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

Syllabus Support Materials
Conceptual Framework for Financial Reporting

Accounting and Finance
General Year 12

2019/34476

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's (the Authority's) Accounting and Finance courses 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*, 4.63)
- 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 12 General Accounting and Finance course, 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*, 2.12–13)

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).

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 *Conceptual Framework,* 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: • 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

Define an expense and provide an example to explain how it meets the definition as per the *Conceptual Framework*. (5 marks)

Description	Marks
Defines an expense	2
Provides a partial definition of an expense	1
Sub-total	**/2**
Explains how the expense meets the definition	3
Provides a partial explanation of how the expense meets the definition	2
Provides an example of an expense	1
Sub-total	**/3**
Total	**/5**
Answer could include, but is not limited to	
The *Conceptual Framework* defines expenses as 'decreases in assets, or increase in liabilities, that result in decreases in equity, other than those relating to distributions to owners'. An example of an expense is wages; it meets the definition as follows: • decreases in assets, or increase in liabilities – if the wages have been paid, they decrease cash (asset) or if not they increase liabilities (accrued expense) • result in decreases in equity – equity can be reduced by decreasing profit or distributions to owners, wages will act to decrease the profit made by the business • other than those relating to distributions to owners – the wages are paid to the employees of the business, not the owners.	

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

For the $3,000,000 compensation to the owners:

- the amount should be recognised in the financial statement
- the information is relevant as is may make a difference to the decision made by users of that information (e.g. shareholders, potential shareholders)
  - 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.

For the cost of decontamination of the site:

- the information is relevant as is may make a difference to the decision made by users of that information (e.g. shareholders, potential shareholders)
  - 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
  - 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.