transactions recorded on cash receipts, tax invoices and credit notes issued to customers, purchase invoices and credit notes from suppliers, and cheque and electronic funds transfer (EFT) payment documentation. These data source documents should always be checked for accuracy, verified and approved according to the organisation's policies and procedures.

As well as maintaining financial records for management planning purposes, the organisation, if it is a reporting entity and subject to the Corporations Law, needs to compile and present its financial data in compliance with regulators such as the Australian Securities and Investments Commission (ASIC). If the organisation is registered for goods and services tax (GST) it must also meet additional statutory requirements such as the preparation of business activity statements (BAS).

In this topic you will learn how to:

- 1A Collect, evaluate and code financial data
- 1B Convert and consolidate financial data
- 1C Make and record asset and liability valuations
- 1D Identify and resolve discrepancies and errors

# 1A

## Collect, evaluate and code financial data

All organisations use accounting procedures to monitor and manage their financial activities. They must also communicate their economic and financial information. Managers use this information to make decisions that benefit the organisation.

The financial activities of an organisation consist of transactions or economic exchanges between the business and other parties. Every organisation has financial dealings with other parties. For example, an organisation may buy goods from suppliers, pay creditors, loans and suppliers, make sales to customers, employ staff, and pay profits to owners and shareholders. Each of these financial transactions results in some kind of financial information being created.



The organisation must record and collect information on every financial transaction it engages in via its accounting systems. This data is then evaluated, coded, aggregated and summarised in the preparation of financial reports for management.

Information used for this purpose must meet high standards of accuracy, consistency and quality to ensure that the financial picture it creates tells the truest financial story. Its financial data helps establish the professional foundation of the organisation.

### Financial reports

The number and types of financial reports prepared within an organisation will vary according to the activities of the business, its reporting requirements, the reporting requirements of statutory bodies and the people who use the information to make decisions.

The people who require financial reports for decision-making can be internal or external to the organisation.

Here is some information about financial reports.

### **Those who require financial reports**

Those who require financial reports in order to analyse information include:

- management
- board members
- owners/shareholders
- employees
- lending institutions
- creditors
- suppliers
- Australian Taxation Office (ATO)
- Australian Bureau of Statistics (ABS)
- Australian Securities and Investments Commission (ASIC).

### **Questions asked by people about financial information**

Common questions that may be asked include:

- Has the organisation made a profit?
- How much money does the organisation owe?
- Does the organisation have enough cash to cover its commitments?
- Should the organisation be selling its products or services at a higher price?
- What proportion of the organisation's financial outlay is paid in wages?
- Are stock levels too high and/or cash levels too low?
- Has the organisation assessed its taxation liabilities correctly?
- Has the organisation met its external reporting obligations properly?

### **The various types of financial reports**

The types of financial reports used within an organisation will differ depending on the nature of the organisation and its financial activities. The most common financial reports used for decision-making include:

- income statements (profit and loss statements)
- balance sheets (statements of financial position)
- cashflow statements
- internal performance reports
- budgets
- ongoing special-purpose analytical reports
- one-off special reports.

### Your role and responsibilities in reporting financial information

You must understand your role and responsibilities with regard to your organisation's financial activities and the preparation of financial information and reports. You should be clear on how your role integrates with those of other staff with responsibilities related to your organisation's financial performance.

Whether you are a bookkeeper in a small organisation or a member of an accounts team in a large organisation, when it comes to reporting on financial activity, essential skills and knowledge include understanding of the financial data used to produce financial reports, and the types of financial reports the organisation prepares for its own purposes and those it is required to produce to meet statutory requirements.

## The accounting process

Accounting records the organisation's financial activities and transactions accurately in a logical and meaningful way in order to provide financial information and reports to interested parties, such as a company's owners, board of directors, management and investors.

The accounting process can be broken down into two distinct stages: bookkeeping (the recording of financial activities and transactions), and analysis and reporting (the interpretation and presentation of the information in financial reports for decision-making).

Large, complex organisations generally demand more diverse and complex financial reporting than smaller, simpler organisations, especially in the areas of analysis, interpretation, forecasting and budgeting.

Here is a list of steps within the accounting process.

### The accounting process

**1****Transactions**

Financial dealings with parties external to the organisation

**2****Business documents**

Documentary evidence raised to validate every transaction

**3****Journals**

Summaries of documentary information

**4****General ledgers**

Accounts prepared for transactions reported in journals

5

#### **Trial balances**

List of accounts and their balances to prove accuracy of general ledgers

6

#### **Financial reports**

Preparation of income statements (profit and loss statements) and balance sheets

7

#### **Decision-making**

Actions recommended and plans and forecasts set

8

#### **Analysis and interpretation**

Financial reports analysed and interpreted for strengths and weaknesses

## Accounting systems

An accounting system comprises the records, procedures, staff and equipment involved in the accounting process. The purpose of an accounting system is to record transactions both logically and accurately so that meaningful and reliable financial reports can be produced. In other words, an accounting system is the means by which accounting data is produced, recorded and reported.

Many organisations use off-the-shelf financial management software, such as MYOB, Quicken or Xero, or have software specifically developed to assist the process of recording and reporting on business transactions and meeting statutory reporting obligations (such as the business activity statement and superannuation guarantee).

## Financial source documents

When a financial transaction takes place, the document that captures the details of the transaction is called the source document. Every financial transaction has a source document that records the details of the transaction such as the date, amount and purpose of the transaction.

Here is a description of source documents and their importance.



Source documents	Importance of source documents
<p>Source documents are created for every financial transaction and include paper-based or electronic invoices, receipts, cheque butts and credit notes. The process of managing financial data involves the gathering of source documents and ensuring they meet desired requirements and are classified, coded and recorded correctly in the organisation's accounting system.</p> <p>Source documents of all of the organisation's financial transactions represent the initial inputs into the organisation's accounting process so that, eventually, financial reports summarising this information can be produced and given to people to assist in their decision-making.</p>	<p>Source documents fulfil two main roles in the organisation's accounting system. First, they provide objective evidence of the financial transactions that have taken place with other parties, their amounts, dates and purposes. Second, they provide an audit trail should the organisation ever need to prove or clarify the details of a particular financial transaction at some point in the future.</p> <p>It is essential that all source documents are collected. Regardless of the format of the source document, the procedures used when collecting, evaluating and coding source documents must be accurate, consistent and compliant with organisational requirements.</p>

## Collect financial data

The collection of source documents requires both paper-based and electronic documents to be recorded and stored for entry into the accounting system and for future auditing requirements. If the collection is incomplete, then the financial reports will be incomplete and inaccurate, providing users of the reports with unreliable information to base decisions on, as well as exposing the business to possible breaches of statutory requirements for recording financial matters.

The main source documents used by an organisation to record its transactions will vary depending on the nature of the organisation and its business; for example, service businesses compared to retailers.

Here is more information about source documents.

### Common source documents

- A purchase requisition is a request to the ordering department that an order be placed for goods or services.
- A purchase order is a request to a supplier to provide goods or services.
- A cash register roll records all transactions including cash, cheques, credit card vouchers and electronic funds received through the cash register.
- A written receipt provides written evidence of cash received by the business.
- A credit card voucher is evidence of payment by credit card and a credit card merchant summary is a summary of manual credit card vouchers.
- A bank deposit form provides evidence of monies deposited and a statement of account provides a summary of all transactions.
- A cheques-received listing is a summary of all cheques received. A cheque requisition is a request for a cheque to be prepared.
- Cheques are written orders to a bank to pay money to someone and cheque butts provide evidence of payment by cheque.
- A remittance advice is a note with payment details that relates to a cheque or electronic payment.
- A tax invoice provides evidence of goods or services supplied stating the amount paid; once supplied, a delivery document may be provided.
- An adjustment note for sales or purchases is issued when the price for goods is reduced after a tax invoice has been issued.
- A petty cash voucher is a document requesting payment from a petty cash fund.

## Source documents created from transactions

An organisation collects extensive financial data whenever it engages in a transaction such as sending an electronic bank transfer, writing a cheque, receiving account statements or sending out invoices to customers.

Here are examples of source documents created from financial transactions.

### Credit transactions

Transactions:

- Credit purchases
- Credit sales
- Credit purchase returns
- Credit sales returns

Created source documents:

- Tax invoice (received)
- Tax invoice (issued)
- Adjustment note

**Cash transactions**

Transactions:

- Cash receipts
- Cash sales
- Cash received from debtors

Created source documents:

- Receipt
- Cash register roll
- Cheques received listing
- Credit card voucher

**Purchases and payments**

Transactions:

- Payments
- Cash purchases
- Cash paid to creditors

Created source documents:

- Cheque butts
- EFT docketts
- Credit card vouchers

## Financial data to collect

Here are some examples of financial data that may be collected or sourced by an organisation.

**Financial data**

- Economic data from the Australian Bureau of Statistics (ABS)
- Budget variances
- Budgets and forecasts
- Cashflow and profit reports
- Financial market data from monitoring services such as Reuters
- Financial/operational statements and reports such as expenditures, receipts and income statements (profit and loss statements)
- Market valuations

## Evaluate financial data

In collecting financial data, it is important to ensure that source documents are evaluated as to their quality and consistency. Collecting source documents that are inaccurate or processing them incorrectly can cause problems.

As financial information is collected from the various source documents of the organisation, each source document should be evaluated for quality in terms of:

- validity
- type
- treatment.



## Document validity

Evaluating the validity of a financial transaction involves checking whether the information in the source document is correct and genuine.

Here is some information about checking the validity of financial source documents.

### Reasons for validating transactions

Evaluating the validity of source documents ensures the quality of the data in your source financial information. This in turn ensures the quality of the accounting records and reports produced. Validity is an important quality control measure for financial information.

### How to validate transactions

In the case of a cheque requisition, for example, before making a payment you need to confirm that:

- there is an invoice from a supplier requesting payment
- the goods or services mentioned on the invoice have been received
- the requisition has been properly authorised
- the details on the requisition are for the correct supplier and amount.

## Document type

Evaluating the type of financial information collected means verifying the type of transaction involved and its effect on the financial records of the organisation. This involves determining exactly what each financial transaction is for and which accounts it affects in the accounting system.

Here we examine why and how to evaluate the type of financial information.

Why evaluate financial data	How to evaluate financial data
<p>Evaluating the type of financial data or information is an important step towards correctly treating every financial transaction in the organisation's accounting records. If the type of transaction is not correctly determined, then the transaction will be entered incorrectly into the accounting system, resulting in financial reports also being incorrect.</p>	<p>An example of checking the type of transaction is looking at a remittance advice for payment to a supplier to see the sort of payment involved. Is it for payment of stock used in a production process, stationery supplies or an electricity bill? Determining the type of payment and what it is for facilitates the transaction being entered in the accounting system correctly.</p>

## Document treatment

Evaluating the treatment of a transaction allows you to identify the correct accounting record in which it should be entered.

For instance, if a payment is for stock, it should be included in the stock purchases account. If it is for stationery, it should be included in the stationery account.

Evaluating the treatment of each transaction ensures that similar and related transactions are treated consistently and accurately over time.

## Evaluate total income and expenses

Once source documents on income and expenses have been added to the organisation's accounting records, you are in a position to evaluate what the total income and expenses in these records are telling you.

This evaluation of results on a regular basis (such as at the end of a week, month or quarter) will keep you informed about the trends in the business and provide answers to key questions about the financial state of the organisation.

Here are examples of questions that can be posed when evaluating financial results.

### Key questions

Is the organisation spending too much money?

Is there enough cash in the bank to pay staff wages?

Does the organisation have debtors who owe it large sums of money?

Does the organisation have large debts it needs to pay?

## Code financial data

Given the large amount of financial transactions and source document data that the organisation must manage, it is important to sort or code these source documents so they can be used in the accounting records and associated reports that are prepared.

Coding is where all the transactions the organisation engages in are allocated to a particular area or account in the accounting records of the business.

Here is an outline of the general process for coding financial data, utilising a chart of accounts.

### Classify balance sheet items and profit and loss items

To begin with, coding classifies all of the financial transactions of the organisation as they affect one of two categories within the accounting records of the business:

Balance sheet items – assets and liabilities

Profit and loss items – revenues (sales) and expenses

### Code items according to the chart of accounts

From this broad classification, coding then seeks to classify every financial transaction into the organisation's chart of accounts. The chart of accounts is the framework of all of the accounts in the organisation's accounting system. Each account in the chart of accounts is used to record a particular type of financial transaction and is given a unique account number (code).

### Group accounts according to classifications

Similar accounts are grouped together by giving them sequential account codes or numbers. The chart of accounts discloses the five account classifications used in the organisation's accounting system: assets, liabilities, owner's equity, revenues and expenses.

**Allocate account numbers to source documents**

When each source document is processed, it is important to mark on the document the account number to which the document transaction is being coded. This allows the person reviewing the source document to ensure that similar and related transactions have been treated consistently and accurately within the accounting system.

## Organisational requirements to consider

Most organisations have policies and procedures in place that influence how financial data is collected, evaluated and coded. It is vital that staff are familiar with the organisational requirements to follow when collecting, evaluating and coding financial data.

Procedures may be outlined in the organisation's policies and procedures manual or documented in a special financial procedures manual; for example, the organisation's pricing and exchange parameters.

The requirements for collecting, evaluating and coding financial data will differ between organisations. Some procedures are a function of size and complexity, and many small- to medium sized businesses may not formally document these requirements. For these organisations, knowledge of processes is passed on verbally; for example, when inducting a new staff member.

## Factors affecting data compilation

Regardless of the size and type of organisation you are employed in, there are some general organisational requirements that affect the ways that financial data is collected, evaluated, coded, reported and recorded.

Here are some factors affecting the financial data compilation processes.

**Quality assurance measures**

There may be processes in place to maximise the quality of a task while minimising the work involved. Examples include processes for ensuring financial data is accurate the first time and establishing service standards such as due dates, turnaround times, levels of accuracy and checking of final outputs. Your organisation may conduct regular financial analysis assessments to ensure continuous improvement measures are in place.

**Security and authorisation**

You must always follow the security or authorisation procedures outlined in your organisation's policies and procedures manual. These may include separating duties so that one person checks the tasks performed by another and that the receiving, recording and banking of cash are not performed by just one employee. There may be a system of authorisation you have to follow; for example, two authorised signatories must sign all cheques issued.

### **Coding and classification**

Make sure you adhere to the organisational chart of accounts code when you enter transactions into the various journals and ledgers within your organisation's accounting system. The classifications of accounts may vary between organisations, so familiarise yourself with the classification system your organisation uses.

### **Reporting requirements**

You need to be familiar with the organisation's financial reporting calendar and know when reports are needed and how they are to be presented. The calendar may include submission dates of reports to meet Australian Taxation Office and other statutory requirements, as well as organisational deadlines. The calendar must be reviewed regularly and incorporate applicable changes made by regulators.

### **Recording and filing systems**

It is essential that you are familiar with your organisation's recording and filing systems. Some organisations use financial software applications, while others use a manual paper-based system to produce financial reports such as income statements, balance sheets and cashflow statements. Familiarise yourself with the various financial reports produced by your organisation.

## Practice task 1

Read the scenario, then answer the questions that follow.

### Scenario

You are the bookkeeper for R Jones Sports Shop. You receive this invoice.

<b>TAX INVOICE</b>		Parramatta Sports		
Invoice no: 52		ABN 69 265 189 592		
Sold to: R Jones Sports Shop 45 Kitch Avenue Balwyn North 3104		52 Rovers Road Albion 3020		
		Phone: 9876 5432		
		Date: 25 September 2016		
Particulars	Quantity	Rate	\$	¢
Hiking T-shirts	60	17.00	1,020	00
Hockey sticks	5	26.00	130	00
GST			115	00
Total amount			1,265	00
Visit us at: <a href="http://www.parramattasports.com.au">www.parramattasports.com.au</a>				
Terms 5/10, net 30				

1. What questions should you ask yourself to check the validity of the data in the invoice?

2. Evaluate the validity of the financial information included in this invoice and determine its type and treatment in terms of what this information will be used for.

*continued ...*

... continued

3. Code and identify the treatment of this transaction in the accounting system; that is, decide which account to record the data in. R Jones Sports Shop has the following cost of goods sold (COGS) accounts: 5000 to 5999:

- 5001 COGS: Clothing
- 5002 COGS: Footwear
- 5003 COGS: Equipment
- 5004 COGS: Other

## 1B

## Convert and consolidate financial data

An important part of compiling financial information and data is to consolidate and convert financial data from a range of financial source documents in order to present an aggregate or summary that can provide useful information for the organisation.

Information from analysis of financial data enables management to make important decisions such as making or buying a component, adding a new product or service, or closing a store or department.

Providing a summary may involve:

- converting sales data to obtain monthly sales information
- converting sales data to identify seasonal trends
- analysing information to provide a profile of current debtors
- obtaining the total cost of production in order to determine the cost per unit
- converting stock information from a range of data to identify current stock levels.

## Present reports and results

Most accounting programs are capable of producing reports by automatically converting data into a format that allows you to analyse the information. For example, if you have been asked to calculate how many people have not paid their account according to the terms on their invoice, a debtors report can be produced that shows the list of outstanding invoices and the ageing of the accounts.

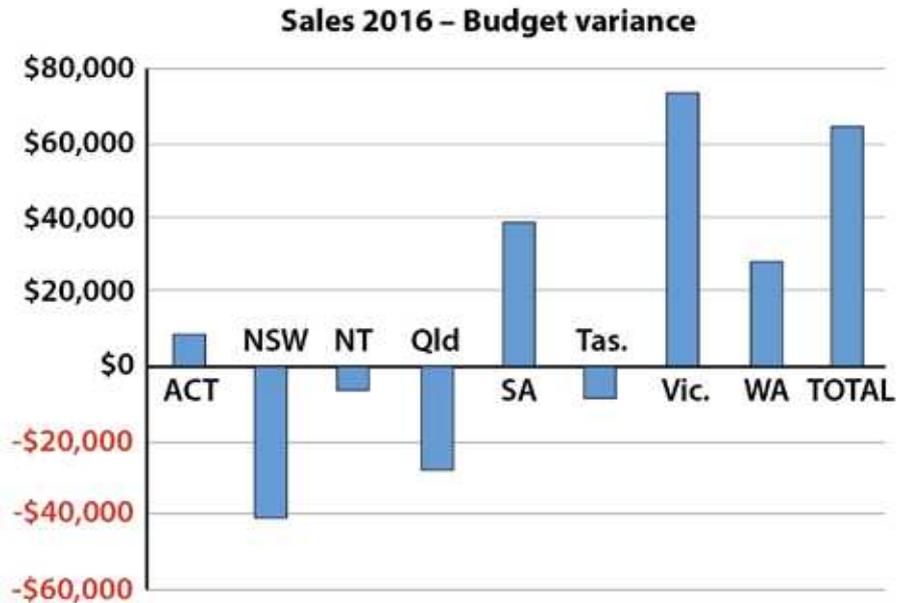
To present the results of converting complex financial statistics and charts, you can use spreadsheets such as Microsoft Excel. Some accounting programs produce spreadsheets and some provide results in line graphs and bar charts.

Here is more information about accounting programs and spreadsheets.

How accounting programs help	How spreadsheets help
<ul style="list-style-type: none"> <li>• Identify money owed to the organisation</li> <li>• Project cashflow required for a period</li> <li>• Compare quantity and value of products sold</li> <li>• Summarise customer activity</li> <li>• Compare level of income in different periods</li> <li>• View expenses by different types</li> </ul>	<ul style="list-style-type: none"> <li>• Consolidate and summarise information</li> <li>• Present information in charts and graphs</li> <li>• Standardise variables and coding for analysis</li> <li>• Calculate moving averages</li> <li>• Calculate unit costs</li> <li>• Show trend analysis</li> </ul>

## Example: present data in a bar chart

The bar chart below shows the sales performance by state and territory of an organisation in meeting its sales budget for 2016. It clearly shows that ACT, SA, Vic and WA were the only states/territories to achieve their sales budgets.



## Practice task 2

To learn more about creating charts in Microsoft Excel, read the article 'Creating charts from start to finish' available on Microsoft Office's support site at: <http://office.microsoft.com/en-001/excel-help/creating-charts-from-start-to-finish-HA104042319.aspx?CTT=1>. This article also shows you how to add a trend or moving average line to a chart.

Accounting software programs are capable of producing a range of financial summaries and reports and presenting analysed data in charts for effective interpretation of results. Conduct some research into the MYOB, Quicken and Xero accounting software programs or another accounting program you are familiar with. Identify five types of summaries and reports that can be produced using one of these packages that you believe would be of benefit to managing the accounts for a retail store.

## 1C

## Make and record asset and liability valuations

For the purpose of making a true and fair disclosure to users of financial information, organisations place dollar values on their assets and liabilities. Users of financial statements are entitled to know the type and approximate value of the assets the organisation has at its disposal and the commitments (liabilities) it owes to other parties.

## Assets

Assets are generally categorised as either physical or non-physical items. Assets are listed in the organisation's balance sheet according to their level of liquidity, which is defined as the ability to be able to turn the asset into cash.

As assets are consumed, depreciate or are used up, they become expenses for the organisation that are recorded in the income statement for the accounting period in which they are consumed.

Here is more information about assets.



### Asset items

Assets are either physical or non-physical items that:

- provide future economic benefits to the organisation by generating revenue and/or through the disposal of the asset
- are controlled by the organisation; for example, through ownership of the asset
- arise due to a past transaction or event; for example, a purchase.

### Asset listings

Assets are usually broken up into two categories:

- Current assets – assets whose future economic benefits will be consumed by the organisation within the current accounting period (usually 12 months)
- Non-current or fixed assets – assets whose future economic benefits will extend beyond the current accounting period

### Typical assets

- Cash
- Debtors (parties who owe the organisation money)
- Premises and buildings
- Stock or inventory
- Motor vehicles and office equipment
- Input tax credits (GST paid on purchases of goods and services)

## Liabilities

Liabilities are amounts the organisation owes to other parties. As with assets, liabilities are listed in the organisation's balance sheet according to liquidity.

Here is more information about liabilities.

### Amounts owed to others

Liabilities:

- represent sacrifices of future economic benefits; for example, the payment of money
- are obligations to another party (most liabilities represent a legal obligation for the organisation)
- arise due to a past transaction or event; for example, taking out of a loan.

### Current and non-current liabilities

Liabilities are also broken up into two categories:

- Current liabilities – liabilities due for settlement within the current accounting period (usually 12 months)
- Non-current liabilities – liabilities due for settlement beyond the current accounting period

### Typical organisational liabilities

- Loans (including mortgage loans) and bank overdrafts
- Liabilities to staff; for example, wages owed, unused annual leave, long service leave
- Creditors (parties to whom the organisation owes money)
- GST and other taxes payable by the organisation

## Valuation methods

There has been much debate within the accounting profession as to how assets and liabilities should be valued or measured. When valuing their assets and liabilities, organisations should follow the procedures, practices and disclosure requirements included in the Australian Accounting Standards maintained by the Australian Accounting Standards Board (AASB).

You can read more about the AASB Standards at: [www.aasb.gov.au/Pronouncements/Current-standards.aspx](http://www.aasb.gov.au/Pronouncements/Current-standards.aspx).

Whichever valuation system is chosen, it must be used consistently throughout the organisation and in all transactions. Valuations should be recorded using general journal entries and posted to the ledger account for a final trial balance. They are disclosed in the balance sheet.

There are essentially two alternative valuation methods the organisation can use:

1. Historical cost valuation
2. Current cost valuation

## Historical cost valuation

Traditionally, assets and liabilities have been valued using their historical cost, which can be defined as the value of the asset or liability at the time the transaction was completed. In this method, adjustments to the value of assets (and to a lesser extent liabilities) due to inflation and/or market forces over time are not incorporated into the value of the asset/liability shown on the organisation's balance sheet.

Here is an explanation of the advantages of using historical cost accounting (HCA).

### Objectivity and certainty

One advantage of using historical cost accounting (HCA) is that its use is objective and provides certainty because assets and liabilities are recorded at their original values. These original values can be verified and audited based on the transaction details and source documents created at the time.

### Conservatism

HCA is compliant with the underlying accounting principle of conservatism. This principle states that when confronted with two valuation methods, the organisation should select the method that is least likely to overstate the value of assets. Increases in an asset's value should only be recognised when the asset is sold or used, and not beforehand. Decreases in an asset's value (or increases in a liability) should be recognised immediately. This leads to responsible accounting practices.

### Historical cost

HCA is compliant with the underlying accounting principle of historical cost. This principle requires organisations to value assets and liabilities at their historical cost, rather than at their current market value. This is designed to support the principle of conservatism in order to provide reliable accounting information that is not susceptible to subjective and biased opinions on what constitutes today's market values.

## Current cost valuation

Current cost accounting (CCA) adopts the accounting principle that asset and liability values should be adjusted for the effects of inflation and/or value changes due to market forces. Therefore, CCA is in direct contrast to HCA and its principle of conservatism.

Here is some information about valuation using CCA.

### How assets and liabilities are valued

Assets are valued at their replacement cost or the cost of obtaining the same asset today (that is, the asset's current market value). In these circumstances, an increase or decrease in an asset's value is recognised as revenue or as an expense (write-down) in the current accounting period. Liabilities are valued at the amount they could be settled for today, regardless of their original values.

### A more relevant valuation of assets and liabilities

Under the CCA philosophy, the only figure relevant to an organisation and its management is the current market value, because this is the amount that will be raised should an asset be sold, or the amount paid should a liability be settled. Organisations operate in a constantly changing environment, so accounting information and valuations should reflect this.

### Consistent with the accounting principle of recognition

The consistency of CCA with the accounting principle of recognition means that changes in the values of an organisation's assets and liabilities are recognised as profits or losses during the period in which they occur. For example, if the value of an organisation's premises and buildings went up this year, why shouldn't the business recognise this as a profit?

## The best valuation

Determining the best valuation method is difficult. Both historical cost accounting (HCA) and current cost accounting (CCA) have their proponents and detractors. Traditionally, HCA has been used by organisations in line with the accounting principles of conservatism and historical cost. However, many organisations are adopting CCA because they believe it is more relevant and applicable in today's changing environments.

The question of which method is best comes down to the notions of relevance and reliability, which have been identified by the accounting profession as two of the fundamental qualities that all accounting information must possess.

Here is more information on the comparison between HCA and CCA.

Relevance	Reliability
<p>Relevant information is that which is most useful in assisting decision-making and making accurate assumptions about the past, present and future. HCA could be seen as less relevant because it values assets and liabilities at their value from the past, which could be months or even years ago.</p> <p>CCA provides a more relevant, current value in today's market. However, if the business has an asset that has increased in value, how relevant is recognition of this profit if the business has no intention of ever selling the asset and receiving this profit? Is this profit relevant if the business will never see it?</p>	<p>Reliable information can be verified and audited, and is objective, neutral and free from bias. HCA could be seen as more reliable than CCA because it values assets and liabilities at the values they were originally recorded at and these values can be verified by source documents.</p> <p>CCA is less reliable because a change in the value of an asset or liability is open to interpretation and potential bias. While one person may believe a particular asset's value has gone up, another person may believe it has gone down in value. It is very difficult to verify changing market values.</p>

### Practice task 3

1. Is an organisation's cash a current or a non-current asset?

2. Is an organisation's inventory a current or a fixed asset?

3. Is a bank overdraft a current or a non-current liability?

4. Is a long-term bank loan a current or a non-current liability?

5. Is HCA compliant with the accounting principle of conservatism or the accounting principle of recognition?

# 1D

## Identify and resolve discrepancies and errors

When collecting and compiling financial information and data, accuracy is essential. However, discrepancies and errors do occur. It is vital that you can identify these and either correct them yourself or refer them to the appropriate person.

For example, figures may have been transposed, calculations carried out incorrectly or financial documents not checked for accuracy. There may have been an incorrect payment made, a receipt incorrectly coded or an inappropriate authorisation made.

There are many types of discrepancies and errors that can occur. Here are several common issues that can arise and their consequences.

### Issuing a payment to the wrong party

Example:

- Payment for a vehicle sent to the wrong wholesaler

Consequences:

- Difficulty recovering the payment
- Difficulties with unpaid supplier

### Recording the wrong amount in records

Example:

- Correct payment of \$20,900 recorded as \$29,000

Consequences:

- Mismatch between source records and accounts and reports
- Stock records and reports overstated
- Profit understated

### Coding to the wrong asset account

Example:

- Asset coded to a Toyota Camry instead of a Ford Falcon

Consequence:

- Inaccurate record of vehicles on hand

**Absence of an auditable trail**

Example:

- Missing invoices

Consequences:

- Unauthorised services, possibly for personal not business use
- Delay in paying invoice while details of who requested it are ascertained

**Inappropriate authorisation**

Example:

- Invoice for car respraying contains no authorising signature and is for \$1,000, which requires the dealership manager's authorisation

Consequences:

- Unauthorised services, possibly for personal not business use
- Delay in paying invoice while details of who requested it are ascertained

**Invoice/purchase order discrepancy**

Example:

- Invoice from local newspaper for advertising lists three advertisements as having been taken out when only two were requested, plus the ABN for the business is incorrect

Consequences:

- Overcharging
- Underpayment if business only pays for two advertisements
- Difficulties with supplier
- Invoice cannot be paid due to incorrect ABN

## Internal control measures

Discrepancies and errors can be minimised through the organisation implementing policies and procedures to follow when collecting financial information, which enable you to identify potential discrepancies and errors and trace any issues back to their source.

Organisations must have a strong set of measures to ensure accurate handling, checking and authorisation of financial information. Issues that cannot be easily resolved should be referred to the relevant manager. Your organisation's accounting system should include measures that will minimise the possibility of errors, prevent theft and fraud, and promote efficiency. Such measures are known as internal control procedures.

Here is more information about internal control measures.

Internal control procedures	Poor/absent internal controls
<p>Internal control procedures include:</p> <ul style="list-style-type: none"><li>• separating duties so that the tasks performed by one employee are checked by another; for example, the separation of ordering, invoicing and cheque preparation duties</li><li>• ensuring there is regular reconciliation of accounts and ledgers</li><li>• ensuring that the receiving, recording and banking of cash are not performed by just one employee</li><li>• ensuring that employees have the appropriate skills to perform the tasks required by providing training and professional development opportunities</li><li>• implementing a system of authorisation; for example, a manager to authorise purchases over a certain amount</li><li>• ensuring that all business documents are pre-numbered so all documents are accounted for and the possibility of fraud is minimised.</li></ul>	<p>If internal controls are poor or absent within an organisation:</p> <ul style="list-style-type: none"><li>• The objectives of the organisation may not be met.</li><li>• Fraud may occur.</li><li>• Errors will occur.</li><li>• Inefficiencies may go undetected, possibly causing an increase in costs.</li><li>• It may be difficult to track the audit trail; that is, the flow of records and documentation through the accounting process.</li><li>• Employees may lose morale.</li><li>• Customers, shareholders, investors, creditors, lenders of finance, etc. may lose confidence in the organisation.</li></ul>

### Practice task 4

What are the potential consequences for an organisation if internal control procedures are not implemented and followed when collecting and compiling financial data?

## Summary

1. Whenever a financial transaction takes place, a source document is created that provides objective evidence of transactions that have taken place with other parties, their amounts, dates and purposes.
2. Organisations must manage many source documents, making it vital that consistency, quality and accuracy are ensured through effective collection, evaluation and coding practices.
3. Conversion and consolidation techniques, such as the use of spreadsheets and charts, can be used to compile, summarise and assess financial information in order to make it more comprehensible, meaningful and useful for people when making decisions.
4. Assets and liabilities must be valued in accordance with the organisation's requirements. The two major valuation methods that can be used are historical cost accounting (HCA) and current cost accounting (CCA). Both HCA and CCA have their pros and cons with regard to relevance and reliability.
5. The organisation must have policies and procedures in place for identifying and resolving discrepancies and errors that can occur while compiling financial information.

## Learning checkpoint 1 Compile financial information and data

This learning checkpoint allows you to review your skills and knowledge in compiling financial information and data.

### Part A

1. List five of the common source documents that are created as a result of financial transactions between the organisation and other parties.

2. Why is it important that all source documents are collected? How does this contribute to accurate and consistent financial reports being produced?

3. With source documents, what should you evaluate to ensure the consistency, quality and accuracy of accounting records and reports?

4. The first step in coding involves classifying transactions as affecting which major categories within the accounting records of business? From this classification, what accounts framework is used to code transactions?

5. What requirements influence how an organisation's financial information and data are collected, evaluated and coded?

6. Why is it important to adopt a consistent valuation method across all assets and liabilities, rather than valuing some using HCA and others using CCA?

7. In valuing assets and liabilities, is HCA more or less relevant and more or less reliable than CCA? Why?

8. How should valuations be recorded and how are they disclosed?

9. List four discrepancies or errors that can occur in financial information and source documents.

10. What procedures and policies should be implemented to resolve discrepancies and errors and ensure they are minimised in the future?

## Part B

Read the scenario, then answer the questions that follow.

### Scenario

Assume that your manager has asked you for information on monthly/seasonal sales trends for each state and territory as shown in the following table.

Month	WA \$	NSW \$	Qld \$	Vic. \$	SA \$	Tas./NT \$	Total \$
January	3,850	21,050	7,000	15,650	11,350	950	59,850
February	2,970	23,210	8,320	13,870	15,287	1,156	64,813
March	5,433	19,568	10,769	14,921	14,390	3,215	68,296
April	7,776	28,216	11,890	18,467	16,347	4,544	87,240
May	10,670	34,875	13,425	23,905	18,020	6,450	107,345
June	9,300	31,723	9,800	22,100	16,345	4,600	93,868
July	13,769	32,450	11,430	21,780	17,650	5,550	102,629
August	11,400	34,600	10,654	19,700	13,560	5,900	95,814
September	11,540	36,700	14,325	23,870	18,500	7,000	111,935
October	10,700	33,210	11,900	18,700	12,300	3,870	90,680
November	7,640	24,760	7,480	14,660	9,420	2,228	66,188
December	4,820	13,800	5,267	11,300	6,230	1,280	42,697

- How could this sales data be converted and consolidated into another format that provides summary information that is more comprehensible and meaningful?

2. How do converting and consolidating this sales data assist your manager in analysing and interpreting this information for decision-making?



---

## Topic 2

# Prepare statutory requirement reports

All organisations are required to meet certain legislative requirements regarding their financial activities. Commitments such as tax liabilities need to be met by all parties. Other more commercial requirements, such as payment of vehicle registrations and WorkCover premiums, exist to ensure that specific needs such as vehicle safety, road systems and insurance of workers on the job are met.

Some of these requirements apply to all organisations that have commercial dealings; for example, completing business activity statements (BAS) and end-of-financial-year taxation returns, as well as special-purpose returns, such as estimates of future wage costs to assess WorkCover premiums. Other requirements, such as annual statements to the Australian Securities and Investments Commission (ASIC), apply only to particular types of organisations, such as incorporated associations and companies. Additional financial reports are required by ASIC for public companies and these include income statements (profit and loss statements), balance sheets (statements of financial position) and cashflow statements.

In this topic you will learn how to:

- 2A Record income and expenditure to meet statutory requirements
- 2B Calculate taxation liabilities
- 2C Identify relevant receipts, revenue documentation and payments
- 2D Claim available benefits and allowances
- 2E Submit statutory reports within stated time lines

## 2A

# Record income and expenditure to meet statutory requirements

Organisations have statutory requirements that influence the manner and frequency of their reporting. To ensure these statutory requirements are met, the organisation needs to understand what these requirements are, the regulatory bodies to whom they must be submitted, the formats to be used when supplying the information and the time lines for their completion and submission.

An important part of your role is to ensure that all information in both source and submitted documents is accurate, relevant and reliable.



## Keep up to date with statutory requirements

It is important that you are aware of the records required to meet the statutory requirements that your organisation must comply with. You need to continually update your knowledge to keep abreast of these changing requirements.

Part of your role may be to brief senior management on the latest changes to ensure compliance and obtain approval for action. If you work in a small organisation, you may liaise with a certified public accountant whose role is to ensure the organisation is kept up to date with changing requirements.

Statutory requirements may include:

- reporting of GST and other taxation-related issues on the business activity statement (BAS)
- administering and reporting the superannuation guarantee levy
- complying with the capital gains tax and fringe benefits tax regulations
- compliance with the Income Tax Assessment Act
- compliance with the Corporations Law
- compliance with the Australian Accounting Standards.

## Understand the main regulatory bodies

The main bodies regulating the reporting of the financial affairs of an organisation in the public arena are:

- Australian Securities and Investments Commission (ASIC)
- Australian Taxation Office (ATO)
- Australian Securities Exchange (ASX)
- Australian Prudential Regulation Authority (APRA).

## Australian Securities and Investments Commission (ASIC)

ASIC is the chief regulatory agency of all incorporated entities (public and private) and fund managers within Australia. ASIC is responsible for protecting investors and consumers in the Australian financial system.

Here is more information about ASIC.

### Legislation administered

ASIC has responsibility for the administration and enforcement of the following legislation:

- *Corporations Act 2001* (Cth)
- *Australian Securities and Investments Commission Act 2001* (Cth)
- *Insurance Contracts Act 1984* (Cth)
- *Superannuation (Resolution of Complaints) Act 1993* (Cth)
- *Superannuation Industry (Supervision) Act 1993* (Cth)
- *Retirement Savings Account Act 1997* (Cth)
- *Life Insurance Act 1995* (Cth)
- *Medical Indemnity (Prudential Supervision and Product Standards) Act 2003* (Cth)

### Disclosing entities

Incorporated entities can take the form of companies, incorporated associations (including not-for-profit entities) and trusts. All disclosing entities covered by ASIC that are not foreign incorporated or formed outside Australia must prepare annual and half-yearly financial reports. Annual reports must be lodged within three months of the end of the financial year and half-yearly reports must be lodged within 75 days of the half-year end. Annual report must be sent to members by the earlier of four months after the year end or 21 days before the next annual general meeting. Reports must be audited or subject to review.

The reporting obligations for disclosing entities are available at: <http://www.asic.gov.au/regulatory-resources/financial-reporting-and-audit/preparers-of-financial-reports/reporting-obligations-for-disclosing-entities/>.

### Public companies

Public companies are grouped into two categories:

- Public companies that are not disclosing entities or companies limited by guarantee
- Public companies that are not disclosing entities

All public companies that are not disclosing entities or companies limited by guarantee must prepare annual reports, lodged within four months of the financial year end and sent to members by either four months after year end or 21 days before the next AGM, whichever is the earliest. Public companies that are not disclosing entities have to prepare audited financial statements.

The reporting obligations for public companies are available at: <http://www.asic.gov.au/regulatory-resources/financial-reporting-and-audit/preparers-of-financial-reports/reporting-obligations-for-public-companies/>.

### Private companies

There are different requirements for different types of private companies. ASIC classifies private companies according to the following:

- All large proprietary companies
- Small proprietary companies that are foreign-controlled
- Small proprietary companies or small companies limited by guarantee that have to prepare financial reports
- Small proprietary companies subject to a shareholder direction
- Small companies limited by guarantee subject to a shareholder direction

## Australian Taxation Office (ATO)

The ATO is the federal government agency for collection of all income-based and asset-based taxes, as well as sales-based taxes such as GST.

Reporting of income and expenditure for GST purposes is required by organisations throughout the year, as are estimates of business and investment income, with a final detailed statement of income and eligible deductions at the end of the financial year.

Companies including sole traders are required to pay income tax to the ATO regularly throughout the year and to prepare an income tax return at the end of each year in accordance with the requirements of the *Income Tax Assessment Act 1997* (Cth).

You can read more about the requirements for businesses on the ATO's website at: [www.ato.gov.au/Business](http://www.ato.gov.au/Business).



## Australian Securities Exchange (ASX)

The ASX requires ongoing disclosure by public companies that are listed. Listed companies must report to the ASX any significant business issue that may reasonably have an impact on company share values or investors' decision-making.

Copies of an organisation's audited annual reports and half-yearly reports that are submitted to ASIC must also be lodged with the ASX. A preliminary final report must be lodged in the same format as ASIC's half-yearly report within 75 days of the end of the accounting period. Final annual accounts must be supplied within 90 days of the end of the financial year.

Companies that have announced significant capital expenditure commitments must lodge quarterly cashflow statements during the periods in which the expenditure is being undertaken. Mining companies must also lodge quarterly cashflow reports and summaries of mining exploration activities during the period.

You can read about the ASX's rules, guidance notes and waivers on its website: [www.asx.com.au/regulation/rules-guidance-notes-and-waivers.htm](http://www.asx.com.au/regulation/rules-guidance-notes-and-waivers.htm).

## Australian Prudential Regulation Authority (APRA)

APRA is the federal government agency responsible for regulating the financial health of Australia's banks, life and general insurers, building societies, credit unions, friendly societies and superannuation funds.

APRA's purpose is to ensure that the financial services industry is operating prudently and in the best interests of investors and those who are insured. If another non-financial services company owns these businesses, the parent company must also comply with ASIC reporting requirements.

The requirements for reporting to APRA depend on the type of institution. There are different frameworks for authorised deposit-taking institutions (ADIs), general insurers, superannuation organisations, life insurance and friendly societies, and non-regulated entities.

## Record individual financial transactions

The statutory requirements described refer to the final (in some cases annual) accounts that the organisation prepares. While it is generally only the final reports (income statement, balance sheet and cashflow statement) that are reviewed by external regulatory parties, the source data and secondary records of income and expenditure must be in an appropriate form and level of detail to provide accurate information.

Secondary records include journals and ledgers in which purchases and income items are recorded, stock-on-hand records that measure movements of stock in and out as a result of sales and restocking, and bank statements.

The process of recording accounts ensures that source data is accurately recorded for each and every financial transaction. Recording also shows that the organisation's accounts have been prepared in accordance with statutory requirements.



## Report based on accrual or cash accounting

The data used to submit information to regulatory bodies is affected by the type of accounting system used, which can be either the accrual accounting system or the cash accounting system.

An organisation's aim is to measure, as accurately as possible, the profit or loss it has earned during an accounting period. In order to do this, it must match, as closely as possible, the revenue earned during the period with the associated expenses of that period.

Here is more information about and examples of the two most common types of accounting system used.

Accrual accounting	Cash accounting
<p>In this system, revenue is recognised when it is earned, not when it is received in cash. Similarly, expenses are recognised when they are incurred and not when they are paid in cash. 'Cash' in this sense refers to the act of payment, not the tender, and can include credit card, cheque or barter as well as coins and notes.</p> <p>For example, if your organisation performed services in June but provided the services on credit to allow the customer to pay in July, then in accrual accounting this revenue would be recognised as income for June (when it was earned) and not July (when payment was received).</p>	<p>The cash accounting system is based on the cashflow of the business. Revenue is recognised when payment is received and expenses are recognised when they are paid.</p> <p>For example, if your business received a phone bill for December that was not due for payment until January, then in cash accounting this would be recognised as an expense for the month of January (when it was paid) and not December (when it was incurred).</p>

## The matching principle

Accrual accounting, rather than cash accounting, is the basis of accounting used by most organisations. It is based on the matching principle; that is, it relies on the accurate matching of the revenue earned in a period with the expenses incurred to generate that revenue, regardless of whether cash was paid or received.

Generally, only smaller private organisations (such as the local milk bar) use a cash basis of accounting, instead of accrual accounting.

Here is more information about the underlying strategies within the matching principle.

### The advantage of matching revenue and expenses

Under the accrual method, expenses are recognised in the period in which they are incurred, not when they are actually paid. Profit is calculated as the revenue recognised in the period less the expenses incurred in earning that revenue.

Matching revenue and expenses in this way provides a more accurate account of the operating performance of an organisation than does the cash basis of accounting.

### Revenue, expenses and their accounting periods

Revenue received and expenses paid within a period may not necessarily relate to that particular accounting period; all or part may apply to the accounting period before or after the period in which it is actually received or paid.

## Balance-day adjustments

While accrual accounting provides a more accurate picture of profitability, the accuracy depends on certain adjustments being made prior to the preparation of the financial statements. It is important that adjustments are made to certain revenue and expenses to show a true net profit for the period.

The end of the accounting period is balance day; so these adjustments are referred to as balance-day adjustments.

Here is an overview of how a business may make balance-day adjustments.

### Accrued expenses

Accrued expenses are those that have been incurred in the current accounting period but not paid as at the end of the accounting period. As expenses are generally recorded only when paid, it is normal to have some expenses that have been incurred but not paid and therefore not yet recorded.

For example, salaries and wages are an expense often incurred but not paid as of the end of the accounting period (balance day). Often balance day will fall midway through a pay period.

### Prepaid expenses

Prepaid expenses are those that have been paid in the current accounting period but relate to the next period. If the cash accounting system is used, expenses for the current period are overstated, as the payment of the expenses is recorded in the current period.

For example, insurance premiums are usually paid for an entire year in advance. If a yearly insurance premium of \$1,200 (that is, \$100 per month) is paid in January, then the remaining months of the year have all effectively been prepaid. Under the accrual method, the insurance expense for January would only be \$100 and the remaining \$1,100 is a prepaid expense that would be expensed throughout the year at the rate of \$100 per month.

**Accrued revenue**

Accrued revenue is revenue that has been earned in the current accounting period, but payment has not been received as at the end of the accounting period. Most organisations have some revenue that has been earned but not yet received.

Many service-based businesses have accrued revenue for services that have been provided but not yet billed or paid for. For example, a builder may provide services over the course of several months or even years, but the customer is not billed until the job is finished. At the end of the current period, the builder would recognise the accrued revenue earned for the period (as represented by the percentage of the job completed during the period), even though payment is not due until later.

**Prepaid revenue**

Prepaid revenue is revenue that has been received in the current accounting period but not yet earned as at the end of the accounting period. As revenue is generally recorded only when received, it is normal to have some revenue that has been received but not yet earned.

For example, rent is revenue often received but not yet earned as of balance day because the end of the accounting period may fall midway through a rental period.

## Treat transactions consistently

If you are responsible for preparing transactions in your organisation, it is important to understand the accounting policies used for recording income and expenses in order to treat transactions consistently, especially towards the end of an accounting period (balance day).

Here are some reasons for treating business transactions with consistency.

**Consistency for tax impact of transactions**

Consistency is important for the tax impact of transactions within a period. Different methods for items such as stock valuation or depreciation produce different amounts of income and deductible expenses that in turn, affect the level of tax payable for the period.

**Consistency for statutory compliance**

The accounting system used by the organisation – cash versus accrual – directly affects the income and expenditure balances shown in statutory reports. It is vital that you follow the system used by your organisation to ensure its reports are compliant with statutory guidelines.

## Comply with the reporting/lodgment period

A crucial part of statutory financial reporting is knowing the reporting or lodgment dates by which reports must be submitted. You should know the submission dates for all financial reports, whether they are statutory guidelines or deadlines the organisation sets for itself in preparing reports.

Refer to your organisation's financial calendar to ensure you provide the right information in the right format, for the correct period and by the due date.

Here is an outline of reporting periods and reporting requirements.

Reporting periods	Reporting requirements
<p>The reporting period covered varies according to the particular regulatory body. All regulators clearly outline their reporting requirements, period covered and due dates.</p> <p>For example, the ATO issues paper copies and makes available online the business activity statement forms specifying the month or quarter to be covered.</p>	<p>Most regulators outline their required formats, frequency of reporting and due dates in an initial bulletin and simply expect compliance thereafter. Regulators are also responsible for communicating any changes to requirements and the dates from which these take effect.</p>

## Follow authorisation procedures

Regulators and other external parties need to have confidence that the information and lodgments they are receiving are correct. A system of sign-offs and authorisations on the statutory reports submitted will help ensure that authorisation procedures are followed.

Here is more information about authorisation procedures.

### Small organisation authorisation

Most statutory reporting requires a signature beneath a statement to the effect that the information delivered is true and correct. In a small private business, it is often the owner who provides this signature and therefore takes responsibility for the accuracy of data submitted.

### Large organisation authorisation

In companies with multiple shareholders, a system of delegated authorities exists. This means that one or some duly appointed representatives are allowed to sign. The appointed representative may vary according to the type of information being provided. In some instances it may be directors, in other situations it may be a person with specialist knowledge of the topic.

## Follow organisational procedures

The manner in which organisations complete their statutory reports and the internal control processes used are not the concern of outside regulators. However, internal controls are an important part of the statutory reporting processes.

Here are some examples of the importance of internal control.

Internal control processes	Elements of internal control
<p>For the directors or senior officers of an organisation to sign a declaration on a statutory report that the information is true and correct, they need to have confidence that internal procedures exist and have been applied in relation to the data on which the report is based. Such procedures form part of an organisation's total set of internal control processes.</p> <p>For instance, a chief financial officer of an organisation needs to be sure that a lodgment of PAYG instalment tax is based on:</p> <ul style="list-style-type: none"> <li>• correct and consistent accounting treatments of income, as outlined in the accounting standards</li> <li>• accounting entries that are reviewed by supervisors for validity before processing</li> <li>• a correct calculation of tax based on the income and payments for the period.</li> </ul>	<p>Key parts of internal control processes may be:</p> <ul style="list-style-type: none"> <li>• procedures for consistent treatment of transactions</li> <li>• delegated authorities for reviewing and authorising cheques prior to issuing</li> <li>• separation of duties so no single person is responsible for the complete payment process</li> <li>• procedures for reviewing and authorising entries posted in the organisation's general ledger</li> <li>• establishing a risk-management function within the organisation if appropriate</li> <li>• progressive internal checks and reviews of proposed reporting prior to final sign-off and submission to regulators.</li> </ul> <p>In small organisations, these procedures may be as simple as separating the duties of preparing and authorising transactions and reporting.</p>

### Example: a large organisation's authorisation procedure

BX Financial Services is a life insurance and superannuation company. In preparing its statutory reports, its delegated authorities are as follows:

- Business activity statement return: chief financial officer or chief taxation officer
- ASIC annual accounts: any two directors as allowed by ASIC
- APRA-format annual accounts: two directors plus accompanying declaration by the chief actuary of the organisation



## Practice task 5

1. Explain the role of ASIC in Australia's financial system.

2. How does the recording of every individual financial transaction in the accounting system of an organisation ultimately affect the quality and accuracy of the statutory reports it submits to regulatory bodies?

3. Why is it important to make balance-day adjustments?

4. Explain which type of accounting system should be implemented for a financial services organisation. Why?

## 2B

## Calculate taxation liabilities

An important part of the organisation meeting its statutory reporting requirements is the calculation and submission of taxation liability. It may be your responsibility to gather the data that is used by the regulatory bodies to calculate your organisation's taxation liabilities.

The Australian Government, through the Australian Accounting Standards Board (AASB), is responsible for developing and issuing accounting standards that comply with the accounting standards used internationally. These accounting standards must be followed by all Australian reporting organisations.

To keep abreast of the development of these accounting standards towards international compliance, refer to the website of the Australian Accounting Standards Board: [www.aasb.gov.au/Home.aspx](http://www.aasb.gov.au/Home.aspx).



## Gather revenue data

There are two accounting standards that are directly relevant to gathering revenue data for statutory recording and reporting: AASB 101 – Presentation of financial statements; and AASB 118 – Revenue.

Here is more information about these accounting standards.

### AASB 101

AASB 101 requires accrual accounting concepts to be adopted and that all information (data), when recorded in source documents and carried through to the accounting records, be:

- relevant, in terms of the size and nature of the transaction
- reliable, in that it faithfully conveys the nature of the underlying transaction
- able to show the economic impact on the business (for example, increasing sales, increasing expense levels, increasing asset or liability levels), with recording at an adequate level of detail
- treated consistently over time so that information is understandable and comparable over different aspects of the business and over different periods of time.

### AASB 118

AASB 118 stipulates that the treatment of income (termed in the standard as revenue) must have these same characteristics, but also prescribes those items that can generally be treated as revenue. AASB 118 applies to revenue arising from the sale of goods, the provision of services and the rendering of interest, royalties and dividends.

It is important that you are aware of the type of revenue that is taxable but that may not be part of your organisation's everyday operations, but must still be included in the income statement (profit and loss statement). For example, your organisation may sell some office equipment during the year.

## Streams of revenue

Here are some examples of the different streams of revenue.

### Proceeds from the sale of goods

This revenue stream occurs mainly in manufacturing, wholesale and retailing operations where goods are either produced and sold or purchased and sold on to other parties, usually at a profit.

### Fees from the provision of services

Income from services, such as professional legal services or plumbing services, is generally fee based. It is just as much income as revenue from physical goods and should be recorded in the accounts as such.

### Rental or lease income from the use of assets by others

Usually these assets are bought with the specific purpose of hiring them to other parties. Examples include a trailer for rent, motor vehicles and commercial premises. Care needs to be taken in understanding the nature of the contract in place, as this will affect how income is to be recorded.

### Working and cash assets

Disposal of working assets for a profit and the gains on the sale of working assets used within a business are to be treated as income and shown as a gain on sale of assets within the income statement (profit and loss statement). There is also income from the use of cash assets; for example, income from loans.

### Interest

Interest earned on the lending of money to other parties is treated as income within the accounts. Interest received on deposits with financial institutions is also treated as income within the accounts.

### Revenue received from royalties

Royalties are payments made to the holders of intellectual property (IP) by those licensed to use the IP and should be shown separately as royalty income within the income statement. Royalty income is generally a proportionate share from each sale of an item paid to its original creator. Common examples are proceeds from the sales of published books and other created works that can be copied and sold under licence.

### Dividend income received

Dividend income received as a return from the ownership of shares in another business must be shown as income. It is important to know whether the income comes to the investor fully franked, partially franked or unfranked.

## Taxation liabilities

You need to be aware of specific forms of taxation, such as GST and payroll tax, that must be calculated and provided for on a regular basis as part of an organisation's statutory responsibilities.

If you are the accounts officer in a small business, you may have to look after the whole spectrum of tax liabilities. However, if you work in a corporate department, such as the payroll department in a large organisation, you may only have partial responsibility for some aspects of payroll tax calculation and nothing else.



Regardless of the size of the organisation, it will still be required to provide accurate information for goods and services tax (GST), pay as you go (PAYG), fringe benefits tax (FBT), the superannuation guarantee and payroll tax.

## Goods and services tax (GST)

Most organisations and sole traders with an annual turnover of \$75,000 or more are required to register for GST. Not-for-profit organisations must register for GST if their annual turnover exceeds \$150,000.

Annual turnover is the total revenue from sales and services provided for the year, excluding GST.

Organisations registered for GST must comply with legislative requirements. It may be your responsibility to obtain the information from the organisation's accounts.

Here are some examples of GST reporting requirements.

### GST reporting requirements

Account for GST on all taxable sales and supplies (one-eleventh of the total sale price).

For a taxable sale of more than \$82.50 (including GST), a tax invoice must be issued to GST-registered customers to be able to claim a GST credit for the purchase price.

Account for and claim GST paid (input tax credits) on all taxable purchases (one-eleventh of the total purchase price).

Organisations with a GST turnover of \$20 million or more report and pay GST monthly and lodge their activity statement electronically.

GST is generally reported and paid quarterly if GST turnover is less than \$20 million.

Organisations registered for GST can report, pay and claim GST credit annually.

## Pay as you go (PAYG)

PAYG is a system of taxation on income. PAYG legislation is found in Schedule 1 of the *Taxation Administration Act 1953* (Cth) and is broken down into two areas: PAYG withholding; and PAYG instalments. You need to obtain the required data from the payroll accounts of the organisation.

Here is further information around the PAYG taxation system.

### PAYG withholding

PAYG withholding requires that organisations (making payments classified as 'withholding') be responsible for deducting tax from the payment to the payee and remitting the amounts withheld to the ATO either weekly, monthly or quarterly. The frequency of the remittance is determined by the size of the paying organisation. Disclosure of the total amounts withheld is shown on the organisation's business activity statement.

Payers of withholding payments must register for PAYG withholding. To register for PAYG withholding, organisations must hold a valid ABN (Australian Business Number).

### PAYG withholding payments

Withholding payments include:

- wages and salary payments to employees
- commissions, bonuses and allowances
- directors' fees
- eligible termination payments
- unused leave paid on termination
- social security payments
- compensation, sickness and accident payments
- withholding of 46.5 per cent on payment of supplies where a supplier does not quote a valid ABN.

### PAYG instalments

Organisations pay tax instalments on their business and investment income, allowing them to pay their tax obligations 'as they go' rather than being required to pay a lump-sum amount of tax at the end of the financial year.

The ATO advises each organisation as to whether it is required to pay PAYG instalments and issues the organisation with a PAYG instalment tax rate.

Payments are shown and remitted with the business activity statement. At the end of the financial year, the organisation lodges an annual income tax return. Any PAYG instalments paid during the year are credited against the total tax liability calculated from the income tax assessment.

## Fringe benefits tax (FBT)

Organisations that provide employees with payments in the form of non-cash (fringe) benefits may be required to register for and remit FBT at the rate equal to the top prevailing marginal rate of personal taxation plus the Medicare levy. This is because the benefit is deemed to be made as a substitute for taxable income.

The FBT year runs from 1 April to 31 March and the rate for the FBT year ending 31 March 2015 is 47 per cent. The rate for the two FBT years ending 31 March 2016 and 31 March 2017 is 49 per cent, and then for the FBT years ending 31 March 2018 onwards it is 47 per cent.

Employers are required to calculate the amount of fringe benefits provided to employees during the FBT year, calculate the amount of FBT payable and complete an FBT return form. Amounts are recorded as liabilities in the general ledger. The timing of the payment of the FBT is determined by the total amount payable and whether the employer has previously lodged an FBT return.

Here are examples of some common types of fringe benefits.

### Common types of fringe benefits

A car fringe benefit arises when a car owned or leased by an employer is made available for the private use of the employee.

A loan fringe benefit arises when an employer provides a loan to an employee either interest free or at an interest rate that is less than the statutory interest rate.

A housing fringe benefit arises when an employer provides accommodation to an employee rent free or at a reduced rental and it is the employee's usual place of residence.

An airline transport fringe benefit arises when an employer provides airline transport (for non-work-related travel) to an employee for free or at a discounted rate.

## Superannuation

All employers are required to contribute to a complying superannuation fund for all eligible employees (currently 9.5 per cent of gross ordinary income). When a company fails to make these contributions, the government effectively fines it an equivalent amount and holds it on behalf of the employees until the organisation makes arrangements with a complying fund.

The government charges interest on the amount involved and an administrative fee per employee. This is a significant incentive to make organisations put in place their own arrangements with complying superannuation funds. Organisations must ensure all employees belong to a complying superannuation fund so that payments can be remitted to their accounts.

Employees not eligible for superannuation contributions include:

- employees who pay less than \$450 (before tax) in salary or wages in a calendar month
- employees under 18 years old working 30 hours or less per week

- employees earning above the maximum superannuation contribution base
- non-resident employees paid for work done outside Australia
- some foreign executives who hold certain visas or entry permits under the migration regulations
- workers paid to do work of a domestic or private nature (relating personally to you) for no more than 30 hours per week
- employees who receive payments under the Community Development Employment Program
- members of the army, navy or air force reserve for work carried out in that role
- eligible employees who made a choice, prior to the abolition of reasonable benefit limits, to not receive employer superannuation contributions
- employees working temporarily in Australia who are covered by a bilateral superannuation agreement.

## Payroll tax

Payroll tax is a state/territory tax imposed on organisations with a total Australian payroll that exceeds the payroll tax-free threshold. The threshold applicable varies between the states and territories. Calculation of the total Australian payroll includes payments made to or on behalf of employees.

Organisations registered for payroll tax are required to complete a monthly payroll tax return and submit it to the state/territory revenue office with the payment by a specified date; for example, in Victoria it is the seventh day following the end of the month.

Here are some examples of common types of payments and payments not subject to payroll tax.

Common types of payments	Payments not subject to tax
<p>Common types of payments recorded in the payroll accounts include:</p> <ul style="list-style-type: none"> <li>• wages and salaries</li> <li>• leave payments</li> <li>• allowances</li> <li>• bonuses and commissions</li> <li>• superannuation guarantee levy</li> <li>• fringe benefits</li> <li>• directors' fees.</li> </ul>	<p>Payments not subject to the payroll tax calculation include:</p> <ul style="list-style-type: none"> <li>• payments to or on behalf of apprentices or registered trainees</li> <li>• workers compensation payments</li> <li>• redundancy payments.</li> </ul> <p>Each state and territory has its own specific exemptions. Be familiar with those that are applicable to your state/territory.</p>

## Practice task 6

Refer to the ATO website at: [www.ato.gov.au](http://www.ato.gov.au) for information on franked dividends.

Although it is not necessary to know the details of franking calculations for this unit, you need to understand the impact of the franking status of dividends on the amount of income and tax liability recorded in the recipient's books.

1. What are franking credits?

Refer to the ATO website for information on making superannuation contributions.

2. When are superannuation contributions for each employee to be made?

## 2C

### Identify relevant receipts, revenue documentation and payments

All organisations collect and record their daily, weekly, monthly and yearly financial transactions using source documents such as receipts, invoices, cheque butts and credit notes. These source documents provide the information from which accounting entries and statutory reports are prepared.

Every time a transaction occurs, a business document must be completed to provide evidence of the transaction and that it has been recorded accurately and consistently in accordance with the organisation's procedures.

Always make sure you are using the appropriate documentation and handling transactions correctly and consistently. It is also important that documents are filed correctly for easy access or retrieval from archives.



### Retain financial records

Taxation law requires that financial records, including source data, be held for at least five years in order to support an audit by the ATO of an organisation's records. You may be asked to produce source data and documents to substantiate expenditures going back several years.

Data and documents you may have to produce include:

- receipts
- invoices
- credit card merchant summaries
- banking records including records of cash received
- declarations
- cheque requisitions
- petty cash vouchers
- bills
- sale proceeds (for example, if an asset is sold)
- debit notes.

### Practice task 7

For how many years does taxation law require that financial records, including source data, be held to support an audit by the ATO of an organisation's records? Is it five, six, seven or eight years from the date you lodge your tax return?

## 2D

## Claim available benefits and allowances

Organisations subject to taxation must be vigilant in their approach to record-keeping and assessment of tax liabilities to ensure they are paying the correct taxation amount. Poor record-keeping or inadequate knowledge of deductions and allowances may also restrict an organisation from taking full advantage of deductions, benefits and allowances.

Here are some examples of problems with benefits and allowances.

#### Examples of problems with benefits and allowances

- Incorrect calculation of motor vehicle deductions based on outdated tables of the amount per kilometre that can be claimed
- Lack of knowledge about export incentives and associated benefits
- Lack of knowledge about concessions available to non-profit organisations

## Deductions and allowances

It is important to understand the deductions and allowances the organisation is entitled to and the requirement to make sure records of expenditure and claims are processed properly and stored correctly.

It may be your responsibility, especially if you are in a small business, to look at the tax liabilities your organisation has and to ensure it takes full advantage of deductions and allowances.

Among the more commonly available benefits and allowances are:

- depreciation of business assets
- donations made to registered charities
- sales tax deductions
- interest payments.



## Keep up to date on entitlements

There are a number of ways that you can keep up to date with the available benefits and allowances for your organisation.

Here are ways an organisation can keep up to date on its legal tax entitlements.

### Accounting firm updates

A number of accounting firms run annual tax and regulatory updates with hard-copy or electronic notes provided. They do this as a marketing exercise for their firms. Make contact and have your details added to their mailing lists. These firms do regular email updates, some to people beyond their immediate client base. Try to have your name put on these lists.

### Australian Tax Office

The Australian Taxation Office's website has a large array of summarised information that can be viewed and downloaded. Learn the sections of legislation that relate to your business and join the ATO's distribution list for updates. There are also a variety of calculation tools.

### Tax consultancy services

Look for accounting firms that provide regular updates on regulatory matters and investigate the costs of receiving tax consulting from these firms for specialised circumstances.

These firms may be listed on the CPA Australia website at: [www.cpaaustralia.com.au](http://www.cpaaustralia.com.au).

### Newspapers and other publications

Regularly browse the Australian Financial Review and consider subscribing to periodicals such as Business Review Weekly. These publications also have online versions with access to alert, portfolio and watchlist functions, where you are notified on issues that you have identified in your subscriber account as important to your role.

## Practice task 8

Refer to the ATO website at: [www.ato.gov.au](http://www.ato.gov.au) for further information about concessions available to non-profit ATO-endorsed registered charities.

List two tax concessions available to these entities.

## 2E

## Submit statutory reports within stated time lines

Keeping to time lines is an important part of managing an organisation's statutory reporting requirements. Throughout the year there are important deadlines you have to meet to provide both internal and external parties with financial information.

Some deadlines are for monthly items and returns, others for quarterly, half-yearly or annual items such as financial statements. Some deadlines involve lodgment of funds as well as information such as payment schedules.

For more information, refer to the ATO website at: [www.ato.gov.au/Business](http://www.ato.gov.au/Business) for activity statement lodgment deadlines.

Here is an example of two types of lodgments an organisation may need to undertake when meeting its taxation obligations.

Monthly lodgment	Quarterly lodgment
<p>Organisations are required to complete an activity statement and remit payment to the ATO every month if:</p> <ul style="list-style-type: none"> <li>• annual turnover exceeds \$20 million</li> <li>• the organisation's income tax year ends on a date other than 30 June</li> <li>• annual PAYG withholding exceeds \$25,000 but is less than \$1 million.</li> </ul> <p>Where an organisation's annual PAYG withholding exceeds \$1 million, there is a requirement that the amount withheld be remitted to the ATO weekly.</p>	<p>Organisations are required to complete an activity statement and remit payment to the ATO every quarter if:</p> <ul style="list-style-type: none"> <li>• annual turnover is less than \$20 million</li> <li>• annual PAYG withholding is less than \$25,000</li> <li>• PAYG instalments are payable</li> <li>• FBT is payable.</li> </ul> <p>All activity statements are due to be lodged and payments made by the 28th day following the end of the reporting period. All organisations with a valid ABN are required to report activity on the applicable activity statements.</p>

## Avoid penalties for late lodgment

Late lodgments to some regulators, particularly taxation lodgments, carry lump-sum and interest penalties. For example, both taxation and ASIC returns carry financial penalties for late lodgments but on different bases. Taxation penalties are usually equal to a proportion of the tax owing plus an interest charge, while ASIC charges a set fee for late lodgment of its returns.

Here are some examples of common strategies that can be deployed to eliminate or avoid penalties for late lodgment of an organisation's statutory reports.

### Set organisational operating procedures

There should be standard operating procedures in place that help your organisation manage the preparation for lodgment deadlines. Keep a copy of your financial calendar displayed in a prominent place or enter the dates in your online calendar and set alerts. If your organisation does not have a comprehensive calendar of critical dates, consider creating one.

### Approach management to identify issues

If you can see that you will not meet a particular deadline, explain the situation to an appropriate person in your organisation. Occasional missing of deadlines may simply indicate short-term pressures. Continuous failure to deliver may suggest a shortage of resources or systemic inefficiencies that need to be addressed.

### Seek advice from the authority

In some circumstances, you may need to contact the relevant statutory authority and seek advice about extensions. Sometimes an extension requires a payment. Extensions may be readily granted during a transition period to meet new requirements.

## Practice task 9

Is the following statement true or false?

Organisations are required to complete an activity statement and remit payment to the ATO on an annual basis if their activities include any of the following:

- Annual turnover is less than \$30 million
- Annual PAYG withholding is less than \$25,000
- PAYG instalments are payable
- FBT is payable

## Summary

1. It is vital that you are aware of the statutory reporting requirements for your organisation and keep up to date with any changing requirements.
2. The Australian Securities and Investments Commission (ASIC), the Australian Taxation Office (ATO), the Australian Securities Exchange (ASX) and the Australian Prudential Regulation Authority (APRA) each impose various reporting requirements on organisations.
3. The reports required by regulatory bodies consist of information on the organisation's financial transactions.
4. The type of accounting system used by the organisation (cash or accrual) affects the level of income and expenditure recorded in statutory reports for a particular period.
5. Organisations face taxation liabilities for income tax, GST, PAYG withholding, PAYG instalments, fringe benefits tax, superannuation guarantee and payroll tax. It is vital that you are aware of how these taxation liabilities are calculated and processed.
6. In preparing statutory reports, you must identify the relevant receipts and documentation required for reporting income and expenditure.
7. Statutory reports should take advantage of the benefits and allowances available to the organisation in order to minimise its taxation liabilities.
8. Statutory reports must be submitted to the relevant regulatory body within the stated time lines.

## Learning checkpoint 2 Prepare statutory requirement reports

This learning checkpoint allows you to review your skills and knowledge in preparing statutory requirement reports.

### Part A

1. Which regulatory body is a business activity statement (BAS) submitted to and when must a BAS be submitted?

2. What are some of the relevant source documents required in order to complete an income tax return?

3. What are some of the relevant source documents required in order to complete a fringe benefits tax (FBT) return?

4. When should an FBT return for a public company be lodged?

5. What are some of the source documents required in order to complete a monthly payroll tax return?

6. Where should annual payroll tax returns be submitted?

7. To which regulatory body and how often must superannuation guarantee reports be submitted?

8. When should ASIC returns be submitted?

## Part B

1. Research and consider your organisation or one you are familiar with. How does the organisation keep up to date with changes to statutory reporting requirements?

2. Explain the difference between cash and accrual accounting systems and how this can affect the income and expenditure figures shown in statutory reports on revenues and expenses for a particular period.

3. What systems should be in place in an organisation to ensure that statutory reports are completed and submitted on time?

4. In a small private business, which role usually takes responsibility for the authorisation of a BAS?

5. In companies with multiple shareholders, who may be responsible for the authorisation of an ASIC return?

6. What sources of revenue do service organisations have to pay income tax on?

7. If you are in charge of the accounts for a small business, where and how can you find out further information on available benefits and deductions?

8. How is payroll tax calculated within an organisation?

9. How is PAYG withholding calculated?

10. How are PAYG instalments calculated?

---

## Topic 3

# Provide financial business recommendations

A main purpose of compiling financial data and producing financial reports is to provide decision-makers within the organisation with the information they need to make effective decisions. It is your responsibility to provide decision-makers with recommendations on the organisation's finances based on your analysis of its financial performance.

This topic will introduce you to the major financial statements that are prepared by businesses and the techniques for analysing them in order to gain insight into the organisation and provide recommendations.

In this topic you will learn how:

- 3A Derive recommendations supported by evidence
- 3B Propose effective and concise recommendations
- 3C Identify significant issues in financial statements
- 3D Ensure structure and report formats comply with requirements

## 3A

## Derive recommendations supported by evidence

Financial statements provide summaries of an organisation's financial transactions throughout the year. Financial statements provide an indication of the organisation's financial performance and are analysed to determine the underlying issues for good or bad performance areas.

Financial statements provide the basis for making recommendations on the direction of the business and may include information on cashflow, consolidation, expenses, profit and loss, and write-offs.

Here is more information about financial statements.

#### Evidence from financial statements

- Budgetary analysis can be used to identify the operating budget over a recommendation's life cycle including capital costs and cashflow.
- Forecasts and estimates can be used to project or pre-empt future sales figures.
- Order and supply documents can be used to identify patterns and market trends.
- Return on investment (ROI) calculations can be used to encourage or recommend particular investment pathways based on the strength of the ROI.
- Taxation and statutory returns can be used in audited annual reports.

## Major financial statements

Organisations are required to produce several major financial statements as part of their requirements in meeting statutory reporting guidelines.

All public companies are required to have copies of their financial statements readily available and free of charge. Most organisations now do this by placing copies of their financial statements (usually contained within the annual report) on their websites.

The two major financial statements that serve as the basis for providing recommendations are the balance sheet (the statement of financial position) and the income statement (the profit and loss statement).



## Balance sheet

The balance sheet (also known as the statement of financial position) represents the financial position of the organisation based on what it owns and what it owes. The financial position of the organisation is the economic condition of the business, its financial structure and its level of solvency.

The balance sheet reports the resources of the organisation and its financial position at a specific point in time. The balance sheet is a snapshot of the business as it currently stands ‘as at’ a certain date.

Here are some commonly used equations that relate to the balance sheet.

### Fundamental accounting equation

The balance sheet is based on the fundamental accounting equation:  
 $Assets = Liabilities + Owner's\ equity$

### The finance of assets and residual balance

This fundamental equation recognises that a portion of an organisation’s assets are financed by debt (liabilities) and the residual balance (owner’s equity) represents the right of owners to the organisation’s assets only after all creditors have been paid.

### Balance sheet assets and liabilities sections

Assets and liabilities can be either current or non-current. Within the asset and liability sections of the balance sheet, items are listed in terms of their liquidity.

## Income/profit and loss statement

The income statement (also known as the profit and loss statement or statement of financial performance) reports the organisation’s financial performance over a specific period of time (for example, a month, quarter or year). The income statement reports on the earning activities of the business, whereby:

**Net profit (loss) = Revenue – Expenses**

Net profit is the balance between revenue (for example, sales, commissions, interest earned) and expenses (for example, wages, inventory, electricity, advertising) of the organisation over the period. When revenues are greater than expenses, a net profit is made by the business. When expenses exceed revenue, a net loss is recorded.

60,302	61,654	52,727	47,18
15,876	6,000	-	1,14
1,490	884,077	1,270	3,88
1,0	813	2,334	838,79
532	9,515		9,28
426	901,757	876	853,12
28	963,411	92	900,11
		86	12,11
24,022	11,691	1,129	6,54
39,763		22,503	23,31
		38,018	41,92
57,497	52,435	51,694	45,52

## Analysis of financial statements – ratio analysis

Once the organisation has prepared its financial statements, it gains evidence and insight into its financial performance. While providing useful information, the study of financial performance requires further analysis of the items contained within the financial statements.

Here are some features of financial statement analysis.

### Analysis methods

The items contained in the balance sheet and income statement are expressed in monetary terms. These amounts are useful, but when reported on their own as individual items they have limited use for decision-making. Significant trends and relationships may not be evident when analysing dollar amounts because they do not provide an indication of whether that amount is good or bad.

### Analysing values

What if profit this year was \$50,000 compared to \$25,000 last year? By simply looking at these monetary values, it could be concluded that performance has improved. But what if the business had to generate sales of \$1,000,000 this year in order to achieve the \$50,000 profit, compared to last year when it only had to generate \$250,000 in sales? Has it performed better or worse? How much debt did the business have to incur in order to increase its profits this year?

### Ratio analysis

Ratio analysis provides decision-makers with the ability to compare the information contained in the financial statements with that of previous years, competitors and other organisations. Ratio analysis provides an efficient method for decision-makers to identify important trends and relationships between items in the financial statements, to make this information more comprehensible and useful in evaluating the organisation.

### Ratio analysis techniques

Ratio analysis works by dividing the monetary (dollar) value of an item in the financial statements by the monetary value of another item reported in the statements. This creates relevant measures of analysis. The most common ratio analysis techniques fall into three categories: profitability ratios, liquidity ratios and financial stability ratios.

## Profitability ratios

Profitability refers to an organisation's ability to achieve a profit and so provide an adequate return on the financial resources invested in the business by its owners. Profitability is evaluated in terms of whether the profits earned justify the owners' investment in the business.

Here are some examples of profitability analysis that can be used to evaluate the profit performance of an organisation.

### Evaluation of profit performance

Profitability analysis evaluates the organisation's profit performance for a period to determine whether it has made a good profit compared to its turnover and how effectively the organisation has used its assets to generate profits.

### Profits are related to other items

The actual net profit (or loss) figure is the primary measure of the profitability of a business. However, more meaningful conclusions can be drawn regarding profitability if profit or loss is related to other items in a business's final reports through ratio analysis.

### Types of profitability ratios

The organisation's profitability performance can be analysed using the following profitability ratios:

- Net profit ratio
- Return on owner's equity ratio
- Return on total assets ratio

## Net profit ratio

After taking into account the cost of goods sold, the administration costs, selling and marketing costs, rent, wages and all the other costs of the organisation, the net profit is the amount that remains.

The net profit ratio indicates the percentage of sales revenue that represents a profit to the organisation. That is, the net profit ratio shows the number of cents in each dollar of revenue that remains as profit after all the costs of the business have been covered.

Interest is usually excluded from this calculation because it is often regarded as the cost of a financing decision and has no effect on how the business is able to use its resources to generate profits.

The net profit ratio is calculated with the following formula:

$$\text{Net profit ratio} = \frac{\text{Net profit (excluding interest expense)}}{\text{Net sales}} \times \frac{100}{1}$$

## Return on owner's equity ratio

As well as relating profits (or losses) to sales, it is also useful to express them in terms of total owner's equity, to give a measure of the return being generated on the funds invested in the business by the owners or shareholders.

Here is more information about the return on owner's equity ratio.

### Calculating the return on owner's equity ratio

The return on owner's equity ratio simply measures the owner's return from the business and is calculated as follows:

$$\text{Return on owner's equity ratio} = \frac{\text{Net profit (loss)}}{\text{Average owner's equity}} \times \frac{100}{1}$$

### Calculating average owner's equity

Average owner's equity is calculated by taking the levels of owner's equity at the beginning and end of the period and dividing by two to get the average for the entire period:

$$\text{Average owner's equity} = \frac{\text{OE at beginning of period} + \text{OE at end of period}}{2}$$

### How the ratio creates a better comparison

The average of owner's equity is used rather than simply the owner's equity at the end of the period because this provides a better indication of the funds employed during the entire accounting period, and therefore creates a better comparison with the profits earned during that period.

### Measure use of equity

The return on owner's equity indicates how efficiently the business has used the resources provided by the owner. The ratio enables the owner to evaluate the return being generated by the business against that available from alternative forms of investment with similar levels of risk and, if necessary, to decide whether to withdraw funds from the business and invest them elsewhere.

### Interpreting the ratio

In interpreting this ratio, it is considered dangerous to make absolute evaluative statements such as that the return is 'good' or 'bad'. It is more appropriate to describe the general trend, such as whether the return on the owner's funds has improved or decreased.

## Return on assets ratio

The return on assets (ROA) ratio is similar to the return on owner's equity ratio because it looks at how effectively the organisation has used the resources at its disposal in order to generate profits. But rather than looking at the return generated on the funds provided by owners, ROA analyses how effectively the business has used its assets throughout the period to generate profits.

Here is more information about the return on assets ratio.

### Calculating the return on assets

The ROA ratio is calculated as follows:

$$\text{ROA} = \frac{\text{Net profit/loss (excluding taxes and interest expenses)}}{\text{Average total assets}} \times \frac{100}{1}$$

### Taxation and interest expenses added

In calculating ROA, the organisation's taxation and interest expenses are added back to profits, to reflect the fact that interest and tax payments are separate from the way that assets are used.

### Use the average of total assets

The organisation's total assets are used as the denominator, which includes both current and non-current assets. The average of total assets is used, rather than the asset levels at the end of the period, as this reflects the assets the organisation had at its disposal throughout the period.

## Liquidity ratios

Liquidity refers how quickly an organisation's assets could be converted into cash and relates to the ability of the organisation to meet its short-term financial obligations as they are due. Liquidity is a very important factor for any business, because organisations that cannot meet their short-term obligations might not be able to exist in the long term.

Here is more information about the liquidity ratios.

### Analysis of balance sheet items

Analysis of an organisation's liquidity requires the analysis of the items on its balance sheet. The purpose of the balance sheet is to provide a picture of the financial position of an organisation. It sets out the assets and liabilities of the organisation at a point in time and indicates the likelihood of the organisation's survival in both the long and short term.

### Evaluation of ability

The balance sheet deals with the organisation's investments in assets and the type of finance used to acquire those assets and to fund the day-to-day operations of the business. Analysis of the balance sheet relates to evaluation of the ability of the business to meet its financial commitments when they are due.

### Types of liquidity ratios

There are a number of liquidity ratios that can be calculated in order to analyse the ability of the organisation to meet its short-term commitments. These include the working capital ratio, quick asset ratio, accounts receivable (debtors) turnover ratio and inventory turnover ratio.

## Working capital ratio

The working capital ratio is also referred to as the current ratio. It expresses an organisation's current assets as a percentage of its current liabilities and so provides an indication of the ability of the business to pay its current liabilities when they fall due.

This effectively measures how much current assets exceed current liabilities on a dollar-for-dollar basis and is usually expressed as a ratio rather than as a percentage.

The working capital ratio is a vital indicator of short-term stability, because if a business cannot meet its debts as they fall due, it will be in a position of possible insolvency.

Here is more information about the working capital ratio.

### Working capital ratio formula

The working capital ratio is calculated as follows:

$$\text{Working capital ratio} = \frac{\text{Current assets}}{\text{Current liabilities}} : 1$$

### Ratio excludes non-current items

The working capital ratio uses only current assets and current liabilities in its calculation – non-current items are excluded. This is because the working capital ratio only looks at liquid items – items that can be quickly turned into cash (current assets) and compares them to items that are due in the short term (current liabilities).

**The meaning of a low ratio**

A low ratio suggests that the business will have difficulty in meeting short-term obligations, but an excessively high ratio may mean that the organisation has invested excessively in working capital items that are not producing returns or profits for the business.

**The ideal current ratio**

It is suggested by many accountants that the ideal current ratio is around 1.5:1. That is, the organisation should have around \$1.50 of current assets for every \$1 of current liabilities, but this figure will vary depending on the nature of the industry the organisation operates in.

**Minimum ratio to maintain**

An organisation should maintain a minimum ratio of 1:1 or \$1 of assets to meet \$1 of liabilities. Anything less than this may indicate that the business is heading for liquidity problems. Rising loans, bank overdrafts and delayed bill payments are all signs that things may be going badly in a liquidity sense.

## Quick asset ratio

The ability of a business to cover its current liabilities as they become due depends not only on the ratio of current assets to current liabilities, but also on the timing of receipts and payments.

Here is more information about the quick asset ratio.

**Quick asset ratio formula**

The quick asset ratio is calculated as follows:

$$\text{Quick asset ratio} = \frac{\text{Current assets} - \text{inventory} - \text{prepaid assets}}{\text{Current liabilities}} : 1$$

In general, a quick asset ratio of 1:1 is considered acceptable because the business has \$1 of current assets that can be readily converted into cash to meet current liabilities. A lower ratio could result in liquidity problems for the organisation in meeting its immediate short-term commitments.

### Test of short-term liquidity

The quick asset ratio is a more stringent test of short-term liquidity than the working capital ratio and is a measure of a business's ability to meet its current liabilities immediately, if required. While inventory and prepaid assets items are liquid in nature, they are not as liquid as cash, marketable securities and amounts owed by debtors. Inventory must be sold, which requires significant effort, and prepaid items (for example, insurance and rent) are usually consumed by the business and are not readily convertible into cash. The quick asset ratio excludes these items from its calculations of the organisation's ability to meet its short-term obligations.

## Accounts receivable (debtors) turnover ratio

Many businesses sell their products and services on a credit basis in order to provide flexible payment options for customers and to encourage business.

If credit is provided to customers (debtors), the organisation must subsequently collect the amounts owed as quickly as is reasonably possible.

Here is more information about the accounts receivable (debtors) turnover ratio.

### Ratio formula

The accounts receivable (debtors) turnover ratio is calculated as follows:

$$\text{Accounts receivable (debtors) turnover ratio} = \frac{\text{Average debtors for period}}{\text{Credit sales for period} / 365}$$

This is expressed in terms of days; for example, 27 days. The average debtors' level for the entire period is used by taking the debtors' balances at the beginning and end of the period and dividing by two. Note that only credit (not cash) sales for the period are included in the denominator and that this figure is divided by 365 to get a daily average for credit sales for the business.

### Measures of performance

The accounts receivable (or debtors) turnover ratio measures the average collection period for the organisation – the average number of days taken by a business to collect money owing by debtors. This is a very important measure of an organisation's performance, as it is cashflow that provides the lifeblood of the business. Credit sales that increase revenues on paper are irrelevant if the cash is never collected from the customer. The calculation of the average collection period allows meaningful comparison with the firm's credit terms, to determine whether debtor collection practices are effective.

## Inventory turnover ratio

The aim of an organisation is to sell its stock as quickly as possible, thereby generating cashflow and making profit each time stock is sold or 'turned over'.

The time taken by a business to sell its inventory (stock) is used to calculate its inventory turnover ratio. This can be expressed either in terms of the number of days taken to turn over stock or in terms of the number of times per annum stock is turned over.

Here is more information about the inventory turnover ratio.

### Inventory turnover ratio formula

The inventory turnover ratio in terms of the number of days taken is calculated as follows:

$$\text{Inventory turnover ratio (no. days)} = \frac{\text{Average inventory for period}}{\text{Cost of goods sold} / 365}$$

### Average stock and cost of goods

Average stock is the average of the stock levels at the beginning and end of the period. It is used to provide a more representative figure of the stock level over the entire period. The cost of goods sold is the original cost to the business of the entire inventory it sold during the period.

### Inventory turnover ratio

The inventory turnover ratio can also be expressed in terms of the number of times per annum that inventory is turned over, using the following calculation:

$$\text{Inventory turnover ratio (no. times per annum)} = \frac{365}{\text{Inventory turnover ratio (no. days)}}$$

### Adequate turnover determination

The stock turnover is compared with the inventory turnover ratio for previous periods. What is an adequate turnover depends on the type of industry the organisation operates in. For example, a supermarket would have a much higher rate of inventory turnover than a car dealership.

### Low ratio equals good inventory management

A low inventory turnover ratio (in terms of the number of days) is a sign of good inventory management, as it indicates that the business is not holding excess stock and is selling its inventory swiftly. A high inventory turnover ratio normally indicates that the business is carrying an excessive stock level.

### Keep in line with industry averages

The organisation should endeavour to keep its inventory turnover as low as is reasonably possible in terms of days and also in line with industry averages. This will ensure the costs of having inventory on hand and managing it are minimised.

## Financial stability ratios

Financial stability is the ability of an organisation to continue business operations in the long term and to meet its long-term obligations while still having enough working capital to operate.

Financial stability ratios look at the financial stability of the organisation in terms of its capital structure. The proportion of debt to equity represents the organisation's capital structure.

The two main financial stability ratios are the debt ratio and the equity ratio.

### Debt ratio

The debt ratio looks at the proportion of an organisation's total assets that are financed by debt (liabilities). This is a vital measure of long-term financial stability for a business because those parties that are owed money by the organisation (creditors) have first claim on the organisation's assets, even before owners (equity).

The greater the percentage of assets that are financed by debt, the greater the claims of creditors on the organisation's assets will be. If a business has an excessively high level of debt, this provides less financial stability because the business has a high level of future obligations to make payments to creditors.

The debt ratio is calculated using the following formula:

$$\text{Debt ratio} = \frac{\text{Total liabilities}}{\text{Total assets}} \times \frac{100}{1}$$

### Equity ratio

The equity ratio is effectively the inverse of the debt ratio, as it analyses the proportion of an organisation's total assets that are financed by equity (owners) rather than through liabilities (debt).

Here is more information about the equity ratio.

#### Equity ratio formula

The equity ratio is calculated with the following formula:

$$\text{Equity ratio} = \frac{\text{Total owner's equity}}{\text{Total assets}} \times \frac{100}{1}$$

#### Percentage claim of owners

The equity ratio measures the long-term financial stability of the business by highlighting the percentage claim of owners on the organisation's assets. The higher the equity ratio for the business, the fewer obligations it will have to creditors (liabilities) in the future.

#### Debt and equity finance

The percentage of assets financed by equity and the percentage financed by debt will always add up to 100 per cent for an organisation. This is by virtue of the basic accounting equation, which shows that all of an organisation's assets are financed from one of two sources – debt and equity.

## Long-term financial stability conclusions

Before any conclusions can be drawn regarding the long-term financial stability of an organisation, the capital structure of similar businesses in the same industry should be considered. The percentage of borrowed funds used by a business to finance its assets and operations will depend on economic circumstances and conditions, such as the level of economic growth, budgeted sales and profits, the objectives of the organisation and the impact of interest rates.

Some organisations choose to make extensive use of borrowed funds when economic conditions are buoyant and interest rates are low. However, if economic conditions are sluggish, organisations may tend to fund the business using owners' funds, rather than borrowed funds.

### Example: equity ratio

This example calculates the equity ratio for Allen's Wholesalers.

Note how Allen's debt (88.4 per cent) and equity (11.6 per cent) ratios add up to 100 per cent to show how its assets have been funded in their entirety.

<b>Allen's Wholesalers</b>			
<b>Balance sheet as at 30 June 2015</b>			
<b>Assets</b>	<b>\$</b>	<b>Liabilities</b>	<b>\$</b>
<i>Current</i>		<i>Current</i>	
Cash (bank account)	42,800	Creditors (accounts payable)	57,239
Debtors (accounts receivable)	35,354	Wages payable	4,209
Stock	11,072		61,448
	89,226		
<i>Non-current</i>		<i>Non-current</i>	
Motor vehicles	67,340	Loan	26,936
Machinery	6,734	Mortgage	353,535
Production equipment	33,670		380,471
Land	185,185	<b>Total liabilities</b>	<b>441,919</b>
Buildings	117,845	<b>Owner's equity</b>	
	410,774	Capital	58,081
<b>Total assets</b>	<b>500,000</b>		<b>500,000</b>

To calculate the equity ratio:

$$\begin{aligned}
 \text{Equity ratio} &= \frac{\text{Total owner's equity}}{\text{Total assets}} \times \frac{100}{1} \\
 \text{Equity ratio} &= \frac{58,081}{500,000} \times \frac{100}{1} \\
 \text{Equity ratio} &= 11.6\%
 \end{aligned}$$

## Practice task 10

1. How do the working capital ratio and the quick asset ratio differ?

2. Explain why the debt and equity ratios for a business always add up to 100 per cent. Explain your answer in terms of the basic accounting equation.

# 3B

## Propose effective and concise recommendations

The analysis of an organisation's financial statements through ratio analysis helps you make recommendations to management on the past performance of the business and areas for improvement in the future. The recommendations you develop must ultimately be aimed at improving the effectiveness of the organisation and its operations by addressing the core or underlying issues.

While subjective opinions and hunches have a minor role to play in management decision-making, effective decisions require sound evidence. The purpose of financial analysis is to provide evidence for the recommendations you develop.



### Translate financial information

An important consideration in developing recommendations for management is the translation of financial information into something comprehensible and meaningful. The analysis needs to be converted and consolidated in order to make financial information more useful for decision-makers.

This is particularly important given the complex nature of the information you are presenting. It is also essential that an organisation presents financial information in a transparent manner.

Financial information and numbers can be difficult to understand for those not knowledgeable about their meaning. You need to use the evidence you have collected to tell a story. This means translating financial information into meaningful insights and clear plans for action.

For example, if debtors' turnover has increased from 35 days to 56 days in the past year, this may mean there is a need to review the credit terms offered by the business, as well as its debt collection practices.

### Practice task 11

Ratio analysis helps you to make recommendations to management on the past performance of the business and areas for improvement in the future. Why do the results need to be translated?

## 3C

## Identify significant issues in financial statements

A major part of providing financial business recommendations is identifying significant issues from the analysis of the financial statements.

The two main techniques for doing this are:

- budgetary analysis
- horizontal analysis.

### Budgetary analysis

Managers need to set a direction for the organisation in order to formulate financial plans. Such plans, or budgets, play an extremely important role in the financial management of a business because they allow for the comparison of actual financial performance with desired (or budgeted) financial performance.

A budget is a detailed forecast of an organisation's expected performance in a particular area of activity for a specified period of time. The budgeting process involves the preparation of budgets for all areas of activity within the organisation and is the essential first stage of management achieving effective planning and control.

Here is more information about budgets.

#### Types of budgets

- A budgeted profit and loss (income) statement
- A budgeted balance sheet
- A sales budget
- A purchases budget
- An operating expenses budget
- A capital expenditure budget
- A cash budget

### Variance reports

Financial managers need constant information about how the organisation is performing against budgets. They need to be able to make informed decisions that will affect the future direction of the business. Management reports, which give recommendations to internal and external users, are based on evidence produced in a variety of financial reports.

The income statement and the balance sheet can both be used to identify significant issues in performance through conducting a variance report between budgeted and actual performance.



## Horizontal analysis

Horizontal analysis compares actual financial performance for the current period with the desired or budgeted performance. Horizontal analysis also provides a comparison of the current period's results with those of the preceding period.

Here is further information around horizontal analysis.

Analysis of change	Change in values
<p>Horizontal analysis is the analysis of how each item in the financial statements has changed between accounting periods. Most larger organisations provide a horizontal analysis in financial statements as part of their annual reports. These statements are referred to as comparative financial statements and they compare current results with those for recent accounting periods.</p>	<p>Horizontal analysis analyses the change in each item of the financial statements in three ways:</p> <ul style="list-style-type: none"> <li>• The change in absolute monetary value</li> <li>• The percentage change from the value of the previous period</li> <li>• Whether the change is favourable or unfavourable for the organisation</li> </ul>

### Example: horizontal analysis

The following analysis for Westpoint Industries shows that overall net profit for the year rose by 42.9 per cent, which is a good result for the business. However, horizontal analysis requires you to investigate further and see that profits rose mostly as a result of sales increasing by 18.6 per cent, while expenses decreased by only 4.3 per cent.

Several issues require further examination:

- What factors led to sales increasing by nearly 20 per cent? This is a significant increase.
- Sales department salaries, advertising and administration salaries all decreased significantly. What strategies were used to achieve this and how can they be maintained?
- Rates and taxes (52 per cent) and office expenses (95 per cent) grew dramatically over the previous year. Why? How can these expenses be reduced for the coming periods?

*continued ...*

... continued

<b>Westpoint Industries</b>					
<b>Comparative income statement</b>					
<b>for the months of March 2015 and March 2016</b>					
<b>Horizontal analysis</b>					
	<b>March 2016</b>	<b>March 2015</b>	<b>Dollar amount</b>	<b>%</b>	
Sales	1,245,000	1,050,000	195,000	18.6	F
Less cost of goods sold	1,070,000	900,000	170,000	18.9	F
<b>Gross profit</b>	<b>175,000</b>	<b>150,000</b>	<b>25,000</b>	<b>16.7</b>	<b>F</b>
Add commission	350	350	0	0.0	-
	<b>175,350</b>	<b>150,350</b>	<b>25,000</b>	<b>16.6</b>	<b>F</b>
Less operating expenses					
Sales salaries	22,500	25,000	-2,500	-10.0	F
Delivery vehicle expenses	435	400	35	8.8	U
Advertising	890	1,100	-210	-19.1	F
Rent	10,200	9,900	300	3	U
Administration salaries	30,750	34,000	-3250	-9.6	F
Telephone	3,300	3,000	300	10.0	U
Rates and taxes	1,750	1,150	600	52.2	U
Power and fuel	7,550	7,250	300	4.1	U
Office expenses	1,735	890	845	94.9	U
Office expenses	845	900	55	-6.1	F
Interest	<b>79,955</b>	<b>83,590</b>	<b>-3,635</b>	<b>-4.3</b>	<b>F</b>
<b>Net profit</b>	<b>95,395</b>	<b>66,760</b>	<b>28,635</b>	<b>42.9</b>	<b>F</b>
F = Favourable U = Unfavourable					

## Practice task 12

1. In what three ways does horizontal analysis analyse the change in each item of the financial statements?

2. When analysing the budgetary performance of your organisation or an organisation you have researched, explain what the following terms mean:

- Favourable outcome
- Unfavourable outcome

# 3D

## Ensure structure and report formats comply with requirements

Financial recommendations and reports must be accurate. They must effectively and successfully guide an organisation's operations. They must also comply with statutory regulations and workplace policies and procedures in terms of content, format and structure.

Financial reports must follow a format that is determined by the statutory authority and/or your organisation's policies and procedures. You need to be familiar with the required formats for balance sheets, cashflow statements, electronic forms, financial year reports, operating statements, spreadsheets and statutory forms. Accounting software packages have compliant structures and formats for reports.



### Example: ASIC requirements

Financial reports can be lodged with ASIC via Standard Business Reporting (SBR)-enabled accounting software. Companies complete a copy of the financial statements and reports lodgment form and attach electronic copies of their financial accounts and reports in PDF format.

The lodgment of reports using XBRL (eXtensible Business Reporting Language) is, at this stage, optional.

Up to five files may be attached and each must be less than 10 MB in size. File attachments cannot contain any active or encrypted content.

For more information on Standard Business Reporting, visit the website at: [www.sbr.gov.au](http://www.sbr.gov.au).



## Practice task 13

Research the Standard Business Reporting website at: [www.sbr.gov.au](http://www.sbr.gov.au), then answer the following questions.

1. What is the Australian Reporting Dictionary?

2. Which agencies have developed SBR-enabled reports?

3. To send your organisation's financial reports to government online, what do you need to register for?

## Summary

1. Financial statements provide the basis for making recommendations about the future direction of the organisation. The two major financial statements are the balance sheet (or statement of financial position) and the income statement (or profit and loss statement).
2. The balance sheet outlines the financial position of the organisation based on what it owns (assets) and what it owes (liabilities) and is based on the fundamental accounting equation:  
$$\text{Assets} = \text{Liabilities} + \text{Owner's equity}$$
3. The income (profit and loss) statement outlines the organisation's financial performance over a specific period of time and reports on the earning activities of the business, whereby:  
$$\text{Net profit (loss)} = \text{Revenue} - \text{Expenses}$$
4. In order to analyse the financial statements of the organisation, ratio analysis is used to create relevant (rather than absolute) measures of position and performance.
5. The most common ratio analysis techniques fall into three categories: profitability ratios, liquidity ratios and financial stability ratios. These types of ratios enable the organisation to be assessed and recommendations made based on its past and estimated future performance.
6. Profitability ratios evaluate profit performance to determine whether the business has made a good profit compared to its turnover and used its assets effectively to generate profits. The three main profitability ratios are the net profit ratio, return on owner's equity ratio and return on assets ratio.
7. Liquidity ratios assess the ability of the organisation to meet its short-term financial obligations as they fall due. The four main liquidity ratios are the working capital ratio, quick asset ratio, accounts receivable (debtors) turnover ratio and inventory turnover ratio.
8. Financial stability ratios analyse the ability of the organisation to continue business operations and meet obligations in the long term while still having enough working capital to operate effectively each year. The two main ratios for this are the debt ratio and equity ratio.
9. Budgetary analysis and horizontal analysis can be used to highlight significant issues in the organisation's operations and to generate recommendations.

## Learning checkpoint 3

### Provide financial business recommendations

This learning checkpoint allows you to review your skills and knowledge in providing financial business recommendations.

#### Part A

1. List the two major financial statements that organisations prepare and explain their format and structure. What information does each of these statements contain?

2. How does ratio analysis provide further evidence of an organisation's financial performance and position beyond that contained in the two major financial statements?

3. Explain what is meant by the following terms:

- Profitability
- Liquidity
- Financial stability

4. Calculate the inventory turnover (in days) for Style Riders based on the following figures:

- Stock at 1 July (beginning of the financial year) \$30,000
- Stock at 30 June (end of the financial year) \$20,000
- Cost of goods sold \$110,000

5. Calculate the inventory turnover (no. times per annum) for Style Riders based on the following figures:

- Stock at 1 July (beginning of the financial year) \$30,000
- Stock at 30 June (end of the financial year) \$20,000
- Cost of goods sold \$110,000

## Part B

Read the case study, then answer the questions that follow.

### Case study

Review the profitability ratios in the following table for an organisation for the last two financial years.

	2014	2015
Net profit margin	5.1%	3.8%
Return on owner's equity ratio	13.4%	11.9%
Return on assets ratio	9.9%	9.1%

1. Interpret these results for management by explaining what each of these ratios tells us about the organisation's profitability.

2. Overall, how would you evaluate the organisation's profitability over the last two years? How does this compare to that of other businesses in the industry?

3. Provide some practical recommendations on how profitability in your organisation could be improved.

## Part C

Read the case study, then answer the questions that follow.

### Case study

Review the liquidity ratios in the following table for an organisation for the last two financial years (assume the credit term given to customers is 30 days).

	2014	2015
Working capital ratio	1.6:1	2.2:1
Quick asset ratio	0.8:1	1.2:1
Accounts receivable (debtors) turnover ratio	28 days	39 days
Inventory turnover ratio	86 days (4.2 times pa)	71 days (5.1 times pa)

1. Interpret these results for management by explaining what each of these ratios tells us about the organisation's liquidity.



2. Overall, how would you evaluate the organisation's liquidity over the last two years?

3. Provide some practical recommendations on how liquidity in your organisation could be improved.

## Part D

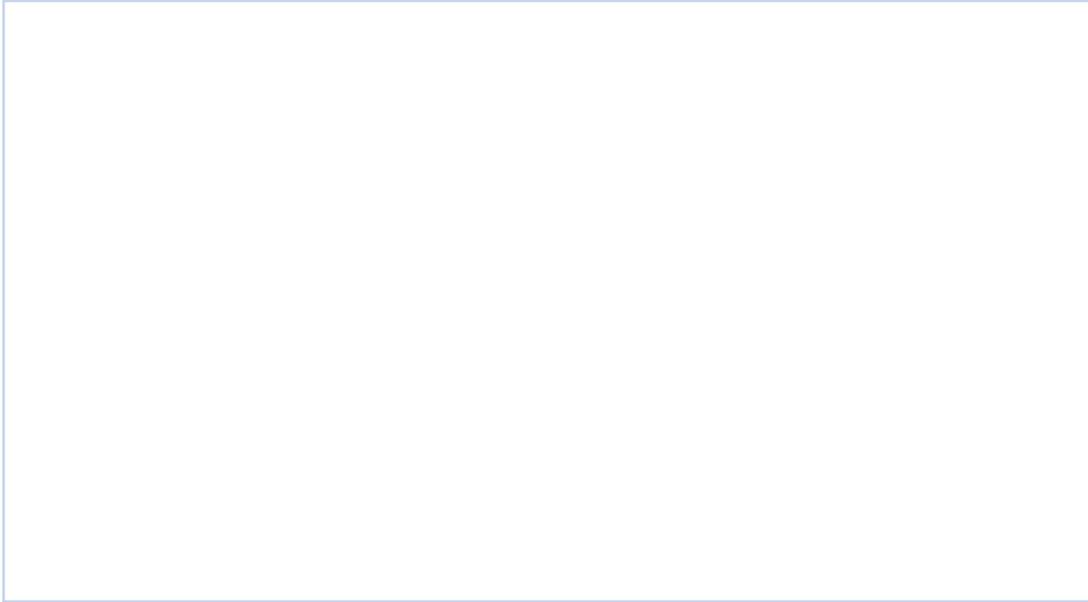
Read the case study, then answer the questions that follow.

### Case study

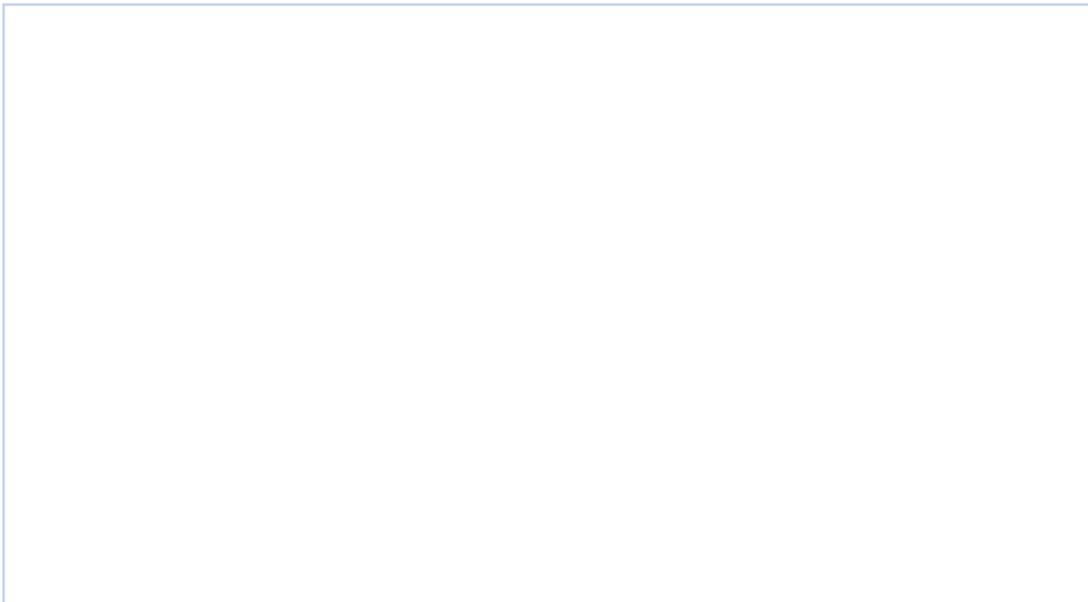
Review the financial stability ratios in the following table for an organisation for the last two financial years.

	2014	2015
Debt ratio	78%	83%
Equity ratio	22%	17%

1. Interpret these results for management by explaining what each of these ratios tells us about the organisation's financial stability and capital structure.



2. Overall, how do you evaluate the organisation's financial stability over the last two years?



3. Provide some practical recommendations on how financial stability in your organisation could be improved.

## Part E

Read the case study, then answer the questions that follow.

### Case study

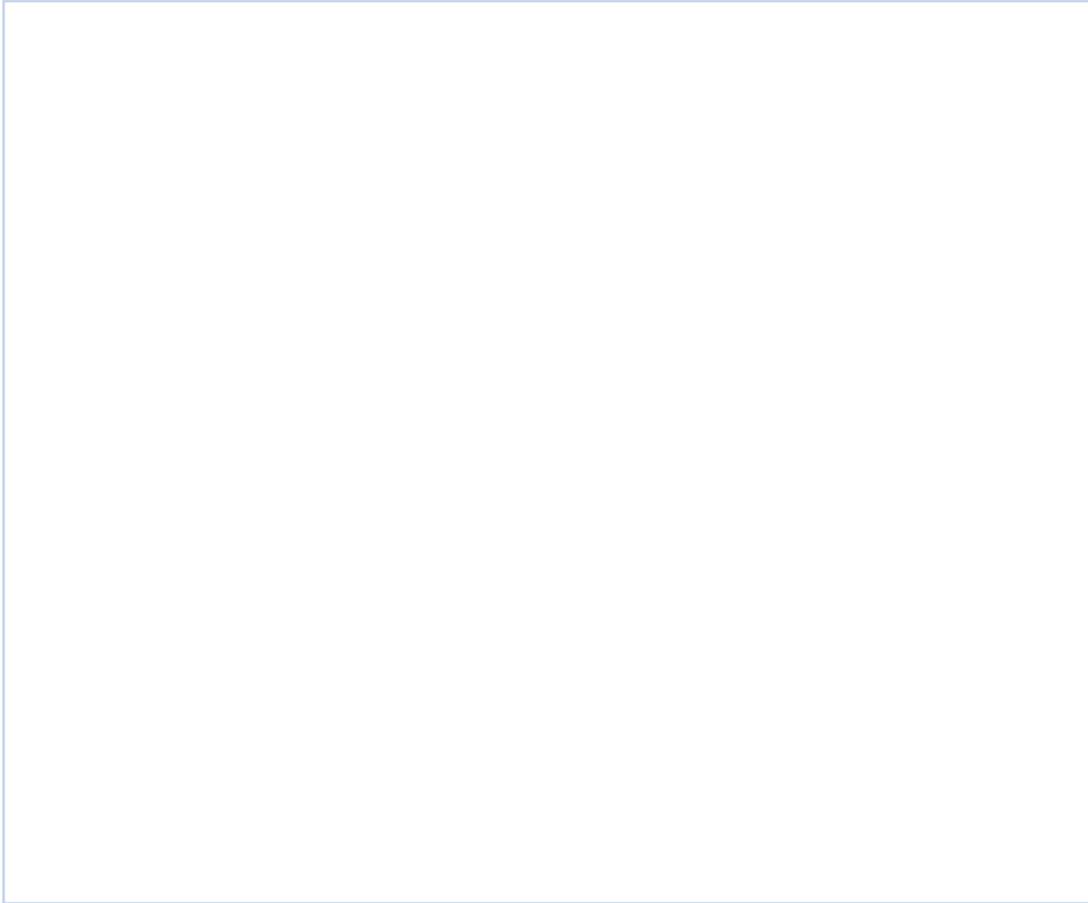
Review the two financial years of an organisation's income statement provided below.

<b>MWF</b>				
<b>Comparative income statement</b>				
<b>for the two years ended 30 June 2014 and 30 June 2015</b>				
<b>Horizontal analysis</b>				
	<b>2014</b>	<b>2015</b>	<b>Dollar amount</b>	<b>%</b>
Revenue	10,300,500	11,600,000		
Sales	3,605,175	3,940,500		
Less cost of goods sold	6,695,325	7,659,500		
Gross profit	25,000	25,000		
Add commission	6,720,325	7,684,500		
Less operating expenses	2,250,000	1,900,000		
Wages and salaries	315,000	250,000		
Motor vehicle expenses	1,200,000	1,050,000		
Marketing and advertising	950,000	925,000		
Rent	70,000	97,000		
Telephone	64,000	61,000		
Office expenses	32,500	37,500		
Interest	4,881,500	4,320,500		
<b>Net profit</b>	<b>1,838,825</b>	<b>3,364,000</b>		
F = Favourable U = Unfavourable				

1. Fill in the missing data from the last two columns. Conduct a horizontal analysis for each item of the income statement and indicate whether each result is favourable or unfavourable for the organisation.

2. Identify items in the income statement that significantly increased/decreased from 2014 and contributed to the overall net profit (or loss) outcome for 2015. List possible reasons for the increase/decrease for each item.

3. Make recommendations for ways that management could address the significant items you identified in question 2. Prioritise each item in terms of its importance to the organisation.

A large, empty rectangular box with a thin blue border, intended for the student to write their recommendations and prioritise the items identified in question 2.