**Syllabus Support Materials**

Accounting and Finance

General Year 12

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# Background

Changes in Australian Accounting Standards and the *Conceptual Framework for Financial Reporting* (the *Conceptual Framework*),which superseded the *Framework for the Preparation and Presentation of Financial Statements* (the *Framework*) on January 1, 2020 require changes to existing teaching practices for the Accounting and Finance General Year 12 course.

Key changes are:

* the qualitative characteristics of financial information
* the treatment of discount allowed and discount received
* the classification of financial expenses.

Details of these changes are outlined below.

# Qualitative characteristics of financial information

The *Conceptual Framework* outlines the concepts that underpin the preparation and presentation of financial statements for external users. The *Conceptual Framework* also outlines and defines the fundamental and enhancing characteristics of useful financial information. These characteristics, while not specific content in the Accounting and Finance General syllabus, apply to all financial information produced in financial reports.

|  |  |
| --- | --- |
| **Current qualitative characteristics** | **Former qualitative characteristics** |
| Fundamental qualitative characteristics   * relevance   + materiality * faithful representation   Enhancing qualitative characteristics   * comparability * verifiability * timeliness * understandability | Principal qualitative characteristics   * relevance * reliability * comparability * understandability |

# Treatment of discounts allowed and received

The following extracts from Australian Accounting Standards specify how discounts should be treated.

**AASB118 Revenue, paragraph 10**

‘The amount of revenue arising on a transaction is usually determined by agreement between the entity and the buyer or user of the asset. It is measured at the fair value of the consideration received or receivable taking into account the amount of any trade discounts and volume rebates allowed by the entity.’

**AASB102 Inventories, paragraph 11**

‘The costs of purchase of inventories comprise the purchase price, import duties and other taxes (other than those subsequently recoverable by the entity from the taxing authorities), and transport, handling and other costs directly attributable to the acquisition of finished goods, materials and services. Trade discounts, rebates and other similar items are deducted in determining the costs of purchase.’

The Australian Accounting Standards require discounts to form part of the calculation of net sales and cost of sales and hence the calculation of gross profit, as follows:

* Net sales = sales – sales returns – discount allowed
* Total cost of sales = cost of sales + import duties + cartage/freight inwards – discount received

This impacts on the preparation of an income statement and the profit, gross profit and expense ratios. There is no change required for the recording of discounts in the general ledger or the general journal.

# Financial expenses

For the purposes of Accounting and Finance General Year 12, Financial Expenses will include only borrowing costs. The Australian Accounting Standards defines borrowing costs as:

**AASB123 Borrowing Costs, paragraph 5**

‘Borrowing costs are interest and other costs that an entity incurs in connection with the borrowing of funds.’

The impacts on the classification of bad debts in the income statement which should now be treated as a selling expense.

The example on pages 3–7 shows:

* an income statement (using both the new report layout and the former report layout)
* a balance sheet (showing that there is no change to the report as a result of these changes)
* the profitability ratios affected by these changes, i.e. profit ratio, gross profit ratio and expense ratio (calculation of these ratios is not required in this course, only interpretation of the ratios).

# Example

This example demonstrates the:

* preparation of an income statement for the year ended 30 June, 2017
* preparation of a balance sheet as at 30 June, 2017
* profitability ratios as at 30 June, 2017.

|  |  |  |
| --- | --- | --- |
| **Urban Garden Traders**  **Trial Balance**  **As at 30 June, 2017** | | |
|  | **Debit ($)** | **Credit ($)** |
| Insurance | 15,000 |  |
| Freight Outwards | 12,200 |  |
| Internet Charges | 750 |  |
| Interest Expense | 650 |  |
| Mortgage (due 2025) |  | 650,000 |
| Bank Fees and Charges on Loan | 55 |  |
| Capital |  | 395,375 |
| Drawings | 11,200 |  |
| Bank Loan (due 2017) |  | 15,900 |
| Inventory | 35,200 |  |
| Wages – Sales Staff | 92,800 |  |
| Salaries – Office Staff | 59,000 |  |
| Cash at bank | 134,000 |  |
| Accounts Receivable | 32,000 |  |
| Accounts Payable |  | 26,000 |
| Interest Income |  | 900 |
| Cost of Sales | 492,500 |  |
| Sales |  | 790,000 |
| Discount Allowed | 2,140 |  |
| Discount Received |  | 2,500 |
| Sales Returns | 3,900 |  |
| Furniture | 97,000 |  |
| Accumulated Depreciation – Furniture |  | 52,300 |
| Bad Debts | 1,370 |  |
| Land and Premises | 900,000 |  |
| Freight Inwards | 16,500 |  |
| Depreciation – Furniture | 3,750 |  |
| Customs Duty | 960 |  |
| Advertising | 22,000 |  |
|  | 1,932,975 | 1,932,975 |

Additional information as at 30 June, 2016

* Total assets amounted to $1,210,000

## Suggested solution – Income Statement

**New report layout (reflecting changes to discounts and financial expenses)**

|  |  |  |  |
| --- | --- | --- | --- |
| **Urban Garden Traders**  **Income Statement**  **For the year ended 30** **June, 2017** | | | |
|  | **$** | **$** | **$** |
| Sales |  | 790,000 |  |
| Less Sales Returns |  | 3,900 |  |
| Discount Allowed |  | 2,140 |  |
| Net Sales |  |  | 783,960 |
|  |  |  |  |
| Less Cost of Sales | 492,500 |  |  |
| Freight Inwards | 16,500 |  |  |
| Customs Duty | 960 | 509,960 |  |
| Less Discount Received |  | 2,500 |  |
| Total Cost of Sales |  |  | 507,460 |
| Gross Profit |  |  | 276,500 |
|  |  |  |  |
| **Add Other Income** |  |  |  |
| Interest Income |  | 900 | 900 |
|  |  |  | 277,400 |
|  |  |  |  |
| **Less Other Expenses** |  |  |  |
| **Selling and Distribution** |  |  |  |
| Bad Debts | 1,370 |  |  |
| Advertising | 22,000 |  |  |
| Freight Outwards | 12,200 |  |  |
| Wages – Sales Staff | 92,800 | 128,370 |  |
|  |  |  |  |
| **General and Administrative** |  |  |  |
| Depreciation – Furniture | 3,750 |  |  |
| Insurance | 15,000 |  |  |
| Internet Charges | 750 |  |  |
| Salaries – Office Staff | 59,000 | 78,500 |  |
|  |  |  |  |
| **Financial** |  |  |  |
| Interest Expense | 650 |  |  |
| Bank Fees and Charges on Loan | 55 | 705 | 207,575 |
| Profit for the period |  |  | 69,825 |

## Suggested solution – Income Statement

**Former report layout (prior to changes to discounts and financial expenses)**

|  |  |  |  |
| --- | --- | --- | --- |
| **Urban Garden Traders**  **Income Statement**  **For the year ended 30 June, 2017** | | | |
|  | **$** | **$** | **$** |
| Sales |  | 790,000 |  |
| Less Sales Returns |  | 3,900 |  |
| Net Sales |  |  | 786,100 |
|  |  |  |  |
| Less Cost of Sales |  | 492,500 |  |
| Freight Inwards |  | 16,500  Former Layout |  |
| Customs Duty |  | 960 |  |
| Total Cost of Sales |  |  | 509,960 |
| Gross Profit |  |  | 276,140 |
|  |  |  |  |
| **Add Other Income** |  |  |  |
| Discount Received |  | 2,500 |  |
| Interest Income |  | 900 | 3,400 |
|  |  |  | 279,540 |
|  |  |  |  |
| **Less Other Expenses** |  |  |  |
| **Selling and Distribution** |  |  |  |
| Advertising | 22,000 |  |  |
| Freight Outwards | 12,200 |  |  |
| Wages – Sales Staff | 92,800 | 127,000 |  |
|  |  |  |  |
| **General and Administrative** |  |  |  |
| Depreciation – Furniture | 3,750 |  |  |
| Insurance | 15,000 |  |  |
| Internet Charges | 750 |  |  |
| Salaries – Office Staff | 59,000 | 78,500 |  |
|  |  |  |  |
| **Financial** |  |  |  |
| Interest Expense | 650 |  |  |
| Discount Allowed | 2,140 |  |  |
| Bad Debts | 1,370 |  |  |
| Bank Fees and Charges on Loan | 55 | 4,215 | 209,715 |
| Profit for the period |  |  | 69,825 |

## Suggested solution – Balance Sheet

|  |  |  |  |
| --- | --- | --- | --- |
| **Urban Garden Traders**  **Balance Sheet**  **As at 30 June, 2017** | | | |
|  | **$** | **$** | **$** |
| **Current Assets** |  |  |  |
| Cash at Bank |  | 134,000 |  |
| Accounts Receivable |  | 32,000 |  |
| Inventory |  | 35,200 |  |
| Total Current Assets |  |  | 201,200 |
| **Non-Current Assets** |  |  |  |
| Furniture | 97,000 |  |  |
| Less Accumulated Depreciation – Furniture | 52,300 | 44,700 |  |
| Land and Premises |  | 900,000 |  |
| Total Non-Current Assets |  |  | 944,700 |
| Total Assets |  |  | 1,145,900 |
|  |  |  |  |
| **Current Liabilities** |  |  |  |
| Accounts Payable |  | 26,000 |  |
| Bank Loan |  | 15,900 |  |
| Total Current Liabilities |  |  | 41,900 |
| **Non-Current Liabilities** |  |  |  |
| Mortgage |  | 650,000 |  |
| Total Non-Current Liabilities |  |  | 650,000 |
| Total Liabilities |  |  | 691,900 |
| Net Assets |  |  | 454,000 |
|  |  |  |  |
| **Equity** |  |  |  |
| Capital |  | 395,375 |  |
| Add Profit for the period |  | 69,825 |  |
|  |  | 465,200 |  |
| Less Drawings |  | 11,200 |  |
| Total Equity |  |  | 454,000 |

Note: these changes to the Australian Accounting Standards have no impact on the balance sheet.

## Profitability ratios

|  |  |  |
| --- | --- | --- |
| **Profitability ratio** | **Calculations**  (reflecting changes to discounts  and financial expenses) | **Calculations**  (prior to changes to discounts  and financial expenses) |
| Profit  profit  net sales | = 69,825 x 100  783,960  = 8.91% | = 69,825 x 100  786,100  = 8.88% |
| Gross profit  gross profit  net sales | = 276,500 x 100  783,960  = 35.27% | = 276,140 x 100  786,100  = 35.13% |
| Expense  operating expenses  net sales | = 207,575 x 100  783,960  = 26.48% | = 209,715 x 100  786,100  = 26.68% |
| Rate of return on assets  profit  average total assets | No change | Average assets  = (1,210,000 + 1,145,900) / 2  = 1,177,950  Rate of return on assets  = 69,825 x 100  1,177,950  = 5.93% |