

ACCT1511: ACCOUNTING & FINANCIAL MANAGEMENT 1B

1 ASSETS

1.1 Introduction: Financial Accounting

- The **Australian Securities and Investments Commission** (ASIC) administers the Corporation Act and oversees compliance, ensuring:
 - financial statements provide *true and fair view* of financial position and performance;
 - financial reports comply with *accounting standards*.
- **Accounting standards:**
 - Generally Acceptable Accounting Principles (GAAP): common set of standards and procedures;
 - International Accounting Standards Board (IASB) develops *international financial reporting standards* (IFRSs).
 - AASB develops accounting standards for Australian companies. Recently adopted most of IFRSs – **harmonisation**.
- Financial reports provide *financial information* about the reporting entity useful in making decisions.
 - **Balance sheet:** financial position;
 - **Income statement:** financial performance;
 - **Cash flow statement:** cash inflows and outflows.
- Financial information should possess these characteristics:
 - **Fundamental characteristics:** relevance and faithful representation;
 - **Enhancing characteristics:** comparability, verifiability, timeliness and understandability.
- Recall the accounting assumptions:
 - Accrual basis and the matching principle (*matching expenses to same period as revenue recognition*);
 - Going concern;
 - Economic entity;
 - Accounting period;
 - Monetary unit;
 - Historical cost.

1.2 Definition of an Asset

- An **asset** is a resource *controlled* by the entity as a result of *past events* and from which *future economic benefits* are expected to flow to the entity.
 - **Future Economic Benefits:** the potential to contribute (*both directly and indirectly*) to the flow of cash/cash equivalents to the entity.
 - E.g. part of operating activities; sell the item; help save cost.
 - **Control:** the entity *controls the benefits* expected to flow to the entity. This does **NOT** mean that the entity has *legal control/ownership* of the item.
 - **Past event/transaction.** *Expected future events do NOT count!*

- An asset is **recognised** on the balance sheet if they also satisfy the **recognition criteria**:
 - It is **probable** that it will bring future economic benefits: *greater than 50% chance*.
 - The asset has a cost or value that can be **measured with reliability**. *Reasonable estimates do not undermine their reliability*.
- If an item does not meet the essential characteristics or recognition criteria, they might appear only in the annual report or notes (respectively).

1.3 Cost vs Assets vs Expenses

- **Cost/expenditure**: amount of cash/equivalents paid or fair value of consideration given. We either:
 - *Capitalise* the cost and record it as an *asset*;
 - *Not capitalise* the cost and record it as an *expense*.
- If an item does not meet the essential characteristics or recognition criteria of an asset, then it is an **expense**.
- Capitalising the cost (*recording as assets*) defers the recognition of expenses to later periods for **the matching principle** – *matching expenses to the period where the revenue is recognised*.
- E.g. **depreciation**:
 - Capitalising the cost: Dr Asset & Cr Cash;
 - Asset → Expense: Dr Depreciation Expense & Cr Accumulated Depreciation;
 - Derecognising the asset at the end of useful life: Dr Accumulated Depreciation & Cr Asset.
- E.g. **inventory**:
 - Capitalising the cost: Dr Inventory & Cr Cash;
 - When revenue is earned: Dr COGS & Cr Inventory (*and revenue entries*).

1.4 Current vs Non-current Assets

- An asset is classified as **current** if it satisfies *any* of the following:
 - it is expected to be realised in, or is intended for sale or consumption in, **the entity's normal operating cycle**;
 - it is held primarily for the purposes of being **traded**;
 - it is expected to be realised within **twelve months after the reporting date**; or
 - it is **cash or cash equivalent** (unless it is restricted from being exchanged or is being used to settle a liability for at least twelve months).
- All other assets shall be classified as **non-current**.
- In other words:
 - Cash → current asset;
 - Inventory → current asset;
 - If the asset is expected to be “used” up within the next 12 months → current asset;
 - If the asset is expected to be “used” up within the entity's normal operating cycle → current asset.
 - *Operating cycle: the time between the acquisition of assets for processing and their realisation in cash or cash equivalents. Or 12 months.*

1.4.1 THE VALUE OF NON-CURRENT ASSETS

- Five ways to record value of non-current assets:
 - **Historical cost** – initial cost;
 - **Current/Market value** (*value in exchange*) – price to sell/buy?;
 - **Value in use** (*present value*) – asset worth to the company;
 - **Liquidation value** – what would we get if we have to sell it really fast?;
 - **Price-adjusted historical cost** – historical cost adjusted for inflation.
- The first three are common and are referred to throughout the accounting standards.
 - Liquidation Value is generally never used unless the company is *not expected to be able continue as a going concern*.
 - Price Adjusted Historical Cost is generally never used unless the company is reporting their financial statements in *a currency from an economy that is experiencing hyperinflation*.
- *Note*: “Fair value” generally means the same as Current or Market Value.

1.5 Property, Plant and Equipment (PPE)

1.5.1 MEASUREMENT AT RECOGNITION

- An item of property, plant and equipment shall be measured at its **cost**, which includes:
 - **Purchase price** (*including duties, non-refundable purchases taxes, less trade discounts and rebates*);
 - **Costs directly attributable** to bringing the asset to the location and condition necessary to operate in the manner intended by management;
 - The initial *estimate* of the cost of **dismantling and removing the item** and **restoring the site** on which it is located.
- Depreciation begins when the asset is **capable of operating** in a manner intended by management.

1.5.2 MEASUREMENT AFTER RECOGNITION

- **Cost model**: After recognition as an asset, an item of PPE shall be carried (*carrying amount/book value*) at its **costs less accumulated depreciation and accumulated impairment**.
 - **Depreciation** is the systematic **allocation** (*not valuation!*) of the **depreciable amount** (*asset cost less residual value*) of an asset over its useful life.
 - Depreciation method depends on useful life, residual value (*sale or scrap*), pattern of flow of benefits over the useful life – *reassessed annually*.
 - **Useful life**: *the period of time over which an asset is expected to be available for use by an entity; or the number of production or similar units expected to be obtained from the asset by the entity*. Relates to expected utility.
 - **Residual value**: *estimated amount that an entity would currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life*.
 - Depreciation methods: **straight-line; reducing balance; units of production**.
 - Recall recording **gain/loss on sale** based on discrepancies between *book value* and *market value*.
 - **Improvements to assets** are **capitalised** (*where repairs/maintenance are expensed*).

1.5.2.1 THE REVALUATION MODEL

- **Revaluation model:** After recognition as an asset, an item of property plant and equipment whose *fair value can be measured reliably* shall be carried at a *revalued amount* – that is, **its fair value at the date of revaluation less any subsequent accumulated depreciation and accumulated impairment losses**.
 - I.e. estimate fair value (current/market value), then *depreciate* the asset based on the fair value until the next revaluation.
- Revaluations shall be made with *sufficient regularity*. This ensures that the carrying amount does not differ materially from the fair value at the reporting date.
 - Practically, this is usually every three to five years – and must be **regular**.
- A revaluation may either be an **increment** or a **decrement** – based on the carrying amount.
- The company must revalue a whole *class* of assets.
- A model is chosen as its accounting policy and shall be applied to an *entire class of PPE*. The company must revalue a whole class of assets.
- For assets **without** depreciations, the **first time** we revalue:
 - Increments: Dr Asset Cr Revaluation Reserve;
 - Decrements: Dr Loss on Revaluation Cr Asset.
 - **Revaluation reserve** is an *equity* account – it does **not** increase period profit.
 - **Loss on revaluation** is an *expense* (i.e. on income statement and decreases profits).
- For subsequent revaluations:
 - Increments that reverses previous decrements:

Dr Asset Cr Gain on Revaluation (*until all prior losses are reversed*)
AND/OR Cr Revaluation Reserve
 - Decrements that reverses previous increments: Dr Revaluation Reserve (*if any*) AND/OR
Dr Loss on Revaluation Cr Asset
- For depreciable assets, we must first write down the asset to its *carrying amount* before we record the increment/decrement:
 1. **Update the depreciation** to the date of revaluation:

Dr Depreciation Expense Cr Accumulated Depreciation;
 2. **Write down the asset to its carrying amount:**

Dr Accumulated Depreciation Cr Buildings
 3. **Record the increment/decrement:**

Dr Building Cr Revaluation Reserve/Gain on Revaluation; OR
Dr Loss on Revaluation/Revaluation Reserve Cr Building
 4. **Recalculate depreciation:**
 - Depreciable amount has increased/decreased. Yearly depreciation expense is thus changed.
- When disposing an asset, any amount that is left in **revaluation reserve** can be taken to **retained earnings** – these increments “belong” to previous periods.
- Previous decrements are recorded as losses in previous periods – they are already included in retained earnings.