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Creating VCE Success

Accounting
Teach Yourself Series
Topic 2: Qualitative Characteristics

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Qualitative Characteristics

In Teach Yourself Series 1 Accounting Principles were discussed. It was noted that these principles guide the way the financial records of a small business are kept. Qualitative Characteristics on the other hand, guide the way that accounting reports are prepared and presented.

There are three accounting reports that will be prepared at the end of a reporting period:

- Cash Flow Statement
- Profit & Loss Statement
- Balance Sheet

The Qualitative Characteristics must be followed to ensure our reports satisfy the Accounting Standards adopted in Australia.

Initial terminology

As it appears in Units 1 - 4

Financial transactions are recorded using journals, ledgers and subsidiary records. This recording is completed following the guidelines set by the Accounting Principles. Once records are complete financial reports are prepared.

These financial reports are used to owners and managers to assess performance by investors and potential investors to determine the value of their investment or future investment and by financial institutions who may be considering providing finance to a business. The Qualitative Characteristics determine how these reports are prepared and presented. There are 4 Qualitative Characteristics that guide the reporting of financial transactions through Units 1, 2, 3 and 4.

These Qualitative Characteristics are:

- Relevance
- Reliability
- Comparability
- Understandability

Two of these characteristics guide the preparation of reports – Relevance and Reliability and two guide the presentation of reports – Comparability and Understandability.

Relevance

As it appears in Units 1 - 4

During a reporting period a business will be involved in numerous transactions – cash, credit, sales, expenses, buying stock, paying debts, etc. Financial records may comprise hundreds, even thousands of separate transactions. When preparing financial reports that information must be summarised and presented in such a manner as to be useful.

The Qualitative Characteristic of Relevance requires a business include information that is useful for decision-making. Any information that is not useful for decision-making should not be included. Hence information presented should be up-to-date and appropriate for the types of decisions to be made.

This does not mean that information is not recorded – it means that the information must be prepared in such a way as to make decision-making easier. Take the following examples:

1. A business has a number of creditors. During a reporting period the business will pay many (if not all) of these creditors as well as incur new creditors. The payments made to creditors are recorded in:

- Cash payments journal
- Creditors Control account
- Creditor subsidiary ledgers

When preparing a Cash Flow Statement this information can be presented in two ways:

OfficeSpace
Cash Flow Statement for quarter ending 31 March 2011 (extract)

Cash Flows from Operating Activities	**$**	**$**
Cash Sales	104 000	
GST Collected	10 400	
Receipts from Debtors	86 350	200 750
Payments to Creditors	(82 000)	
GST Paid	(6 180)	

OR

OfficeSpace
Cash Flow Statement for quarter ending 31 March 2011 (extract)

Cash Flows from Operating Activities	**$**	**$**
Cash Sales	104 000	
GST Collected	10 400	
Receipts from Debtors	86 350	200 750
Payments to Creditor – Hayman Ltd	(12 000)	
Payments to Creditor – Linfix	(8 000)	
Payments to Creditor – Little Furniture	(22 000)	
Payments to Creditor – Chairs R Us	(40 000)	
GST Paid	(6 180)	

Which report format is more useful for decision-making?

The first report format provides much more useful information. It is not necessary to know who the business paid – this information is available elsewhere. To assist planning, to determine the cause of a cash deficit, to assess liquidity and efficiency, the business decision-makers only need to know the total amount paid to creditors.

2. In preparing a Profit and Loss Statement, the Accounting Principle of Reporting Period requires a business to only record transactions for that period. In preparing reports, it is not appropriate or relevant to include last period's Wages figure or estimates of future Sales in the report for this period.

3. In the Balance Sheet a similar situation to the Cash Flow Statement arises. Which report format provides the more relevant information?

Office Space
Balance Sheet as at 1 January 2011 (extract)

	$	**$**		**$**	**$**
Current Assets			**Current Liabilities**		
Debtors Control	23 400		Cash at Bank	3 800	
Stock Control	35 460		Creditors Control	11 580	
Prepaid Rent Expense	8 000	66 860	GST Clearing	5 900	
			Loan - QBF	12 000	33 280

OR

Office Space
Balance Sheet as at 1 January 2011 (extract)

	$	**$**		**$**	**$**
Current Assets			**Current Liabilities**		
Debtors – P. Lawson	2 400		Cash at Bank	3 800	
Debtors – B. Thompson	5 000		Creditors Control	11 580	
Debtors – S. Wilson	8 800		GST Clearing	5 900	
Debtors – S. Nicholls	7 200		Loan - QBF	12 000	33 280
Stock Control	35 460				
Prepaid Rent Expense	8 000	66 860			

The first report format provides much more useful information. It is not necessary to know who owes the business money or how many debtors there are. To assist planning, to determine the future cash inflows, to assess liquidity and efficiency, the business decision-makers only need to know the total amount owing to the business.

The relevance of information is determined by its materiality. Is the listing of individual debtors in the Balance Sheet material? That is, will the omission of this detail and its replacement with a total influence the decisions made? If the answer is no, then the information is immaterial and in the examples given, no material information has been omitted.

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Solutions to Review Questions

1. The Qualitative Characteristic of Relevance is applied through:
   - **a.** Reporting the item as an expense is acceptable as reporting the item as an Asset would not change or affect decisions made by the owner.
   - **b.** Combining the financial records of two businesses will make it difficult to determine how each individual business is performing. Decision-making would be improved if both businesses prepared their own reports.

2. Debtors Control - The total figure of how much debtors owe the business is the amount that is relevant to stakeholders. It is not necessary to show individual debtors and their balances. This can be found elsewhere.

   Stock Control

   Creditors Control

3. Documents are the starting point of the recording process. They provide evidence that a transaction has occurred and are therefore free from bias which means they cannot be disputed. The characteristic that is satisfied is Reliability.

4. Land & Buildings - Land and Buildings has been revalued by an independent valuer. This figure is unreliable as there is no supporting documentation.

5. *Answer*: C

   Explanation - $36,[illegible]0 is the only value that is supported by a document and is therefore free from bias.

6. Documents provide a reliable source of evidence regarding a transaction. They allow for recording that is free from bias and allow for checking between our records and those of a creditor (in this case), a customer, the bank, etc.

7. By continuing to make balance day adjustments Josh will be able to compare accurately his performance from one period to the next to ensure decisions made are based on accurate information and planning is carried out using reliable information This is the purpose of the Qualitative Characteristic of comparability

8. The Qualitative Characteristic of Comparability will apply in this situation. The report should continue to be classified as it will allow comparison with previous reports so as to provide better information for decision-making

9.

Balance Sheet as at 30 June 2010

	$	$		$	$
CURRENT ASSETS			*CURRENT LIABILITIES*		
Bank	5 600		Creditors Control	15 130	
Debtors Control	6 950		Loan – Wiz Loans	4 000	
Stock Control	35 470		GST Clearing	4 900	
	48 020	48 020		24 030	24 030
NON-CURRENT ASSETS			**NON-CURRENT LIABILITIES**		
Shop Equipment	37 000		Loan – Wiz Loans		20 000
Accumulated Depreciation	(12 000)				
Motor Vehicle	42 000		**OWNERS EQUITY**		
Accumulated Depreciation	(7 000)		Capital		63 990
	60 000	60 000			
TOTAL ASSETS		**108 020**	**TOTAL EQUITIES**		**108 020**