THE UNIVERSITY OF WESTERN AUSTRALIA
Achieve International Excellence

UWA BUSINESS SCHOOL

ACCT3321 FINANCIAL ACCOUNTING: THEORY AND PRACTICE (FATP)

WORKSHOP NOTES

Semester 1- 2015

Lecturer: Ms. Lee Krug

<u>WORKSHOP # 1</u>:
ACCOUNTING REGULATION AND THE CONCEPTUAL FRAMEWORK

Open Safari Case Study

C1. Is the website an asset of Open Safari?

Asset – is a resource **controlled** by an entity **arising from past events** from which **future economic benefits** is expected to flow within the entity.

1. Resource containing future economic benefits – must have the potential to contribute, directly or indirectly to the flow of cash and cash equivalents to the entity.
    a. Can it be exchanged for another asset?
    b. Can it be used to settle a liability?
    c. Can it be used singly or in combination with other assets to produce goods or services to be sold by the entity?
2. Control- can deny or regulate the access of others to those economic benefits.
3. Event giving rise to entity's control must have occurred.

Conceptual Framework:
Asset recognition- probable that future economic benefits will flow to the entity and asset has a cost or other value that can be measured reliably. (e.g. development costs are not recognised as an asset because it is not "probable" that future economic benefits will eventuate)

Analysis:

Asset
- *Resource containing future economic benefits* - It is probable that future economic benefits will flow to the entity as users will use the website as a mechanism to book for lodges and ecotourism activities from which will eventuate to a cash flow once the service has been provided. CASH RECEIPTS FROM CUSTOMERS.
- *Control* – obvious that there is control of economic benefits here as it is something that was internally generated.
- *Past event*- must have been a part of the company's strategy to implement this website. Development that happened in the past

The website in this case is an internally generated intangible asset. It is probable that future economic benefits will flow to the entity as users will use the website as a mechanism to book for lodges and ecotourism activities from which will eventuate to a cash flow once the service has been provided. It can also be measured reliably as the development cost was deemed to be £100,000.

C5. Is the initial operating loss an asset of Open Safari?

- Conceptual framework guidance – does it meet the definition of an asset?
    - Resource controlled? No resource
    - Result of past events- first year of trading
    - Economic benefits? – no benefits, no future economic resource.

The operating loss obviously does not contain any future economic benefits hence it is not considered as an asset.

D4. Is the trained staff (assembled workforce of WoXy Safaris) an asset of Open Safari?

Note: some staff possess specialised skills that are essential for Open Safari's agribusiness (for example, beekeepers and horticulturalists) and ecotourism business (for example: mahouts)

The *Conceptual Framework* does not require that a cost is incurred in order to determine the existence of an asset.

- *Resource (future economic benefits)* - likely that this criteria is met as they are probably the ones who provide the services that in turn introduces cash flow into the business.
- *Control* – it is likely that the entity does not have sufficient control over its employees to satisfy the criteria for an existence of an asset. (Every business has a turnover capacity, hence employees may just leave anytime they want therefore making it hard for businesses to obtain control over its employees).

Due to dissatisfaction of the control criteria, retained (obtained) employees of WoXy Safari are not considered an asset.

D5. Are the horses acquired in a separate acquisition assets (from a third party) of Open Safari?

It is an asset as (1) it provides future economic benefit to the entity (used to provide services; used for safaris and ecotourism) (2) there is sufficient control by Open Safari apart from having legal ownership to it and (3) it arose from a past event – purchase (which is a past transaction).

Note; WoXy's land is securely fenced and the horses are trained and actively managed (this satisfies the control requirement as well).

D9. What is the 'unit of account' for the assets recognised by Open Safari for the first time in 20X4?

Unit of account- how you would recognise an asset. A number of criteria must be taken into considerations to determine what unit of account to use:
- Materiality judgements – value of each asset or as a whole?
- E.g. individual animals for elephants, but swarm of bees. (size of the assets and the value).

For 20X4, the unit of accounts recognised by Open Safari are
- Land- individually because of high material value
- Quaggas – record mature and immature separately
- Elephant – individual due to materiality
- Beehives- individually.

Loftus Chapter 1

<u>Comprehensive question 14 p.27</u>

A government gives a piece of land to a company at no charge. The company builds a factory on the land and employs people at the factory to produce jam that is sold in local and interstate markets. Considering the definition of income in the Conceptual Framework, do you think the receipt of the land is income to the company? Would your answer depend on how the land is measured?

Income – increases in economic benefits during the accounting period in the form of inflows or enhancement (increases) of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants.

Two arguments:

Equity	Income
• Gov't not an equity participant. (in kind) • Grant not earned. Simply an incentive provided by government without any related costs.	• Land owned by the company. Increases the assets attributable to shareholders of the company. • Once all the obligations are met the asset can be realised

• Therefore the land should be recognised as a direct credit to equity • B/S – "donated capital"	• While the land is held it helps to generate profits • Grant is income to be matched against that cost as a result of "strings attached" • (if there is strings attached we recognise it proportionately over the costs incurred) • Government grants are like a "reverse income tax"

It is likely that the land is an incentive, the government expects the company to somehow use that land, this could be an argument to be used as an equity.

The definition is wide in its scope, in that income in the form of inflows or enhancement of assets can arise from providing goods or services, investing in or lending to another entity, holding and disposing of assets, and receiving contributions such as grants or donations. IT MUST HAVE THE EFFECT OF INCREASING EQUITY.

Non-reciprocal transfers of future economic benefits such as donations represent income on the transferee. Receipt of land does not give rise to a liability of that entity (transferee) and therefore constitutes an inflow of future economic benefits in the form of an increase in assets that results in an increase in equity.

In this case, the land is likely to be classified as income.

NOTE: IF THERE IS NO SPECIFIC ANSWER, DISCUSS BOTH ARGUMENTS (DISCUSS WHY IT IS EQUITY AND WHY IT IS INCOME). If the answer is not on the conceptual framework, this is where you need to go to the next step and look for a standard.

<u>Exercise 1.4 FINANCIAL STATEMENTS OF A REAL ESTATE INVESTOR</u>

An entity purchases a rental property for $10,000,000 as an investment. The building is fully rented, and is in a good area. At the end of the current year, the enterprise hires an appraiser who reports that the fair value of the building is $15 000 000 plus or minus 10%. Depreciating the building over 50 years would reduce the carrying amount to $9 800 000.

a. *What are the relevance and faithful representation accounting considerations in deciding how to measure the building in the entity's financial statements?*

Don't be shy to make an assumption?

- Relevance – is it capable of making a difference in the decisions made by capital providers as users of FS? Is it capable of making a difference whether the users use it or not? Materiality? (difference between to measurement methods? Pretty material) Timeliness?
- Faithful representation – is it complete? Is it free of bias? Is it free from material error? Doesn't have to be perfect as accounting is sometimes based on estimates. Prudence – conservatism.

Note: measurement base that provides the most relevant information about an asset will not always provide the most faithful representation.

b. *Does the Conceptual Framework lead to measuring the building at $15,000,000? Or at $9 800 000? Or at some other amount?*

- Relevance-is it able to influence or make the difference to the decisions made by the users of information? Is the information material?
- Faithful representation – is it neutral, free from bias and free from material error? (doesn't have to be perfect)

There is no guidance in the conceptual framework to determine the measurement basis to use when recognising sometimes. It does not include concepts or principles for selecting which measurement basis should be used for particular elements of financial statements or particular circumstances.

Qualitative characteristics do provide some guidance, particularly the characteristics of relevance and reliability. But it doesn't mean these must be followed all the time.