Accounting for Business Decisions B Notes:

Lecture 1:

Define accounting:

- Accounting is the art of recording classifying and summarising transactions in a significant manner and in terms of money, transactions and events that are, in part at least, of a financial character, and interpreting the results thereof.
- Accounting is a service activity. Its function is to provide qualitative information, primarily financial in nature, about economic entities that is intended to be useful in making economic decisions, in making reasoned choices among alternative courses of action.

Describe the functions of accounting:

- **Stewardship function:** focus is on delegating compliance with delegated authorities
- **Decision making:** providing information for decisions about the allocation of scarce economic resources

Lecture 2: non-current assets and intangible assets:

Non-current assets:

Recording non-current assets:

- A non-current asset is any tangible resource that is expected to be used in the normal course of operations for more than one year and is not intended for resale.
- Non-current assets should be recorded at the cost of acquiring them, including the:
    - purchase price
    - taxes and duties paid on the purchase
    - fees such as closing costs paid to attorneys
    - delivery costs
    - insurance costs during transit
    - installation costs

Expensing non-current assets:

- A non-current asset converts to an expense as it is used or consumed.
- The expensing of non-current assets is accomplished through depreciation.
- Depreciation is the process of allocating the cost of a non-current asset over its useful life.
- Depreciation is an application of the matching principle; because a non-current asset is used to generate revenues period after period, some of its cost should be expensed in, or matched to, those same periods.

Depreciation:

Recording depreciation:

- Depreciation expense is normally calculated at the end of an accounting period and recorded with an adjusting journal entry.
- The general form of the entry to record depreciation is:
  - Debit depreciation expense (expense increasing)
  - Credit accumulated depreciation (contra asset increasing)
- Accumulated depreciation is a contra-asset account, meaning that its balance is subtracted from the non-current asset account to yield the carrying amount (*net book value)* of the non-current asset.
- It is recorded on the statement of comprehensive income, often as a separate item.

Calculating depreciation expense:

- When a company owns depreciable assets, it must calculate depreciation expense each period.
- Doing so requires the following information about the asset:
  - cost
  - residual or salvage value
  - useful life
  - depreciation method
- Cost refers to the historical cost of the asset being depreciated.
- Residual or salvage value refers to the net realisable value (market value) of the asset at the end of its useful life.
- Useful life refers to the length of time the asset will be used in operations.
- Depreciation method refers to the method used to calculate depreciation expense. Generally accepted accounting principles allow the use of several different methods for calculating depreciation expense

Depreciation methods:

- Straight line:
  - Straight-line depreciation spreads depreciation evenly over the useful life of an asset. It is commonly used because it is a simple technique.
  - The depreciable cost of the asset is divided by the useful life of the asset (in years) to yield the amount of depreciation expense per period.
- Reducing-balance method:
  - The reducing-balance method of depreciation is an accelerated method that results in more depreciation expense in the early years of an asset's life and less depreciation expense in the later years.
  - Accelerated depreciation methods may match expenses to revenues better than the straight-line method. More depreciation expense is recorded when the asset is more useful.
  - They provide larger expenses (and if used for tax purposes larger tax deductible expenses) in earlier years of a non-current asset's life.

- For simplicity often 1.5 or 2 times the straight-line rate is used.
- This often means the last depreciation expense calculation is to reduce the book value to the residual value.

- Units of activity method:
  - Both the straight-line and reducing-balance methods are a function of the passage of time rather than the actual use of the asset.
  - In contrast, the units-of-activity method of depreciation calculates depreciation based on use.
  - Because it relies on an estimate of an asset's lifetime activity, the method is limited to assets whose units-of-activity can be in some way determined.
  - Depreciation per unit of expected activity is the depreciable cost of the asset divided by the estimated units-of-activity over the life of the asset.

Adjustments:

- Since non-current assets are used for multiple years, companies sometimes need to make adjustments as new information is available or as new activity occurs.
- These adjustments can arise from the following:
  - changes in estimates
  - additional expenditures to improve the non-current asset
  - significant declines in the asset's net realisable value

Changes in depreciation:

Step 1	Calculate carrying amount revision time	
	Cost of the asset, 1 July, 2010	$90 000
	Less: accumulated depn. for four years	$32 000
	Carrying amount on 1 July, 2014	$58 000
Step 2	Calculate depreciable cost for future depreciation:	
	Net book value on 1 July, 2014	$58 000
	Less: estimated residual value	$6 000
	Remaining depreciable cost	$52 000
Step 3	Calculate revised depreciation expense:	
	$52 000 ÷ 4 remaining years = $13 000 annual depn.	

Expenditures after acquisition:

- Most non-current assets require expenditures throughout their useful lives. The accounting treatment for expenditures made during the useful life of a non-current asset depends on whether they are classified as 'capital' or 'revenue' expenditures.
- A capital expenditure increases the expected useful life or productivity of the asset. A revenue expenditure maintains the expected useful life or productivity of the asset.

Capital expenditure:

- A company purchases a non-current asset for $50 000 on 1/1/2013, with a five-year life and no residual value. During the fifth and final year of the asset's life, the company incurs $8 000 for upgrades that extend the asset's life for two years.

General journal

Date	Description	Debit	Credit
Year 5	Non-current asset	8 000	
	Cash		8 000
	(To record upgrade to asset)		

Step 1		
	Calculate net book value after capital expenditure:	
	Cost of the asset, 1 July, 2010	$50 000
	Less: Accum depn for four years	$40 000
	Net book value on 1 July, 2014	$10 000
	Plus: Upgrades made in 2014	$ 8 000
	Updated Carrying Amount for 2014	$18 000

Step 2		
	Calculate depreciable expense:	
	Updated book value for 2014	$18 000
	Less: Estimated salvage value	$ 0
	Remaining depreciable cost	$18 000
	Divided by remaining useful life	÷ 3
	Annual depreciation expense	$ 6 000

Asset impairment:

- When a non-current asset's recoverable amount falls below its carrying amount, the asset is considered impaired.
- Under *AASB 136* entities apply conservatism by writing these assets down from their carrying amount to their recoverable amount (through use or sale).
- Normally any loss on impairment is an expense.
- Special rules apply to impairment of assets previously revalued and reversal of impairments.

Disposals:

Rule for calculating the gain or loss on disposal:

1. Record any necessary depreciation expense (possibly for a partial period) to update the accumulated depreciation account.
2. Calculate any gain or loss on the disposal by comparing the asset's carrying amount.
3. Prepare a journal entry that decreases the asset account and its related accumulated depreciation account.
4. Record any gain or loss on the disposal.

Management of non-current assets:

Evaluating management of non-current assets:

- Three issues are important when managing non-current assets:
  - How productive are the company's non-current assets in generating revenues?
  - What is the condition of the company's non-current assets?
  - How are cash flows affected by the purchase of non-current assets?

	Horizontal analysis	Vertical analysis
Non-current assets	$\frac{\text{CY non-current assets} - \text{PY non-current assets}}{\text{PY non-current assets}}$	$\frac{\text{Non-current assets}}{\text{total assets}}$
Depreciation expense	$\frac{\text{CY depreciation} - \text{PY depreciation}}{\text{PY depreciation}}$	$\frac{\text{Depreciation expense}}{\text{total sales}}$

Non-current asset turnover ratio:

- While the horizontal and vertical analyses show changes in assets and asset structure. The non-current asset turnover ratio looks at productive use of non-current assets question.
- The non-current asset turnover ratio compares total revenues during a period to the average carrying value of non-current assets during that period.
- In general, companies want this ratio to be high. This can be achieved by not revaluing assets and renting rather than buying.

Average life of non-current assets:

- Non-current assets in poor condition are usually less productive and normally require significant expenditures either to repair or replace.
- The average useful life of non-current assets represents the number of years, on average, that a company expects to use them.
- The ratio divides the total cost of non-current assets by the amount of annual depreciation expense to approximate the number of years that it will take to fully depreciate the assets.

Intangible assets:

- A patent is the right to manufacture, sell or use a particular product or process exclusively for a limited period of time.
- A trademark or trade name is the right to use exclusively a name, or symbol, to identify the business.
- A copyright is the right to reproduce or sell an artistic or published work.
- A franchise is the right to operate a business under the trade name of the franchisor.

Recording goodwill:

- Goodwill is created when one company buys another company and pays more than the value of the net assets of the purchased company.