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# 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

**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.

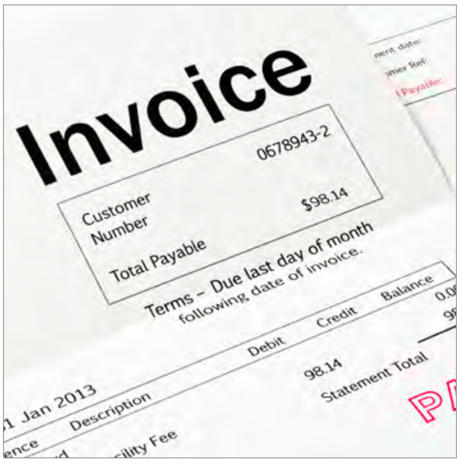
Many organisations use off-the-shelf financial management software, such as MYOB, Quicken or Xero, or have software specifically developed to assist the process of recording and reporting on business transactions and meeting statutory reporting obligations (such as the business activity statement and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

## 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.

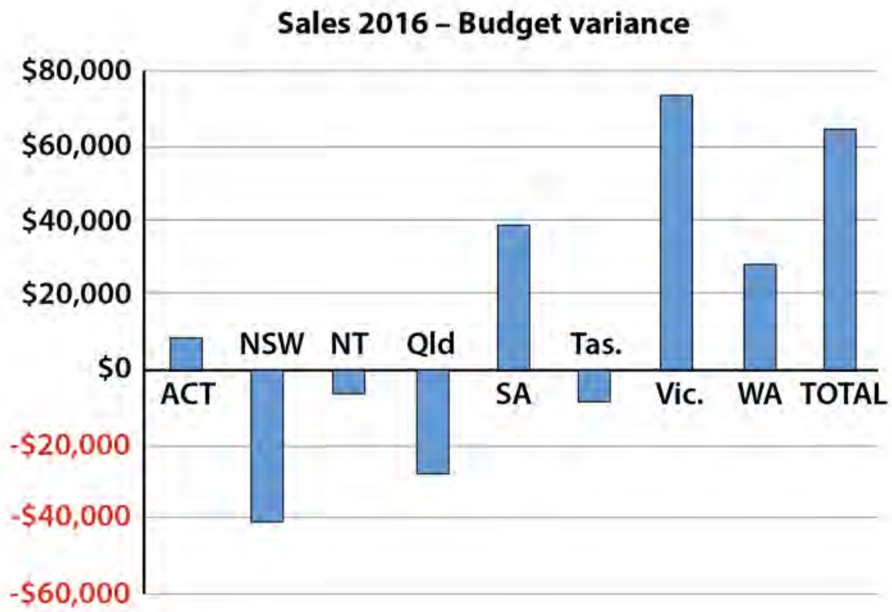
| Coding and classification |
| --- |
| Make sure you adhere to the organisational chart of accounts code when you enter transactions into the various journals and ledgers within your organisation's accounting system. The classifications of accounts may vary between organisations, so familiarise yourself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

## 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.

**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?

Here is more information about internal control measures.

| Internal control procedures | Poor/absent internal controls |
|---|---|
| Internal control procedures include:<br>• 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<br>• ensuring there is regular reconciliation of accounts and ledgers<br>• ensuring that the receiving, recording and banking of cash are not performed by just one employee<br>• ensuring that employees have the appropriate skills to perform the tasks required by providing training and professional development opportunities<br>• implementing a system of authorisation; for example, a manager to authorise purchases over a certain amount<br>• ensuring that all business documents are pre-numbered so all documents are accounted for and the possibility of fraud is minimised. | If internal controls are poor or absent within an organisation:<br>• The objectives of the organisation may not be met.<br>• Fraud may occur.<br>• Errors will occur.<br>• Inefficiencies may go undetected, possibly causing an increase in costs.<br>• It may be difficult to track the audit trail; that is, the flow of records and documentation through the accounting process.<br>• Employees may lose morale.<br>• Customers, shareholders, investors, creditors, lenders of finance, etc. may lose confidence in the organisation. |

## 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?

# 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

## 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.

## 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 |
|---|---|
| The reporting period covered varies according to the particular regulatory body. All regulators clearly outline their reporting requirements, period covered and due dates.<br><br>For example, the ATO issues paper copies and makes available online the business activity statement forms specifying the month or quarter to be covered. | 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. |

## 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.

## 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 earnt 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. |

- 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 |
|---|---|
| Common types of payments recorded in the payroll accounts include:<br>• wages and salaries<br>• leave payments<br>• allowances<br>• bonuses and commissions<br>• superannuation guarantee levy<br>• fringe benefits<br>• directors' fees. | Payments not subject to the payroll tax calculation include:<br>• payments to or on behalf of apprentices or registered trainees<br>• workers compensation payments<br>• redundancy payments.<br>Each state and territory has its own specific exemptions. Be familiar with those that are applicable to your state/territory. |

## 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.

**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 for further information about concessions available to non-profit ATO-endorsed registered charities.

List two tax concessions available to these entities.

# 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?

# 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.

**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 meets 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:

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

**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).

# 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:

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

**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.

# 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<br>• A budgeted balance sheet<br>• A sales budget<br>• A purchases budget<br>• An operating expenses budget<br>• A capital expenditure budget<br>• 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.

# 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.