



Government of **Western Australia**
School Curriculum and Standards Authority

SYLLABUS SUPPORT MATERIALS
CONCEPTUAL FRAMEWORK FOR FINANCIAL REPORTING

ACCOUNTING AND FINANCE
ATAR YEAR 11 AND YEAR 12

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Any resources such as texts, websites and so on that may be referred to in this document are provided as examples of resources that teachers can use to support their learning programs. Their inclusion does not imply that they are mandatory or that they are the only resources relevant to the course.

Background

In May 2019, the Australian Accounting Standards Board (AASB) released the *Conceptual Framework for Financial Reporting* (the Conceptual Framework) effective from 1 January 2020 which replaces the *Framework for the Preparation and Presentation of Financial Statements*. From January 2020, the *Conceptual Framework* supersedes:

- the *Framework for the Preparation and Presentation of Financial Statements* (July 2004), and
- Statement of Accounting Concepts SAC 1 *Definition of the Reporting Entity* (August 1990).

The purpose of the *Conceptual Framework* is to describe the objectives of, and the concepts for, general purpose financial reporting. This assists:

- the AASB to ensure that the Australian Accounting Standards (Standards) they develop are based on concepts which are consistent across all Standards. The consistency in these Standards brings transparency, accountability and efficiency to Australian financial markets
- preparers to develop accounting policies that are consistent when no Standard exists for a particular item, or when there is a choice of accounting policies within a Standard
- all individuals to understand and interpret the Standards.

The *Conceptual Framework* however is not a Standard issued by the AASB; nothing in the *Conceptual Framework* overrides any Standard or requirement within a Standard.

Implementation timeline

All teachers of the School Curriculum and Standards Authority (the Authority) Accounting and Finance course must implement the changes resulting from the *Conceptual Framework* from the beginning of 2020 as related to each Year 11 and Year 12 Accounting and Finance course syllabus.

The following support materials have been provided by the Authority to highlight the significant changes as a result of this new *Conceptual Framework*. Teachers will need to refer to the *Conceptual Framework* for more details regarding these changes and other items in the syllabus. The *Conceptual Framework* can be accessed via the following link:

https://www.aasb.gov.au/admin/file/content105/c9/Conceptual_Framework_05-19.pdf.

Definition of the elements of financial statements

Students should be able to, but not limited to, define, classify, describe and justify elements of financial statements as per the *Conceptual Framework*.

The elements are defined in the *Conceptual Framework (CF)* as follows:

- An asset is ‘a present economic resource controlled by the entity as a result of past events.’ (CF, Table 4.1)
An economic resource is defined as ‘a right that has the potential to produce economic benefits.’ (CF, 4.3)
The three aspects of the definition of an asset are:
 - right
 - potential to produce economic benefits, and
 - control. (CF, 4.4)
- A liability is ‘a present obligation of the entity to transfer an economic resource as a result of past events.’ (CF, 4.26)
The three criteria that must exist for a liability to exist are:
 - ‘the entity has an obligation
 - the obligation is to transfer an economic resource
 - the obligation is a present obligation that exists as a result of past events.’ (CF, 4.27)
- Equity is ‘the residual interest in the assets of the entity after deducting all its liabilities.’ (CF, 63)
- Income is ‘increases in assets, or decreases in liabilities, that result in increases in equity, other than those relating to contributions from holders of equity claims.’ (CF, 4.68)
- Expenses are ‘decreases in assets, or increases in liabilities, that result in decreases in equity, other than those relating to distributions to holders of equity claims.’ (CF, 4.69)

Recognition criteria

Students should be able to, but not limited to, define, recognise and justify whether assets, liabilities, income and expenses should be recognised in financial statements as per the *Conceptual Framework*.

The *Conceptual Framework* states that ‘Only items that meet the definition of an asset, a liability or equity are recognised in the statement of financial position. Similarly, only items that meet the definition of income or expenses are recognised in the statement(s) of financial performance. However, not all items that meet the definition of one of those elements are recognised.’ (CF, 5.6)

The *Conceptual Framework* outlines that ‘An asset or liability is recognised only if recognition of that asset or liability and of any resulting income, expenses or changes in equity provides users of financial statements with information that is useful,’ (CF, 5.11) i.e. with:

- (a) relevant information about the asset or liability and about any resulting income, expenses or changes in equity; and
- (b) a faithful representation of the asset or liability and of any resulting income, expenses or changes in equity (see CF, 5.12–5.25).’

The *Conceptual Framework* also states that ‘even if an item meeting the definition of an asset or liability is not recognised, an entity may need to provide information about that item in the notes’. (CF, 5.11)

For the purposes of the Year 11 and 12 ATAR Accounting and Finance courses, the factors determining the recognition criteria for relevance and faithful representation of assets and liability will be limited to the following.

Relevance

As defined in the qualitative characteristics of the *Conceptual Framework*, ‘Relevant financial information is capable of making a difference in the decisions made by users. Information may be capable of making a difference in a decision even if some users choose not to take advantage of it or are already aware of it from other sources.’ (CF, 2.6)

According to the *Conceptual Framework*, an asset or liability may not be recognised if:

- ‘it is uncertain whether or not the asset or liability exists,’ or
- ‘it may exist, but the probability of an inflow or outflow of economic benefits is low.’ (CF, 5.13)

Faithful representation

As defined in the qualitative characteristics of the *Conceptual Framework*, ‘To be useful, financial information must not only represent relevant phenomena, but it must also faithfully represent the substance of the phenomena that it purports to represent’ and ‘To be a perfectly faithful representation, a depiction would have three characteristics. It would be complete, neutral and free from error.’ (CF, 5.12–13)

According to the *Conceptual Framework*, for an asset or liability to be recognised it must be measured. The level of measurement uncertainty associated with the asset or liability may impact on whether a faithful representation can be provided of the item. Measurement uncertainty is defined as ‘uncertainty that arises when monetary amounts in financial reports cannot be observed directly and must instead be estimated.’ (CF, page 60) Measurement requires the elements to be able to be quantified in monetary terms. To be able to quantify or measure with certainty the elements, the business must select a measurement basis, i.e. either historical cost or current value (current value includes fair value, value in use/fulfilment value or current cost).

The *Conceptual Framework* points out that recognition links the elements in the statement of financial position (i.e. assets, liabilities and equity) and the elements in the statement of financial performance (i.e. income and expenses). The link between the two statements arises because the recognition or change of one item requires the recognition, or derecognition, of one or more other items. Derecognition is defined as ‘the removal of all or part of a recognised asset or liability from an entity’s statement of financial position.’

The *Conceptual Framework* provides examples of this link and how to recognise income and expenses as follows:

- ‘the recognition of income occurs at the same time as:
 - the initial recognition of an asset, or an increase in the carrying amount of an asset; or
 - the derecognition of a liability, or a decrease in the carrying amount of a liability.
- the recognition of expenses occurs at the same time as:
 - the initial recognition of a liability, or an increase in the carrying amount of a liability, or
 - the derecognition of an asset, or decrease in the carrying amount of an asset.’ (CF, 5.4)

Reporting Entity

Students should be able to, but not limited to, define and recognise a reporting entity and explain the circumstances under which an entity may be required to prepare financial statements as per the *Conceptual Framework*.

The *Conceptual Framework* states that ‘A reporting entity is an entity that is required, or chooses, to prepare financial statements’ (CF, 3.10) and also states that ‘a reporting entity is not necessarily a legal entity.’ (CF, 3.10)

A reporting entity is required to prepare financial statements if it has public accountability. *AASB 1053 Application of Tiers of Australian Accounting Standards (AASB 1053)*, specifies that ‘Public accountability means accountability to those existing and potential resource providers and others external to the entity who make economic decisions but are not in a position to demand reports tailored to meet their particular information needs.’ (*AASB 1053*, page 12)

Users of financial statements need information that is relevant and faithfully represents what it purports to represent.

Sample questions

The following questions and marking keys are provided as examples of questions that demonstrate knowledge, understanding and application of the *Conceptual Framework*, specifically the changes outlined in this document.

Question 1

An asset is defined as a present economic resource controlled by the entity as a result of past events. Explain how a business determines if an item is an economic resource and therefore can be classified as an asset. (3 marks)

Description	Marks
Explains an economic resource	3
Provides a brief explanation of an economic resource	2
States a fact about an economic resource	1
Total	/3
Answer could include, but is not limited to	
As per the <i>Conceptual Framework</i> , an economic resource is a right that has the potential to produce economic benefits. These rights can be established by contract, legislation or other means and may include leased items.	
These rights can take many forms, including the right to:	
<ul style="list-style-type: none"> • receive cash from another party • receive goods or services from another party • exchange economic resources with another party on favourable terms • rights over physical objects (e.g. property, equipment, inventories) • rights to use intellectual property. 	

Question 2

Describe how each of the following may occur.

- Income may be recognised as a result of the:
 - derecognition of a liability
 - initial recognition of an asset.
- An expense may be recognised as a result of the:
 - the initial recognition of a liability
 - derecognition of an asset.

(8 marks)

Description	Marks
For each criteria	
Describes how the income or expense is recognised relevant to the criteria	2
Provides an example of an income or expense that may be recognised relevant to the criteria	1
Total	/8
Answer could include, but is not limited to	
An example of an income item that may be recognised as a result of the:	
<ul style="list-style-type: none"> • derecognition of a liability is discount received – accounts payable are reduced due to the discount being received • initial recognition of an asset is credit sales – accounts receivable are recognised as a result of goods being sold. 	
An example of an expense item that may be recognised as a result of the:	
<ul style="list-style-type: none"> • initial recognition of a liability may be wages – if the wages are not yet paid, but are owing then an accrued expense for wages payable is recognised • derecognition of an asset is bad debts – accounts receivable are decreased due to the amount being written off. 	

Question 3

Bunyip Ltd is a mining company that has been exploring for minerals in a remote area of Australia. A recent accident at the site has caused some chemicals to leak into the soil at a site that the company leases from the owners of the land.

The owners of the site have just successfully sued the company and, as a result, the company must pay for damages awarded to the owners of \$3,000,000 and also carry out decontamination of the soil at the company's expense. The company is not yet sure how much this is going to cost as there are limited experts in this field in Australia.

You are required to determine what liabilities, if any, the Bunyip Ltd needs to recognise in its financial statements, which are due to be finalised and published this week. (10 marks)

Description	Marks
For the \$3,000,000 compensation	
Provides reasons to support recognising the liability related to faithful representation	1–2
Provides a reason to support recognising the liability related to relevance	1–2
Determines the liability should be recognised	1
Subtotal	/5
For the cost of decontamination of the site	
Provides reasons to support, or not support, recognising the liability related to faithful representation	1–2
Provides a reason to support recognising the liability related to relevance	1–2
Determines whether the liability should be recognised or not	1
Subtotal	/5
Total	/10
Answer could include, but is not limited to	
<p>For the \$3,000,000 compensation to the owners:</p> <ul style="list-style-type: none"> • the amount should be recognised in the financial statement • the information is relevant as it may make a difference to the decision made by users of that information (e.g. shareholders, potential shareholders) <ul style="list-style-type: none"> ▪ the obligation to pay compensation certainly exists due to the court ruling ▪ the probability of the outflow of economic benefits is high (i.e. payment of cash to owners) as the company will need to abide by the court ruling • the information can be faithfully represented as it can be measured with certainty, i.e. the \$3,000,000 set by the court. <p>For the cost of decontamination of the site:</p> <ul style="list-style-type: none"> • the information is relevant as it may make a difference to the decision made by users of that information (e.g. shareholders, potential shareholders) <ul style="list-style-type: none"> ▪ the obligation to pay for the cost of decontaminating the site certainly exists due to the court ruling ▪ the probability of the outflow of economic benefits is high (i.e. payment of cost to carry out the decontamination) as the company will need to abide by the court ruling • for a liability to exist it must be able to be faithfully represented by being measured, it could be argued that <ul style="list-style-type: none"> ▪ if the company is able to estimate/measure the cost of the decontamination with some certainty it could recognise the amount as a liability in the financial statements ▪ if the company is not able to estimate/measure the cost of decontamination with any certainty it does not recognise the amount as a liability in the financial statements, but would include reference to it in the notes to the financial reports. 	

Question 4

Quander Pty Ltd is a new technology company established by teenagers Bill and Ben. Bill, Ben and their four parents are currently the only shareholders of the proprietary company and are also the directors of the company. The company has only existed for a few months, and all the directors still consider themselves inexperienced in the role as directors and often rely on the advice provided by the managers and financial advisors they employ.

The success of the company has led to the decision to become a public company. Their accountant has advised that once they are a public company they will be a reporting entity required to prepare financial records.

Explain to the directors why the public company will be a reporting entity. (3 marks)

Description	Marks
Explains why the company is a reporting entity required to prepare financial statements	3
Provides a brief explanation of why the company is a reporting entity required to prepare financial statements	2
States a fact about reporting entities	1
Total	/3
Answer could include, but is not limited to	
<p>The <i>Conceptual Framework</i> defines a reporting entity as one that is required to or chooses to prepare financial statements.</p> <p>As a public company, Quander Ltd will be required to prepare financial statements given that it may have existing and potential providers, external to the company (e.g. current shareholders, potential shareholders, lenders), who may need these reports to make economic decisions. As these parties are external to the company they are not in a position to demand that the company prepares reports tailored to their particular needs.</p>	