Accounting Units 1 & 2

Chapter 1 The nature and role of accounting

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Theory

Every business, from a one-person mobile car wash to a national retailer, must make decisions: what to charge, what to spend, whether it can afford to hire, whether it earned a profit, whether it can repay a loan. Good decisions depend on good information, and **accounting** is the system that produces that information. Accounting is the process of **collecting, recording, reporting, analysing and interpreting** financial and non-financial data, and using it to **provide advice** to the owner and other stakeholders so that they can make sound decisions and improve the performance of the business. In short, accounting exists to turn the raw facts of a business's activity into useful **information for decision-making**.

Data versus information. The two words are not the same, and the difference explains why accounting is needed at all:

- **Financial data** is the raw, unprocessed facts about individual transactions — for example, "received $220 on 3 March" or "paid $88 for fuel on 5 March". On its own, a single figure tells the owner very little.
- **Accounting information** is data that has been **recorded, classified, summarised and reported** so that it becomes **useful**. "The business earned $14 000 in fees this quarter but spent $16 000, so it made a $2 000 loss" is information — it has meaning, and a decision can be based on it.

A business generates hundreds or thousands of pieces of financial data. Left as a shoebox of receipts, that data is almost useless. Accounting is the system that **processes** the data into information.

Accounting as an information system. It is helpful to think of accounting as a system with three parts: an **input**, a **process** and an **output**. The **inputs** are the financial data captured on **source documents** (receipts, invoices, bank records). The **process** is the recording, classifying and summarising of that data. The **outputs** are the **accounting reports** — and, beyond the reports, the **advice** drawn from them. Because the outputs feed back into the next round of decisions, accounting is often described as the **information system** at the centre of a business. A business needs accounting because without this system it cannot reliably answer basic questions about its own performance and position.

Why a business needs accounting. Accounting information supports two broad kinds of decision:

- **Operational (day-to-day) decisions** — what price to set, whether to spend on advertising, whether the business can afford another employee, which costs are rising. These use information such as the profit earned and the cash available.
- **Investment (strategic) decisions** — whether to establish or expand the business, whether it is succeeding or failing, and whether it is a worthwhile place to invest money compared with the alternatives. These use information about profit, return and financial position over time.

Accounting information also lets an owner judge the **success or failure** of the business against measurable indicators, rather than relying on a "gut feeling". A business that keeps no accounting records is effectively flying blind: it may feel busy and still be trading at a loss without knowing it.

Users of accounting information. Accounting information is prepared for a range of **users** (also called **stakeholders**). They fall into two groups:

- **Internal users** work inside the business. For a sole proprietor the key internal user is the **owner** (who is also the manager). The owner uses accounting information almost constantly — to price jobs, control spending, plan cash and decide whether to grow.
- **External users** are outside the business but have an interest in it. The main external users of a small service business's information are:
    - a **bank or other lender**, deciding whether to lend to the business and on what terms (can it repay?);
    - a **supplier** offering goods or services on credit, deciding whether the business will pay its accounts on time;

- the **Australian Taxation Office (ATO)**, checking that the correct GST and income tax have been reported and paid;
- a **prospective purchaser or investor**, deciding whether the business is worth buying or investing in.

Different users need different information, and they do not all have the same right of access: the owner sees everything, whereas an external user usually sees only the reports the owner (or the law) provides. This is one reason the reports must be prepared **honestly and completely** — a point returned to below.

The accounting process. The work of accounting flows through **four stages**, from the moment a transaction happens to the moment advice is given. In order, the stages are **source documents → recording → reports → advice**:

1. **Source documents.** Every transaction generates a **source document** — a **receipt**, a **tax invoice**, an **EFT record**, a **cheque butt** or a **memo** — which provides the financial data *and* the **evidence** that the transaction actually occurred. Source documents are the **input** to the whole system; if a transaction is not documented, it cannot be recorded reliably.
2. **Recording.** The data on the source documents is entered into the business's **records**. In Units 1 & 2 the recording is done in the **special journals** — the **Cash Receipts Journal**, **Cash Payments Journal**, **Sales Journal** and **Purchases Journal** — which sort each transaction into the accounts it affects.
3. **Reports.** At the end of a period the recorded data is **summarised** into the **accounting reports**: the **Cash Flow Statement** (cash in and out), the **Income Statement** (revenues against expenses to determine profit) and the **Balance Sheet** (what the business owns and owes — its **assets**, **liabilities** and **owner's equity**). The reports condense thousands of figures into a picture a user can read.
4. **Advice.** The reports are **analysed and interpreted**, and **advice** is provided to the owner to inform a decision — for example, "profit has fallen because wages rose faster than fees; consider raising prices or reducing hours". This final stage is where data finally becomes **useful**, because a report that is never interpreted changes no decision.

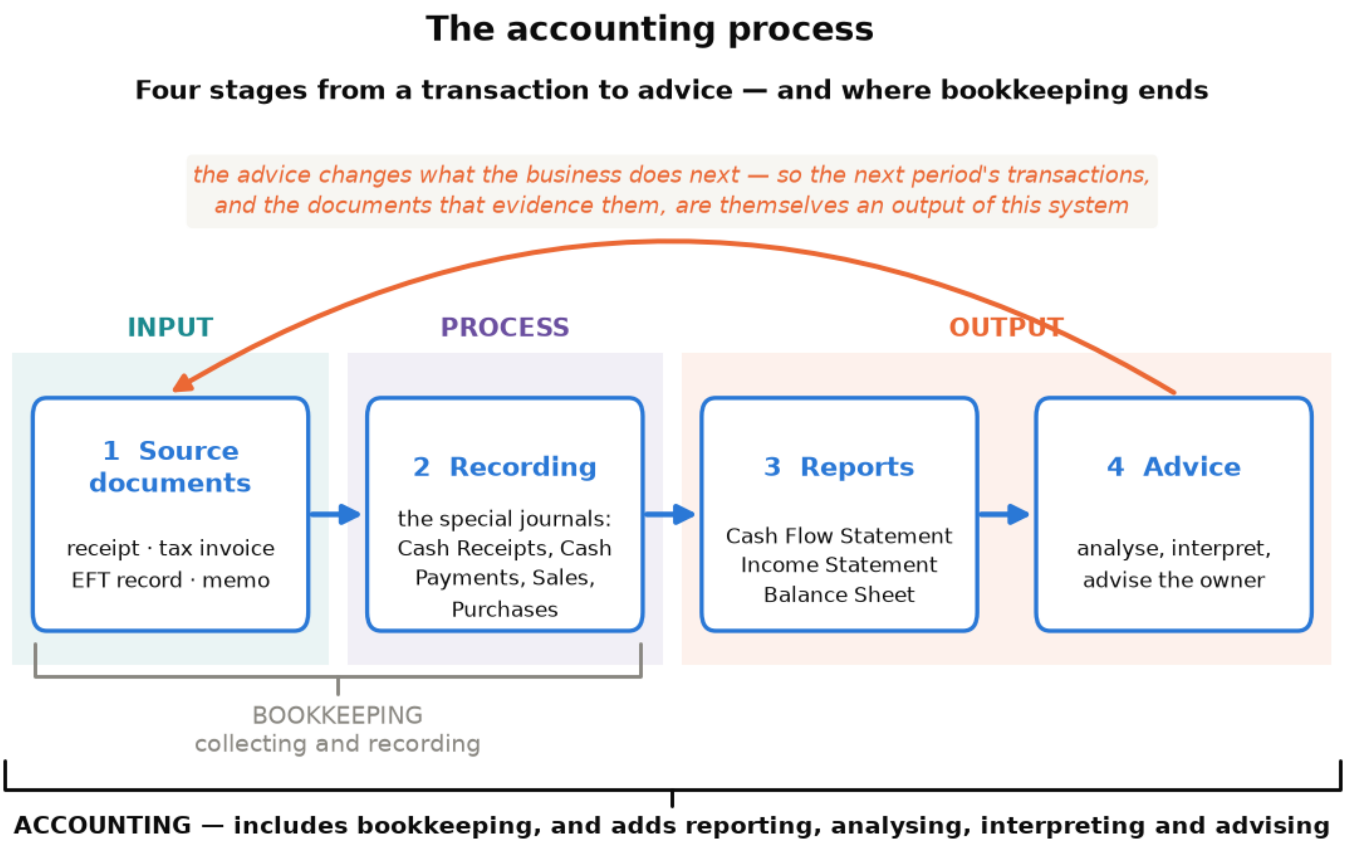
These four stages map onto the fuller description of accounting as **collecting, recording, reporting, analysing and interpreting** data and providing **advice** — the "collecting" happens through source documents, and "analysing, interpreting and advising" together make up the advice stage.

Bookkeeping versus accounting. These terms are often used loosely, but they are not the same:

- **Bookkeeping** is the **recording** part of the process — the accurate **collecting and recording** of financial data from source documents into the business's journals and records. It is largely **mechanical and procedural**: the same rules are applied to every transaction.
- **Accounting** is the **broader** process. It **includes** bookkeeping but goes further, adding the **reporting**, **analysing and interpreting**, and **advising** stages. Accounting requires **professional judgement** — deciding how to classify an item, what a report reveals, and what the owner should do about it.

Put simply, a **bookkeeper records** the data, whereas an **accountant** uses that data to **produce information and give advice**. All bookkeeping is part of accounting, but not all accounting is bookkeeping. Because the recording stage feeds every later stage, accurate bookkeeping is essential — poor records make good accounting impossible.

The figure below sets the three structures of this section side by side: the **four stages** in order, the **input–process–output** system they make up (source documents are the input, recording is the process, and the reports *and* the advice are the output), and the point at which **bookkeeping** ends and the rest of **accounting** begins.



The accounting process — four stages from a transaction to advice, and where bookkeeping ends

Notice that the bookkeeping span sits *inside* the accounting span: bookkeeping is not a rival to accounting but the first part of it. Notice too the arrow returning from **Advice** to **Source documents** — the advice given at the end of one period changes what the business does in the next, so the transactions (and the documents evidencing them) that begin the next cycle are themselves a product of this system. That loop is what makes accounting an **information system** rather than a one-way chain.

The role of professionals. Owners rarely hold all this expertise themselves. **Accountants**, **business advisors** and **professional organisations** provide advice that helps a business succeed: interpreting the reports, meeting tax and reporting obligations, and recommending improvements. This advisory role is the reason accounting is described as playing a central role in the **management** of a business, not merely in its record-keeping.

Ethical considerations. Because so many decisions rest on the reports, accounting information must be **honest and complete**. Under the qualitative characteristic of **faithful representation**, the reports must present the business's transactions **completely**, **neutrally** and **without bias**; under **relevance**, they must include everything that could affect a user's decision. An owner who leaves cash fees out of the records, or who inflates profit to impress a lender, is not merely "bending the rules" — they are producing information that **misleads** the very users who rely on it. A bank that lends against an overstated profit, a buyer who pays too much for a business, or the ATO that receives too little tax are all harmed by dishonest reporting, and understating income to reduce tax is also **illegal**. Ethical accounting means giving **every** user — internal and external — information that is truthful and complete, even when an honest figure is less flattering than the owner would like. This is the foundation on which the usefulness of all accounting information rests.

Worked examples (scaffolded)

Example 1 — identifying users and their decisions (model response with marking logic)

Kerbside Mobile Detailing (owner J Okafor) is a sole-proprietor service business. Identify **three** users of Kerbside's accounting information — one internal and two external — and for each state **one** decision the information helps them make.

Working	Comment
The owner, J Okafor — an internal user. Decision: whether to raise the price of a detailing job, or hire a casual to cope with demand.	Award 1 mark for correctly classifying the owner as the *internal* user; 1 mark for an **operational** decision that genuinely uses report information (pricing, staffing, spending).
The bank / lender — an external user. Decision: whether to approve a $15 000 equipment loan, and on what terms.	The lender uses the reports to judge the business's ability to **repay**. Award the mark for a lending/credit decision — not a vague "to see how it is going".
A supplier offering credit — an external user. Decision: whether to supply cleaning materials on 30-day credit terms.	Any valid external user (supplier, the ATO, a prospective buyer) with a decision that depends on the reports earns the mark; do **not** award two marks for the same user named twice.

∴ Kerbside's information serves one internal user (the owner) and several external users, each making a different decision from the same reports.

Example 2 — describing the accounting process (model response with marking logic)

Describe the **four stages** of the accounting process, from the source document to advice, using the service business *Greenline Lawn Care* to illustrate each stage.

Working	Comment
1. Source documents. Each transaction — a mowing fee received, a fuel purchase — generates a source document (a **receipt**, an **EFT record**, a **tax invoice**) that provides the financial **data** and the **evidence** the transaction occurred.	Award the mark for naming the stage **and** its role (data + evidence). A bare "source documents" with no description earns nothing.
2. Recording. The data on the source documents is entered into Greenline's **records** — in Units 1 & 2, the **special journals** (the Cash Receipts and Cash Payments Journals).	The recording stage turns evidence into an ordered record; look for "entered/recorded into the journals".
3. Reports. The recorded data is **summarised** into the accounting reports — the **Cash Flow Statement**, **Income Statement** and **Balance Sheet**.	Name at least one report. The mark is for **summarising** recorded data into a report, not for repeating "recording".
4. Advice. The reports are **analysed and interpreted**, and **advice** is given to the owner to inform a decision — e.g. whether Greenline made a profit and can afford a second mower.	The final stage adds **meaning** (analysis + advice for a decision). A response that stops at "reports" has not described the whole process.

∴ the process runs **source documents → recording → reports → advice**, and only the last stage makes the data genuinely useful.

Worked examples (unscaffolded)

Example 3 — distinguishing bookkeeping and accounting

Distinguish between **bookkeeping** and **accounting**, and state which of the two requires more professional judgement.

Bookkeeping is the **recording** part of the accounting process: the accurate collecting and recording of financial data from source documents into the business's journals. It is largely mechanical, applying the same rules to every transaction. **Accounting** is the **broader** process that **includes** bookkeeping but also **reports** the data, **analyses and interprets** it, and **advises** the owner. A bookkeeper *records* the data; an accountant uses it to *produce information and give advice*. Because classifying items, reading the reports and recommending action all call for interpretation, **accounting** requires the greater professional judgement.

∴ all bookkeeping is part of accounting, but accounting adds reporting, interpretation and advice, and so demands more judgement.

Example 4 — why a business needs accounting

Tidewater Kayak Tours (a sole-proprietor service business) has never kept proper records; the owner "keeps it all in her head". Explain why the business needs accounting, with reference to **one** decision it would help the owner make.

A business needs accounting because it is the **information system** that turns the raw **data** of its transactions into **information** the owner can act on. Without records, Tidewater cannot reliably know whether it earned a **profit**, how much **cash** it holds, or whether it owes more than it owns. Suppose the owner must decide whether to buy a second set of kayaks. That decision needs information the owner cannot hold "in her head": the profit earned last season (from the **Income Statement**), the cash available (from the **Cash Flow Statement**) and what the business already owes (from the **Balance Sheet**). Accounting collects, records and reports that data so the owner can decide on the basis of **evidence** rather than guesswork — and can later judge whether the decision succeeded.

∴ Tidewater needs accounting to convert its transaction data into information, so that decisions such as expanding the fleet are made on evidence rather than memory.

Practice questions — scaffolded

Question 1

a. Define the term **accounting**.

b. State the **purpose** of accounting in a business (why a business keeps accounting records).

c. Identify the stage of the accounting process at which financial data **first enters** the system.

Question 2

Harbourview Physiotherapy is a sole-proprietor service business.

a. Distinguish between an **internal** user and an **external** user of accounting information.

b. Identify **one** external user of Harbourview's accounting information and state **one** decision that user makes using it.

c. Explain why the **owner** typically needs accounting information more frequently than an external user does.

Question 3

a. List, in order, the **four stages** of the accounting process, from source document to advice.

b. Describe the role of a **source document** in the accounting process.

c. Identify which stage of the process turns recorded data into the **Income Statement**, **Cash Flow Statement** and **Balance Sheet**.

Question 4

a. Define **bookkeeping**.

b. Explain **one** way in which **accounting** is broader than bookkeeping.

c. Identify which stage(s) of the accounting process a **bookkeeper** performs.

Question 5

For each of the following activities in *Cornerstone Tutoring*, identify the stage of the accounting process it belongs to (**source documents**, **recording**, **reports** or **advice**):

a. issuing **Receipt 88** for a $120 tutoring fee;

b. entering that fee in the **Cash Receipts Journal**;

c. preparing the **Income Statement** for the month;

d. recommending to the owner that fees be raised because the profit margin is thin.

Question 6

a. Distinguish between financial **data** and accounting **information**.

b. Explain how accounting acts as an **information system** (input → process → output).

c. State **one** decision the owner of a service business could make using the **Income Statement**.

Practice questions — unscaffolded

Question 7

Ridgeway Mobile Mechanics keeps every receipt and tax invoice in a shoebox, but has never entered any of them in a journal or prepared a report. Using the **input → process → output** description of an information system, explain why the owner still has **no accounting information**, and state **one operational** and **one investment** decision the owner is currently unable to make well.

Question 8

Distinguish between financial **data** and accounting **information**, using an original example of each.

Question 9

Explain why the four stages of the accounting process must be carried out **in order**, and describe what goes wrong if a business tries to prepare its **reports** without completing the earlier stages.

Question 10

Corvina Print Studio employs a **bookkeeper** and also engages an **accountant**. Explain why the business needs **both**, and identify **one** task performed by the accountant that requires **professional judgement**.

Question 11

A **supplier** deciding whether to offer *Fairlight Signage* 30-day credit and a **prospective purchaser** deciding whether to buy the business both read the same set of reports. Explain why the two users are looking for **different** information, and explain why the **owner** has access to information that neither of them sees.

Question 12

A bank is deciding whether to lend $20 000 to a sole-proprietor service business. Explain how the business's accounting reports help the bank make this decision, and identify the **stage** of the accounting process that produces those reports.

Question 13

Explain the role of **source documents** in the accounting process, and describe **one** consequence for the reports if a source document is lost or is never created.

Question 14

Northbridge Bookkeeping Services records its clients' transactions accurately but does not report, analyse or advise on them. Explain whether Northbridge is performing **bookkeeping**, **accounting**, or both, justifying your answer.

Question 15

Distinguish between the **recording** stage and the **reporting** stage of the accounting process.

Question 16

Explain why **advice** is described as the stage of the accounting process that adds the most value for the business owner.

Question 17

The owner of a service business asks their bookkeeper to leave a $3 000 cash fee out of the records so the business appears less profitable to the ATO. **Discuss** this request with reference to the need for accounting information to be **honest and complete**, and identify **one** user who would be misled and how.

Question 18

When applying for a loan, a business owner is tempted to give the bank an Income Statement that **overstates** the business's profit. **Discuss** the ethical considerations involved, and explain the financial implications for the business if its reports do not present honest, complete information to users.

Answers

1.
    a. See solutions b. See solutions c. The **source document** stage
2.
    a. See solutions b. See solutions (e.g. a bank — whether to lend) c. See solutions
3.
    a. Source documents → recording → reports → advice b. See solutions c. The **reports** (reporting) stage
4.
    a. See solutions b. See solutions c. The **source document** and **recording** stages
5.
    a. Source documents b. Recording c. Reports d. Advice
6.
    a. See solutions b. See solutions c. See solutions (e.g. whether to change prices, given the profit)
7. See solutions (the data is never processed, so the system produces no output)
8. See solutions
9. See solutions (each stage supplies the raw material for the next)
10. See solutions (**both** — recording, and reporting/analysis/advice)
11. See solutions (different decisions need different information; the owner sees everything)
12. Reports help the bank judge the ability to repay; produced at the **reports** (reporting) stage
13. See solutions
14. **Bookkeeping** only (see solutions)
15. See solutions
16. See solutions
17. See solutions
18. See solutions

Fully-worked solutions

Question 1

a. **Accounting** is the process of **collecting, recording, reporting, analysing and interpreting** financial (and non-financial) data, and using it to provide **advice** to the owner and other stakeholders so they can make informed decisions.

b. The purpose of accounting is to turn the raw **data** of a business's transactions into **information for decision-making** — it lets the owner and other users judge the business's performance and position and decide what to do next.

c. Financial data first enters the system at the **source document** stage (the receipt, invoice or EFT record that captures and evidences each transaction).

Question 2

a. An **internal user** works inside the business — for a sole proprietor, the **owner/manager**, who uses the information to run the business day to day. An **external user** is outside the business — a bank, supplier, the ATO or a prospective buyer — who has an interest in the business but usually sees only the reports provided to them.

b. Any **one** external user with a matching decision, e.g. a **bank**: whether to lend to Harbourview and on what terms (judging its ability to repay); or a **supplier**: whether to offer materials on credit; or the **ATO**: whether the correct GST and income tax have been reported.

c. The **owner** manages the business continuously — pricing treatments, controlling spending, planning cash — so needs up-to-date information **frequently** (weekly or monthly). An external user such as a bank generally needs the reports only occasionally, e.g. when a loan is being considered.

Question 3

a. **Source documents → recording → reports → advice.**

b. A **source document** (receipt, tax invoice, EFT record, memo) provides the financial **data** for a transaction **and** the **evidence** that the transaction occurred. It is the **input** to the accounting system; without it a transaction cannot be recorded reliably or verified later.

c. The **reports** (reporting) stage — the recorded data is summarised into the Income Statement, Cash Flow Statement and Balance Sheet.

Question 4

a. **Bookkeeping** is the accurate **collecting and recording** of financial data from source documents into the business's journals and records — the recording part of the accounting process.

b. Accounting is broader in any **one** of these ways: it **reports** the recorded data into financial statements; it **analyses and interprets** those reports; and it **advises** the owner on decisions — none of which is part of bookkeeping. Accounting also requires **professional judgement**, whereas bookkeeping is largely mechanical.

c. A bookkeeper performs the **source document** (collecting) and **recording** stages — capturing and recording the data. Reporting, analysis and advice belong to the accountant.

Question 5

a. **Source documents** — issuing Receipt 88 creates the source document for the fee.

b. **Recording** — entering the fee in the Cash Receipts Journal records the data.

c. **Reports** — preparing the Income Statement summarises the recorded data into a report.

d. **Advice** — recommending a price rise is analysing the report and advising the owner.

Question 6

a. **Financial data** is the raw, unprocessed facts about individual transactions (e.g. "received $220 on 3 March"). **Accounting information** is data that has been recorded, classified, summarised and reported so that it is **useful** for a decision (e.g. "the business made a $2 000 loss this quarter").

b. Accounting is an **information system**: the **inputs** are the financial data on source documents; the **process** is recording, classifying and summarising that data; and the **outputs** are the accounting reports (and the advice drawn from them), which feed back into the next round of decisions.

c. Any reasonable decision informed by profit, e.g. whether to **raise or lower prices**, whether to **cut a rising expense**, or whether the business can afford to **expand** — each uses the profit figure from the Income Statement.

Question 7

Ridgeway has the **input** to the information system and nothing else. The receipts and tax invoices in the shoebox are financial **data** — raw, unprocessed facts about individual transactions, each of which records what happened once. Because that data is never put through the **process** — recording, classifying and summarising — the system generates no **output**: no Cash Flow Statement, Income Statement or Balance Sheet, and no advice drawn from them. Data becomes **information** only once it has been processed into a form that carries meaning for a decision, so the shoebox leaves the owner able to see individual transactions but unable to see the business as a whole.

Neither kind of decision can therefore be made well:

- an **operational** decision — for example, whether the hourly service rate still covers Ridgeway's rising parts and fuel costs — because no summary of revenue against expenses has ever been prepared;
- an **investment** decision — for example, whether to fit out and staff a second van — because the owner cannot show what profit the business earns, what cash it generates or what it already owes.

Until the data is processed, Ridgeway is deciding on impression rather than evidence, and could be busy every day while steadily making a loss.

Question 8

Financial data is the raw, unprocessed fact about a single transaction — for example, "*Riverstone Cleaning* received $330 on 6 April". By itself it carries little meaning. **Accounting information** is that data once it has been recorded, classified, summarised and reported into a form that is useful for a decision — for example, "*Riverstone Cleaning* earned $9 400 in fees but incurred $10 100 in expenses in April, so it made a $700 loss". The information has meaning and a decision (such as reviewing prices) can be based on it, whereas the isolated $330 figure cannot support such a judgement.

Question 9

Each stage produces the raw material that the next stage works on, so the order **source documents → recording → reports → advice** is not merely a convention. The **source documents** must come first, because they supply both the data and the evidence that a transaction occurred; the **recording** stage can only enter data that has been captured on a document. **Reports** can only summarise what has already been recorded, and **advice** can only interpret a report that has already been prepared. Removing or re-ordering a stage breaks that chain, because a stage cannot work on material that does not yet exist.

A business that jumps straight to the reports is therefore summarising figures that were never captured or verified. Transactions with no source document behind them are either **omitted** altogether or written in from memory at the wrong amount, so the reports are **incomplete and inaccurate** and no figure in them can be checked back to evidence. An Income Statement built this way may show a profit the business never earned. The advice stage is then corrupted as well: interpreting an unreliable report can only produce unreliable recommendations, and the owner, the bank and the ATO would each act on information that does not represent the business truthfully.

Question 10

The two roles cover different stages of the same process, and Corvina needs both because neither is complete on its own.

The **bookkeeper** carries out the **collecting and recording** stages: capturing the data from Corvina's source documents and entering it accurately in the special journals. This work is largely **procedural** — the same rules are applied to every transaction — but it is indispensable, because every later stage draws on the recorded data, and inaccurate records make reliable reports impossible.

The **accountant** carries out the stages bookkeeping does not reach: **reporting** the recorded data, **analysing and interpreting** those reports, and **advising** the owner. Recording alone produces no information the owner can act on; equally, reports and advice are worthless if the records beneath them are wrong. The two roles are complementary rather than alternatives.

A task requiring **professional judgement**: deciding how an item should be **classified** in the reports — for example, whether the money spent on a new printing press is an **expense** of this period or the purchase of an **asset** the studio will use for years. The rule does not apply itself; the accountant must judge the nature of the item, and the profit reported depends on that judgement. (Interpreting *why* profit has fallen, or recommending a change to Corvina's pricing, are equally acceptable examples.)

Question 11

Both are **external users**, but they are making different decisions, so they value different information from the same reports.

- The **supplier** is deciding whether Fairlight will **pay its account on time** — a short-term question about the next 30 days. It looks for evidence that the business holds enough **cash**, and generates enough cash from its operations, to settle the account when it falls due (the **Cash Flow Statement**), and for how much the business already **owes** others (the **Balance Sheet**).
- The **prospective purchaser** is deciding whether the business is **worth buying** — a long-term question about future returns. It looks at the **profit** Fairlight earns and whether that profit is rising or falling over several periods (the **Income Statement**), and at the **assets** it would acquire and the **liabilities** that would come with them (the **Balance Sheet**).

The **owner** is an **internal user** and also the manager, so has access to everything the accounting system holds — every source document, every journal entry and every report — at any time. External users have no such right of access: they see only the reports the owner (or the law) provides to them, usually after the end of a period and usually only when a decision such as granting credit or buying the business is actually being made.

Question 12

The bank uses the business's **accounting reports** to judge whether it can **repay** the $20 000. The **Income Statement** shows whether the business earns a profit (a source of repayments); the **Cash Flow Statement** shows whether it generates enough cash to meet loan instalments; and the **Balance Sheet** shows what the business already owns and owes, indicating how much it has already borrowed and what security exists. Together these let the bank assess the **risk** of lending and set the terms. The reports are produced at the **reports (reporting)** stage of the accounting process, after the data has been recorded.

Question 13

Source documents (receipts, tax invoices, EFT records, memos) provide the **financial data** for each transaction **and** the **evidence** that it occurred; they are the **input** that begins the accounting process and the proof that later allows a figure to be **verified**. If a source document is **lost or never created**, the transaction may be **omitted** from the records or recorded at the wrong amount. The reports would then be **incomplete or inaccurate** — for example, a fee left unrecorded understates revenue and profit in the Income Statement and cash in the Cash Flow Statement — and any user relying on those reports would be misled.

Question 14

Northbridge is performing **bookkeeping** only. Bookkeeping is the **recording** stage — accurately capturing and recording financial data from source documents. Because Northbridge **records** transactions but does **not report, analyse or advise**, it is not carrying out the later stages that make up the full **accounting** process. Accounting would require it to summarise the data into reports, interpret them and provide advice; performing only the recording means the work is bookkeeping, a part of accounting but not the whole of it.

Question 15

The **recording** stage **enters** the financial data from source documents into the business's records (the special journals), transaction by transaction, as they occur throughout the period. The **reporting** stage comes later: it **summarises** the recorded data into the **accounting reports** — the Cash Flow Statement, Income Statement and Balance Sheet — at the end of the period. Recording deals with **individual transactions as inputs**; reporting **condenses many recorded transactions into the outputs** a user reads. Recording must be complete and accurate before reporting can be reliable.

Question 16

Advice adds the most value because it is the stage at which data finally becomes **useful for a decision**. Source documents, recording and even the reports only **assemble and present** the information; on their own they change no decision. In the advice stage the reports are **analysed and interpreted**, and the owner is told **what the numbers mean and what to do** — for example, that profit fell because an expense rose, so prices should be reviewed. A report that is never interpreted or acted upon leaves the business no better off, so it is the advice — the analysis, interpretation and recommendation — that turns accounting into a tool for **improving performance**.

Question 17

Leaving a $3 000 cash fee out of the records is **unethical** and **illegal**. Accounting information must be **honest and complete**: under **faithful representation** the reports must record every transaction **completely** and **without bias**, and under **relevance** they must include everything that affects a user's decision. Omitting the fee deliberately understates revenue and profit, so the reports no longer represent the business truthfully. The **ATO** would be **misled** — it would receive an Income Statement showing less profit than was really earned, and so would collect **too little tax**, which is tax evasion and against the law. Other users are harmed too: a **bank** or **prospective buyer** relying on the understated profit would misjudge the business. A bookkeeper asked to do this should **refuse**, because producing false information breaches the professional duty to report honestly and completely.

Question 18

Overstating profit to obtain a loan is a serious **ethical** breach. Reports must be a **faithful representation** of the business — complete, neutral and free from bias — and inflating profit makes them **biased and misleading**. The **bank** (an external user) would decide whether to lend, and on what terms, using information that is **not true**, so its decision would be based on a false picture of the business's performance. The **financial implications** are serious: the business may take on a loan it **cannot actually afford to repay** from its real (lower) profit and cash, risking **default**, penalty interest and possible loss of assets used as security; and if the bank later discovers the overstatement, the business may lose the loan, its **reputation** and the bank's trust, and the owner may face **legal consequences**. Honest, complete reporting protects both the users who rely on the reports and the business itself.

Chapter 1 The nature and role of accounting — 1B Accounting assumptions and qualitative characteristics

Theory

Accounting is an **information system**: it collects financial data about a business and reports it as information that owners, lenders and other users rely on to make decisions. For that information to be trustworthy and comparable from one business to the next, every accountant works to the same foundations. The VCE Accounting Study Design (2025–2029) sets out two of these foundations — the four **accounting assumptions**, which are the ground rules about *how* data is recorded and reported, and the six **qualitative characteristics**, which are the qualities that make the reported information *useful*. **Explain and apply relevant qualitative characteristics and accounting assumptions** is a key skill of Unit 1 Area of Study 2 and of all three Areas of Study in Unit 2, and both units direct that the Conceptual Framework be applied wherever it is relevant to the accounting procedures being developed. So you must be able to define each one, recognise which is at work in a given situation, and justify a recording or reporting decision by naming the assumption or characteristic that supports it.

The four accounting assumptions

An **accounting assumption** is a rule that the accountant assumes to be true whenever financial data is recorded or reported. There are exactly **four**.

1. The accounting entity assumption. Under the **accounting entity** assumption, the records of the assets, liabilities and activities of the business are kept **completely separate** from those of the owner, and from those of any other entity. A separate set of accounting records is kept for each entity, and every report describes that one entity only. For a sole proprietor this is the single most important starting point: the business and its owner are one and the same person in law, but in accounting they are treated as **two separate entities**. If the owner of *Meridian Tutoring* uses the business bank account to pay the $210 registration on her private car, the payment is **not** a business expense — it is recorded as **Drawings**, a withdrawal of business resources by the owner for private use. The assumption is what makes the accounts **Capital** and **Drawings** necessary in the first place.

2. The accrual basis assumption. Under the **accrual basis** assumption, **revenue is recognised when it is earned** (when the expected inflow of economic benefits can be measured in a faithful and verifiable way), and **expenses are recognised when they are incurred** (when the consumption of goods or services can be measured) — regardless of when the cash is received or paid. Accrual-basis **profit** for a period is revenue earned for the period minus expenses incurred for the same period. If a plumber completes a $1 800 job on 27 June but the customer does not pay until 12 July, the $1 800 is revenue of the period in which the work was **done** (June), not the period in which the cash **arrives** (July). This is the key difference between accrual accounting and simple cash accounting.

3. The going concern assumption. Under the **going concern** assumption, reports are prepared on the basis that the business will **continue to operate into the future** and will not be wound up in the near future. Because the business is assumed to keep trading, it can report resources it will use over many future periods — such as equipment or a vehicle — as **non-current assets** at cost less accumulated depreciation, spreading the cost across the years that will benefit, rather than valuing everything at the amount it would fetch in an immediate forced sale today.

4. The period assumption. Under the **period** assumption, the continuous life of the business is divided into **periods of time** — a month, a quarter or a year — so that reports can be prepared for each period and results compared. Profit is determined by recognising the revenue earned for a period and deducting the expenses incurred in that **same** period. The period assumption is what lets a going concern with an indefinite life produce an Income Statement "for the year ended 30 June", and it is the reason a business must distinguish an **asset** (which will benefit future periods) from an **expense** (which is consumed within the current period).

The six qualitative characteristics

A **qualitative characteristic** is a quality that financial information must have to be useful to the people who make decisions with it. The IASB Conceptual Framework — the source the Study Design draws on — sets out **six**. Two are **fundamental** (information must have both to be useful at all) and four are **enhancing** (they increase the usefulness of information that is already relevant and faithfully represented).

Fundamental characteristics.

1. Relevance. Information is **relevant** if it directly assists a user in making a decision. Relevant information helps a user **predict** future outcomes (predictive value) or **confirm or change** an earlier evaluation through feedback (confirming value). Reporting the profit a service business earned this year is relevant because it helps the owner predict next year's result and confirm whether last year's plan worked.

2. Faithful representation. Information is a **faithful representation** when it depicts the real economic event as it actually is. To be a faithful representation, information must be **complete** (it leaves nothing out that a user needs), **free from material error**, and **neutral** — presented without bias, so it neither overstates nor understates to make the business look better or worse than it is.

Enhancing characteristics.

3. Comparability. Comparability enables a user to identify and understand the **similarities and differences** between items. Information is more useful if it can be compared with similar information about other entities, and with the same entity across different periods. Comparability is supported by applying the **same accounting methods and classifications** from one period to the next.

4. Verifiability. Verifiability means that different **knowledgeable and independent observers** could examine the same information and reach a **consensus** that it is a faithful representation. Verifiability is maintained by **retaining the source documents** used to record each transaction and is checked through **auditing**. Its purpose is to hold the accounting professional **accountable** for their work.

5. Timeliness. Timeliness means information is available to decision-makers **in time to influence** their decisions. Information provided sooner is generally more useful; the older the information, the less useful it becomes, and information that arrives too late to act on has lost its usefulness.

6. Understandability. Understandability requires information to be **comprehensible** to a user with a reasonable knowledge of business and economic activities. To be understandable, information must be presented **clearly and concisely** — well classified, plainly labelled and free of unnecessary jargon.

How the assumptions and characteristics connect

The foundations reinforce one another, and questions often reward you for showing the link:

- **Verifiability supports faithful representation.** Because independent observers can trace a figure back to a source document and agree on it, users can trust it is faithfully represented — which is why the accrual basis itself requires revenue to be measured in a "faithful and verifiable" way.
- **Timeliness supports relevance.** Information that is relevant loses its usefulness if it is delivered too late to act on, so timely reporting protects relevance.
- **The period assumption supports comparability.** Dividing the continuous life of a going concern into equal periods is exactly what allows results to be compared period-to-period.
- **The accounting entity assumption supports faithful representation.** Keeping the owner's private transactions out of the accounts is what makes the reported profit and position of the *business* a complete and neutral picture of the business alone.

Ethical considerations. The qualitative characteristics are not only technical requirements — they express the **ethical obligations** of anyone who prepares financial reports. **Neutrality** (part of faithful representation) means the accountant must resist any pressure to bias the figures, and **completeness** means genuine losses or liabilities cannot be quietly omitted to flatter a result. **Verifiability** exists precisely to hold the professional **accountable**: because an independent observer can check the work against source documents and through auditing, deliberately misstating or concealing information is likely to be detected and exposes the preparer to professional and legal consequences. Acting ethically therefore means recording the owner's private dealings as Drawings (the entity assumption), reporting bad news as faithfully as good news, and giving users — including a bank deciding on a loan — a clear, complete and neutral picture on which to base their decision. A report that is technically arranged but deliberately misleading fails the very characteristics it claims to satisfy.

Worked model. *Brightpath Consulting* (a sole-proprietor service business) is preparing its 30 June reports. The owner has (i) paid a $600 personal gym membership from the business bank account, and (ii) asked that a $1 200 electricity bill received on 28 June — but not yet paid — be left out "because no cash has moved". The **accounting entity**

assumption says the gym membership is **Drawings**, not a business expense. The **accrual basis** assumption says the $1 200 electricity is an **expense of the year ended 30 June**, because it has been *incurred* (consumed) even though it is unpaid; omitting it would also breach **faithful representation** by understating expenses and overstating profit.

Worked examples (scaffolded)

Example 1 — identify and apply the accounting entity assumption

Harbourline Physiotherapy is a service business owned by Dev, a sole proprietor. During June, Dev withdrew $500 cash from the business bank account to pay his children's school fees, and recorded it as a "Wages" expense of the business. Explain why this treatment is incorrect and state how it should be recorded.

Working	Comment
Name the assumption: the **accounting entity** assumption keeps the records of the business separate from those of its owner.	An "identify" step. Always name the specific assumption before applying it.
Apply it to the facts: paying school fees benefits **Dev personally**, not Harbourline Physiotherapy, so it is not a cost incurred in earning the business's revenue and is **not a business expense**.	Link the rule to the actual transaction — this is what "apply" asks for.
State the correct treatment: the $500 is recorded as **Drawings** — a withdrawal of business resources by the owner for private use.	Drawings reduces Capital (owner's equity), not profit.
State the effect of the error: recording it as Wages **overstates expenses and understates profit**. **Total** owner's equity is **unchanged** — it falls $500 either way — but **Drawings is understated**, so the equity section is misclassified.	Showing the consequence earns the explanation mark. Do **not** claim total equity is misstated: an expense and drawings reduce it by the same $500, so only the composition is wrong.

∴ under the accounting entity assumption the $500 is **Drawings, not Wages**.

Example 2 — distinguish two easily-confused characteristics (relevance vs faithful representation)

The owner of *Kestrel Design* (a service business) wants to record the business's delivery van in the Balance Sheet at $52 000, the amount a salesperson claims it "could fetch", even though the van cost $45 000 and there is no independent evidence supporting $52 000. Distinguish **relevance** from **faithful representation**, and identify which characteristic this proposal most threatens.

Working	Comment
Define relevance: information that directly assists the user to make a decision — with predictive and/or confirming value.	Both fundamental characteristics must be defined before you can distinguish them.
Define faithful representation: information that depicts the real event completely, free from material error, and neutrally (without bias).	Use the three SD criteria — complete, free from material error, neutral.
Distinguish them: relevance is about *whether the information matters* to a decision; faithful representation is about *whether the depiction is accurate and unbiased*.	The distinction is the heart of the answer.
Apply to the facts: a current value may be *relevant*, but $52 000 has **no verifiable evidence**, so recording it is **not free from material error and not neutral** (it overstates the asset).	Connect the rule to the proposal.
Identify the threatened characteristic: faithful representation.	The specific answer the command term requires.

∴ the $52 000 valuation most threatens **faithful representation**; the van should be reported at its cost of $45 000 (less any depreciation).

Worked examples (unscaffolded)

Example 3 — apply the going concern assumption

Ferngully Landscaping owns a ride-on mower that cost $18 000. At balance day the owner asks why the mower is reported at cost less accumulated depreciation rather than at the $6 000 it would raise in an immediate clearing sale. Explain, with reference to an accounting assumption.

Under the **going concern** assumption, reports are prepared on the basis that the business will **continue to operate into the future** rather than be wound up. Because Ferngully Landscaping is assumed to keep trading, the mower will be **used to earn revenue over several future periods**, so its cost is carried forward as a **non-current asset** and allocated across those periods as depreciation. The $6 000 forced-sale figure would only be appropriate if the business were about to close — which the going concern assumption specifically assumes is **not** the case. ∴ the mower is reported at cost less accumulated depreciation, not at its forced-sale value.

Example 4 — identify a characteristic and explain its purpose (verifiability)

An independent auditor examines the reports of *Quill & Co Bookkeeping* and is able to trace every figure back to a source document — receipts, invoices and bank records — and reach the **same** totals the bookkeeper reached. Identify the qualitative characteristic being demonstrated and explain its purpose.

The characteristic is **verifiability**: different **knowledgeable and independent observers** (here, the auditor and the bookkeeper) reach a **consensus** that the figures are a faithful representation, and they can do so because the **source documents** have been retained. Its purpose is to hold the accounting professional **accountable** for their work and to give users confidence that the information can be trusted. ∴ retaining source documents and enabling an audit is what makes the reports verifiable.

Practice questions — scaffolded

Question 1

Meridian Tutoring is a sole-proprietor service business owned by Anaya. During July, Anaya paid the $210 registration on her private car using the business bank account.

a. Define the **accounting entity** assumption.
b. Identify the accounting assumption Anaya's treatment breaches if the $210 is recorded as a business expense.
c. Explain how the $210 payment should be treated in the records of Meridian Tutoring.

Question 2

Colt & Vale Plumbing (a service business, sole proprietor, reporting for the year ended 30 June) completed a $1 800 job on 27 June. The customer paid on 12 July.

a. Define the **accrual basis** assumption.
b. State the reporting period in which the $1 800 revenue should be recognised, and justify your answer.
c. Distinguish the accrual basis of recognising revenue from cash-based recognition in one sentence.

Question 3

a. Define the **going concern** assumption.
b. Define the **period** assumption.
c. Explain how the going concern and period assumptions work together to allow a business to report its profit.

Question 4

Alder & Fig Catering is preparing its Balance Sheet as at 30 June. The business still owes $8 400 to the bank on the loan it took out when it started trading, but the owner wants the loan left out of the report because "it doesn't change what the business owns".

a. Define **relevance**.
b. Define **faithful representation**.
c. Identify which qualitative characteristic leaving the $8 400 loan out of the Balance Sheet would most threaten, and explain your choice.

Question 5

a. Define **comparability**.
b. Each year *Harbourline Physiotherapy* classifies its expenses in a different way, so its Income Statements cannot be lined up from one year to the next. Identify the qualitative characteristic this practice undermines.
c. Explain how retaining source documents supports the qualitative characteristic of **verifiability**.

Question 6

a. Define **timeliness**.
b. Define **understandability**.
c. *Northwind Web Studio* gives its owner an Income Statement eight months after the year has ended, written in dense technical jargon. Identify the **two** qualitative characteristics this report fails to satisfy.

Practice questions — unscaffolded

Question 7

Explain the **accounting entity** assumption, and using an original example of a service business, describe one specific transaction it affects and how that transaction is treated.

Question 8

The owner of *Ferngully Landscaping* personally owns a yacht worth $120 000. Identify the accounting assumption that explains why the yacht is **not** recorded as an asset of Ferngully Landscaping, and justify your answer.

Question 9

Sela's Hair Studio (a service business, sole proprietor, reporting monthly) provides $640 of hairdressing services on 29 May, but the client pays on 3 June. With reference to the **accrual basis** assumption, explain the month in which the $640 revenue is recognised, and contrast this with when the cash is received.

Question 10

Grangeford Mowing reports its trailer as a **non-current asset**, and a $30 000 bank loan that is not repayable for another four years as a **non-current liability**. Explain how the **going concern** assumption makes both of these classifications possible.

Question 11

Explain the **period** assumption, and explain how it supports the qualitative characteristic of **comparability**.

Question 12

Distinguish between **relevance** and **faithful representation**, and explain why an accountant sometimes has to weigh the two against each other.

Question 13

The owner of *Ironbark Mobile Mechanics* pays cash for small parts and supplies and throws the receipts away, saying "I know what I spent." At year-end the accountant can find no documentation at all for several of the expense figures.

Identify the qualitative characteristic this practice undermines, and explain the consequences for the business's reports and for the accountant.

Question 14

Quill & Co Bookkeeping produces reports for its owner every month rather than a single report once every three years. Identify the qualitative characteristic that most supports monthly reporting, and explain why.

Question 15

Two service businesses in the same industry each prepare an Income Statement for the year ended 30 June using the **same** classifications and methods. Explain how this supports **comparability**, and state one decision a user could make as a result.

Question 16

The owner of *Tan Family Cafe* has little accounting knowledge. Explain what the qualitative characteristic of **understandability** requires of the accountant preparing the cafe's reports, and give one specific way it can be achieved.

Question 17

Roverline Dog Grooming (a service business, sole proprietor, reporting for the year ended 30 June) receives an invoice on 26 June for $2 400 of advertising that ran throughout June. The invoice is not paid until 20 July, and the owner argues that the $2 400 "belongs to July, because that is when the money leaves the bank". Explain, with reference to the relevant accounting assumption(s), the reporting period in which the $2 400 must be reported as an expense.

Question 18 (ethics — discuss)

At year-end the owner of *Cedar Lane Bakery* instructs the bookkeeper to leave a $3 500 inventory loss out of the reports so that the profit "looks healthier" for a bank loan application. Discuss the bookkeeper's ethical obligations, with reference to at least one relevant qualitative characteristic and to the accountability of the accounting professional.

Answers

1.
    a. records of the business kept separate from those of the owner (and other entities) b. the accounting entity assumption c. record as **Drawings**, not an expense
2.
    a. revenue recognised when earned / expenses when incurred, regardless of cash b. year ended 30 June (revenue earned when the job was completed on 27 June) c. accrual = when earned/incurred; cash = when money is received/paid
3.
    a. the business is assumed to continue operating into the future b. the life of the business is divided into periods for reporting c. the period assumption divides the going concern's continuous, indefinite life into segments so profit can be measured and compared
4.
    a. information that directly assists a user's decision (predictive/confirming value) b. complete, free from material error and neutral c. **faithful representation** — the omission leaves the report incomplete and not neutral (liabilities understated, owner's equity overstated)
5.
    a. enables users to identify similarities and differences between items (across entities/periods)
    b. **comparability** c. source documents let independent observers confirm each figure, producing consensus and accountability
6.
    a. information available in time to influence decisions b. information comprehensible to a user with reasonable business knowledge, presented clearly and concisely c. **timeliness** and **understandability**
7. accounting entity assumption + original example (e.g. owner's private purchase → Drawings)
8. the **accounting entity** assumption — the yacht is the owner's private asset, kept separate from the business
9. recognised in **May** (earned when the service was performed on 29 May); cash received in June
10. going concern assumes continued operation, so it is meaningful to report items the business will still hold, use or owe **beyond the next 12 months** — the trailer as a non-current asset, the four-year loan as a non-current liability
11. period assumption divides the life into equal periods, which lets results be compared period-to-period (comparability)
12. relevance = does the information matter to the decision; faithful representation = is the depiction complete/error-free/neutral; the most relevant measure is not always the most faithfully representable
13. **verifiability** — with no source documents retained, independent observers cannot trace the figures and reach a consensus, the expenses cannot be audited, and the accountant cannot be held accountable for (or demonstrate) their accuracy
14. **timeliness** — monthly information reaches the owner in time to act on it
15. same methods/classifications make the two Income Statements comparable; e.g. a user could choose which business is more profitable / where to invest
16. present information clearly and concisely for a user with reasonable business knowledge; e.g. use plain labels and proper classification instead of jargon
17. **year ended 30 June** — under the **accrual basis** the advertising was consumed (incurred) in June, and the **period** assumption matches expenses incurred against the revenue earned in that same period; the 20 July payment date is irrelevant
18. record the loss; omitting it breaches **faithful representation** (not complete/neutral); the professional is held accountable through **verifiability**/auditing and must act with integrity

Fully-worked solutions

Question 1

a. Under the **accounting entity** assumption, the records of the assets, liabilities and activities of the business are kept **completely separate** from those of the owner (and of any other entity), and each report describes that one business only.

b. Recording the $210 car registration as a business expense breaches the **accounting entity assumption**.

c. The car is Anaya's **private** asset, so its registration is a personal cost, not a cost incurred in earning Meridian Tutoring's revenue. The $210 is recorded as **Drawings** — a withdrawal of business resources by the owner for private use — which reduces the owner's Capital rather than reducing profit.

Question 2

a. Under the **accrual basis** assumption, revenue is recognised when it is **earned** and expenses when they are **incurred**, regardless of when cash is received or paid; profit is revenue earned for a period less expenses incurred in the same period.

b. The $1 800 is recognised in the **year ended 30 June**. The revenue is *earned* when the plumbing job is completed (27 June), because that is when the service has been provided; the later receipt of cash on 12 July does not change the period in which the revenue was earned.

c. On the **accrual basis** revenue is recognised when the service is performed (earned), whereas on a **cash basis** it would be recognised only when the $1 800 cash is received.

Question 3

a. Under the **going concern** assumption, reports are prepared on the basis that the business will continue to operate into the future and will not be wound up in the near future.

b. Under the **period** assumption, the continuous life of the business is divided into periods of time (such as a month or a year) so that reports can be prepared and results compared for each period.

c. A going concern has an **indefinite life**, so on its own it could never produce a profit figure — profit only has meaning for a defined stretch of time. The **period** assumption solves this by slicing that continuous life into equal segments; within each segment the revenue earned and the expenses incurred are matched to determine that period's profit, and the equal segments make one period's result **comparable** with the next.

Question 4

a. **Relevance** is the quality of information that directly assists a user in making a decision, because it has **predictive value** (helps forecast future outcomes) and/or **confirming value** (confirms or changes a previous evaluation).

b. **Faithful representation** means information depicts the real economic event as it actually is — **complete**, **free from material error** and **neutral** (without bias).

c. Leaving the $8 400 loan out most threatens **faithful representation**. A Balance Sheet must depict the real economic position of the business as it actually is, which requires the information to be **complete** and **neutral**. Omitting a genuine obligation makes the report incomplete: liabilities are **understated** by $8 400 and owner's equity is **overstated** by the same amount, so Alder & Fig Catering appears stronger and less indebted than it really is. The owner's reasoning is also mistaken — a Balance Sheet reports what the business **owes** as well as what it controls. (The loan balance is highly *relevant* to a user such as a lender considering further finance, but the characteristic the omission most directly breaches is faithful representation, because the depiction of the business's position would simply not be true.)

Question 5

a. **Comparability** is the qualitative characteristic that enables a user to identify and understand the **similarities and differences** between items — comparing one entity with another, or the same entity across different periods.

b. Classifying expenses differently each year undermines **comparability**, because the Income Statements can no longer be lined up meaningfully from one year to the next.

c. **Verifiability** requires that different knowledgeable and independent observers could reach a **consensus** that a figure is faithfully represented. Retaining the **source documents** (receipts, invoices, bank records) lets any independent observer trace each figure back to its evidence and confirm it, which is how verifiability is maintained and checked through auditing — holding the preparer accountable.

Question 6

a. **Timeliness** means information is available to decision-makers **in time to influence** their decisions; the older the information, the less useful it becomes.

b. **Understandability** requires information to be **comprehensible** to a user with a reasonable knowledge of business and economic activities, by being presented **clearly and concisely**.

c. The report fails **timeliness** (delivered eight months late, too late to act on) and **understandability** (dense jargon the owner cannot readily comprehend).

Question 7

Under the **accounting entity** assumption, the business is treated as an entity **separate** from its owner, so only the assets, liabilities and transactions of the business are recorded in its accounts, and each report describes that business alone. For example, if the owner of the service business *Riverbend Consulting* uses the business bank account to buy $300 of groceries for home, the groceries are **not** a business expense: the purchase benefits the owner personally, so it is recorded as **Drawings** (a withdrawal of business resources for private use), which reduces the owner's Capital and leaves the business's reported profit unaffected.

Question 8

The relevant assumption is the **accounting entity** assumption. The yacht is the **owner's private asset**, held completely separately from the business; because the assumption requires the business's records to be kept separate from those of the owner, only assets **controlled by and used in the business** are reported as its assets. The $120 000 yacht neither belongs to nor is used by Ferngully Landscaping, so it is excluded from the business's Balance Sheet.

Question 9

Under the **accrual basis** assumption, revenue is recognised when it is **earned** — that is, when the service has been provided and the inflow of economic benefits can be measured faithfully and verifiably. Sela's Hair Studio performs the $640 of services on **29 May**, so the $640 is revenue of **May**, the month the service was earned. The cash is not received until **3 June**; under the accrual basis this later receipt does not shift the revenue into June — it merely settles the amount already earned and recognised in May. (On a cash basis the $640 would instead have been recognised in June, when the money arrived.)

Question 10

Under the **going concern** assumption, reports are prepared on the basis that the business will **continue to operate into the future** and will not be wound up in the near future. Classifying an item as **non-current** is a statement that the business will still hold, use or owe it **beyond the next twelve months**, and that statement only carries meaning if the business is assumed to still be operating beyond those twelve months. Because Grangeford Mowing is assumed to keep trading, the trailer can be reported as a resource it will **use to earn revenue over several future periods** rather than as something to be sold now, and the $30 000 loan can be shown as an obligation it will **settle in four years' time** rather than one that must be met immediately. If instead the business were about to be wound up, everything would have to be sold or settled within months, every item would effectively become **current**, and the current/non-current distinction would lose its meaning altogether.

Question 11

Under the **period** assumption, the continuous life of the business is divided into **periods of time** (such as months or years) so that reports can be prepared for each period, with the revenue earned and expenses incurred matched within that period to determine profit. This supports **comparability** because each report covers an equal, clearly defined length of time: an Income Statement for one year can be set alongside the Income Statement for the next year (or for another business's matching year) and the similarities and differences read off meaningfully. Without consistent periods there would be no common basis on which to compare results.

Question 12

Relevance is about **whether the information matters** to the decision the user is making — whether it has predictive or confirming value. **Faithful representation** is about **whether the depiction is accurate** — complete, free from material error and neutral. The two are distinct: information can be highly relevant yet impossible to depict faithfully, or perfectly faithful yet irrelevant. An accountant must sometimes weigh them because the **most relevant** measure is not always the **most faithfully representable** one — for example, the current market value of a specialised asset may be more relevant to a decision than its original cost, but if that market value cannot be measured completely, without error and without bias, then reporting the verifiable cost gives a more faithful representation. Useful information needs **both** fundamental characteristics, so the accountant chooses the measure that best serves relevance **while** still being faithfully representable.

Question 13

The practice undermines **verifiability**. Verifiability requires that different **knowledgeable and independent observers** could examine the same information and reach a **consensus** that it is a faithful representation; it is **maintained by retaining the source documents** used to record each transaction and is **checked through auditing**. Once Ironbark Mobile Mechanics destroys its receipts there is no evidence left to trace those expense figures back to, so no independent observer — an auditor, the bank or the Australian Taxation Office — can confirm them. The consequences run two ways. For the **reports**, the undocumented expenses cannot be shown to be a **faithful representation**: users have only the owner's memory to rely on, so they cannot be confident that expenses, and therefore profit, are complete and free from material error. For the **accountant**, verifiability exists precisely to hold the accounting professional **accountable** for their work — with no source documents the accountant cannot demonstrate that the figures reported were accurate, and cannot defend them if the reports are later questioned. Source documents must therefore be retained for every transaction, however small.

Question 14

The characteristic is **timeliness**. Reporting monthly means information reaches the owner **while it is still able to influence decisions** — the owner can respond to a poor month's cash position or a rising expense almost straight away. A single report every three years would be so out of date by the time it arrived that most of the decisions it might have informed would already have been made; the information would have lost its usefulness. Monthly reporting therefore keeps the information timely (and, in turn, protects its relevance).

Question 15

Because both businesses use the **same classifications and methods** for the **same period** (the year ended 30 June), their Income Statements can be placed side by side and the **similarities and differences** identified and understood — which is exactly what **comparability** provides. If the two statements were prepared on different bases, any difference in reported profit might reflect the different methods rather than genuinely different performance. As a result, a user (for example an investor or a lender) could make a decision such as **choosing which of the two businesses is more profitable**, and direct their investment or lending accordingly.

Question 16

Understandability requires the accountant to present the cafe's information so that it is **comprehensible to a user with a reasonable knowledge of business** — which the owner has, even without accounting expertise — by presenting it **clearly and concisely**. In practice this means the reports must be well classified, plainly labelled and free of unnecessary technical jargon. One specific way to achieve it is to use **clear, everyday line-item labels and proper report classification** (for example, grouping and heading the reports as "Income Statement for the year ended 30 June" with plainly named revenues and expenses) rather than dense accounting terminology the owner would struggle to interpret.

Question 17

The $2 400 is an expense of the **year ended 30 June**. Under the **accrual basis** assumption, expenses are recognised when they are **incurred** — that is, when the consumption of the goods or services can be measured — **regardless of when the cash is paid**. Roverline Dog Grooming consumed the advertising during June, and the invoice received on 26 June measures that consumption, so the expense was incurred within the year ended 30 June. The **period** assumption then requires the expenses incurred in a period to be deducted from the revenue earned in that **same** period in order to determine profit; the advertising worked to earn June's revenue, so it must be reported against it. The owner's reasoning describes **cash** accounting, not the accrual basis: paying on 20 July merely settles an **account payable** that already existed at balance day, and does not shift the expense into the following year. Leaving the $2 400 out of the year ended 30 June would understate expenses, overstate that year's profit and understate liabilities, so the reports would not be a **faithful representation**.

Question 18

The bookkeeper should **refuse to omit the $3 500 inventory loss** and record it in full. Leaving the loss out breaches **faithful representation**: the reports would no longer be **complete** (a real economic event has been left out) or **neutral** (they have been deliberately biased to overstate profit), and would not be free from material error. The purpose of the reports is to give users — here, a **bank** deciding on a loan — a true picture on which to base a decision; presenting an inflated profit could mislead the bank into lending on false grounds, which is both unethical and potentially unlawful. The bookkeeper is also bound by the **accountability** that **verifiability** demands: because independent observers and auditors can trace the reports back to the source documents, the omission is likely to be **detected**, exposing both the owner and the bookkeeper to professional and legal consequences. Acting with **integrity**, the bookkeeper should explain to the owner that the loss must be reported, decline to alter the figures, and if the owner persists, escalate the matter rather than become complicit in producing misleading reports. The short-term appeal of a "healthier" profit does not outweigh the professional obligation to report honestly, completely and neutrally.