

ACCT20002

Intermediate Financial Accounting

Summary

---

## *Lecture 1 Summary*

### ✓ Definitions

**Disclosing entity:** Generally entities listed on a securities exchange.

**Public company:** Companies that can raise funds from the public, which includes listed and unlisted. (LTD)

**Proprietary company:** Companies that cannot raise funds from the public, which can be small or large. (PTY LTD)

- ① consolidated revenue is less than \$25m
- ② consolidated gross asset is less than \$12.5m
- ③ less than 50 employees at the end of financial year

**Reporting entity:** there are users depend on the information provided by the entity, which can be divided into Tier1 or Tier2.

**Tier 1: comply with all relevant accounting standards.**

- ① For profit private sector entities that have public accountability
- ② Australian government and state territory and local government

**Tier 2:** comprises the recognition, measurement and presentation requirements of Tier 1, but has substantially reduced disclosure requirements in comparison with Tier 1.

- ① For profit private sector entities that do not have public accountability
- ② Not-for-profit private sector entities
- ③ Public-sector entities, other than Australian government and state territory and local government

## ✓ The Conceptual Framework

### • It includes:

① **AASB Framework:** Framework for the preparation and presentation of Financial statements (Consistent with IASB framework)

② Statement of accounting concepts **SAC 1** Definition of the Reporting Entity.

Assist with **ensuring consistency** in standards, **assists preparer in applying AAS**, **assists auditors' opinion** and **assists users in interpreting info in financial statement**.

### • The IASB Framework comprises 4 chapters:

#### ① Objective of general purpose financial reporting:

To provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decision about providing resources to the entity. (Emphasize on capital provider)

#### ② Reporting entity

Critical factor to determine whether an entity is a reporting entity is the existence of dependent users:

- The greater the spread of ownership
- Economic or political importance which have significant impact on the welfare of external parties.
- Financial characteristics include size or debt of the entity

#### ③ Qualitative characteristics of useful information (what makes it useful)

##### ★ Fundamental qualitative characteristics:

- **Relevance:** Information that is capable of making a difference in the decisions made by users, that has predictive value, confirmatory value, or both. Materiality is an entity specific aspect of relevance based on nature and magnitude.

- **Faithful representation** represents econ phenomena, which seeks to maximize the underlying characteristics of completeness, neutrality and free from material error.

##### ★ Enhancing qualitative characteristics:

- **Comparability:** Consistency of preparation and application

- **Verifiability:** Achieved if different independent observers arrive at the same conclusion

- **Timeliness:** To be useful, must be available in a timely manner

- **Understandability:** Appropriate presentation is important; assumed users have reasonable knowledge

#### ④ Framework (Definition, recognition and measurement)

##### ★ Definitions of the elements

**Asset:** Present economic resources controlled by the entity as a result of a past transaction.

**Liability:** Present obligations of the entity to transfer an economic resource as a result of past events.

**Equity:** The residual interest in the assets of the entity after deducting all its liabilities.

**Income:** Increase in economic benefits in the form of increase of assets or decrease of liabilities that result in increases in equity, other than those relating to contribution from equity participants.

**Expense:** Decrease in economic benefits in the form of decrease of assets or increase of liabilities that result in decreases in equity, other than those relating to distribution from equity participants.

##### ★ Recognition of elements

Recognition is the process of incorporating in the balance sheet or income statement, an item that meets the definition of an elements and satisfied the criteria for recognition.

##### **Criteria for recognition:**

- Relevant information about the asset or liability
- Faithful representation of the asset or liability and of any resulting income and expense
- Information that results in benefits exceeding the cost of providing that information

##### **Criteria is not met when one or more of the following applies:**

- It is uncertain whether an asset or liability exists (Not relevant)
- There is only a low probability of future inflows
- The level of measurement uncertainty is so high (No faithful representation)

##### ★ Measurement of Elements

Measurement is the process of assigning a monetary amount. Common measurement includes historical cost and current value/fair value.

## ✓ Fair value measurement

- IFRS 13 Fair value measurement provides a single IFRS framework for measuring fair value and requires disclosures about fair value measurement.
- The standard defines fair value on the basis of an exit price notion and uses a fair value hierarchy which results in a market-based measurement.
- Fair value is the price would be *received to sell an asset or paid to transfer a liability* in *an orderly transaction between market participants* at the measurement date. It is based on **how much the market willing to pay for the asset. Exit price is the price what is a market participant willing to offer.**
- **Transaction costs:** Incremental direct costs that would not have been incurred if the decision to sell/to transfer the liability is not been made. Fair value is not adjusted for transaction costs as the costs are specific to a transaction and will differ depending on how an entity enters into a transaction. For example, Advertising costs, legal costs.
- **Transport costs:** Costs incurred to transport an asset from its current location to its principal market. Fair value is adjusted for transport costs as it is a characteristic of the asset.

## **Fair Value Application to non-financial assets**

**Non-financial assets: Property, plant & machinery, equipment, intangibles.**

**Step 1:** Determine the asset that is the subject of measurement. State the asset or the liability we are measuring.

**Step 2:** Determine the valuation premise that is appropriate

- **HBU is the use of asset which will maximize the value of the asset.** These uses must be physically possible, legal and financially feasible.
- **In terms of the in-combination valuation premise, fair value is the price that would be received in a current sale to market participants, in combination with those assets.**
- **In terms of stand-alone valuation premise, fair value is the price that would be received in a current sale to a market participant, on a stand-alone basis.**

**Step 3:** Determine the principal or most advantageous market

**The principal market** is the market with the greatest volume and level of activity, or in the absence of principal market.

**The most advantageous market** is the market that maximizes the amount that would be received to sell the asset after taking out transaction costs and transport costs.

**Step 4:** Determine the appropriate valuation techniques

**Estimate the fair value with the most appropriate valuation technique**

**Market approach** uses **prices generated by market transactions.** The market approach **would not be applicable if the equipment is unique.** Use of the market valuation approach would **require the existence of comparable equipment.**

**Cost approach** would **require the estimation of what it would cost currently to construct substitute equipment** that would perform the same tasks as the equipment being valued. **A difficulty** could arise if some of the components of the equipment are **unique and difficult to replicate by another market participant.**

**Income approach** could be applied with the **present value being used.** The cash flows used in this technique would be based on the income stream expected to result from the use of the equipment over its economic life.

**For consistency and comparability, AASB13/IFRS13 provide a hierarchy of inputs:**

**Level1 inputs: Unadjusted Quoted prices** in active market for identical assets or liabilities

**Level2 Inputs: Other than level 1 Quoted price** for similar assets in active market or identical items in inactive markets

**Level3 inputs: unobservable inputs**

## Lecture 2 Summary

### AASB116: Individual PPE items

#### ✓ Recognition of asset

A single asset can be recognized if it is probable that future economic benefits will flow into the business, secondly the cost of the item can be measured reliably.

Some cost can be **capitalized** if the cost can make probable future economic benefits for the company.

#### ✓ Carrying amount

The amount that the company has on its books for an asset or liability.

**CA=Cost - Accumulated depreciation**

**Depreciation expense=[(Cost - Residual)/useful life]**

**CA > FV, loss on sale/revaluation**

**CA < FV, gain on sale/revaluation**

#### ✓ Example 1

A acquires a VW vehicle for \$120,000 from B, and settles amount by a payment of \$102,000 cash and trades in a old Volvo motor vehicle. The CA of Volvo is \$15,000 and the fair value of it is \$18,000.

DATE	DETAILS	DR	CR
	Motor Vehicle – Volvo	3,000	
	Gain on sale of Motor Vehicle - Volvo		3,000
	<i>Re-measurement of Motor Vehicle (Volvo) to FV</i>		
	Motor Vehicle - VW	120,000	
	Motor Vehicle – Volvo		18,000
	Cash		102,000
	<i>Acquisition of Motor Vehicle (VW) via trade in and balance in cash</i>		

#### ✓ The cost of PPE

① purchase price (import duties and non-refundable taxes after deducting trade discounts and rebates)

② any costs **directly attributable** to bringing the asset to the location and condition.

-Employee costs arising from construction or acquisition, costs of site preparation, delivery and handling costs, installation and assembly costs, costs of testing to ensure proper function, legal or brokerage professional fees



③ the initial estimate of costs of dismantling and removing the item and restoring the site on which it is located.

**Subsequent costs can be capitalized** if the expenditure can extend the useful life, improve the quality of the assets output and decrease the operating costs associated with the PPE.

✓ **Example 2**

IFA Ltd pays vendor \$27500 cash and issues 5000 ordinary shares currently trading at \$4.40. It incurs GST exclusive costs of delivery \$750, installation \$1000, transit insurance \$500, annual insurance \$1200, interest on loan \$2000.

Consideration = \$27500 + 5000 shares × \$4.4/share = \$49500

$\$49500 \times 100/110 = \$45000$

<b>Equipment</b>	<b>45000<sub>+</sub></b>	
<b>Cash</b>		<b>25000<sub>+</sub></b>
<b>Share capital</b>		<b>20000<sub>+</sub></b>
<b>GST</b>	<b>4500<sub>+</sub></b>	
<b>Cash</b>		<b>4500<sub>+</sub></b>

✓ **The cost model**

After recognition as an asset, an item of PPE shall be carried at its cost less any accumulated depreciation and any accumulated impairment losses.

Management makes conscious choice not to revalue PPE

Depreciation applied based on cost

Assets subject to impairment test under AASB136

### ✓ The revaluation model

After recognition as an asset, an item of PPE whose value can be measured reliably shall be carried at revalued amount, being its fair value at the date of the revaluation less any accumulated depreciation and subsequent accumulated impairment losses.

Management makes conscious choice on revalued amount

Assets subject to impairment test under AASB136

### ★ Revaluation Increase

**When FV is greater than CA**, there is a revaluation increase. The increase is recognized in *other comprehensive income (OCI)* and accumulated in equity under the heading of revaluation surplus.

**Example 3:** Accumulated depreciation is \$250,000, CA is \$375,000, FV is \$450,000 and there are no prior revaluations

Revaluation increase =  $450,000 - 375,000 = \$75,000$

DATE	DETAILS	DR	CR
2014 June 30	Accumulated Depreciation Equipment <i>Depreciation write back</i>	250,000	250,000
	Equipment Gain on Reval. of Equipment (OCI) <i>Revaluation of asset to fair value</i>	75,000	75,000
	Gain on Reval. of Equipment (OCI) Asset revaluation surplus <i>Accumulation of reval. gain in equity</i>	75,000	75,000

### ★ Revaluation Decrease

**When FV is less than CA**, there is a revaluation decrease. The decrease is recognized in profit or loss (P/L).

**Example 4:** Equipment is \$625,000, Accumulated depreciation is \$250,000, CA is \$375,000, FV is \$330,000 and there is no prior revaluations.

Revaluation decrease =  $375,000 - 330,000 = \$45,000$

DATE	DETAILS	DR	CR
	Accumulated depreciation Equipment	250 000	250 000
	<i>Depreciation write back</i>		
	Loss – Downward Reval of Equip** Equipment	45 000	45 000
	** Taken to P&L via closing entry <i>Revaluation decrease</i>		

**★ Revaluation Decrease after prior revaluation increase**

**Example 5:** Equipment is \$625,000, Accumulated depreciation is \$250,000, CA is \$375,000, FV is \$330,000 and this asset was subject to a prior revaluation upwards of \$15,000.

DATE	DETAILS	DR	CR
2014 June 30	Accumulated depreciation Equipment	250 000	250 000
	<i>Depreciation write back</i>		
	Loss on revaluation (P&L) Loss on revaluation (OCI) Equipment	30 000 15 000	45 000
	<i>Downward revaluation of equip</i>		
	ARS LoR of Equip (OCI) <i>Reduction in acc equity due to reval dec in equipment</i>	15,000	15 000

**★ Revaluation increase reversing prior revaluation decrease**

**Example 6:** Equipment is \$625,000, Accumulated depreciation is \$250,000, CA is \$375,000, FV is \$450,000 and this asset was subject to a prior revaluation decrease of \$20,000.

*Purchase To Read The Whole Comprehensive Summary*

