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# Accounting
# Teach Yourself Series
## Topic 3: Accounting Elements



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# Accounting Elements

Accounting is a system for recording and reporting financial transactions. The records and reports prepared reflect changes in the elements of the accounting system.

## Initial terminology

### As it appears in Units 1 - 4

For the purposes of the VCE Accounting course there are 5 Accounting elements which students should be aware of. Every transaction will impact upon one or more of these accounting elements and the financial reports prepared will be expressions of these accounting elements.

These Accounting Elements are:

- Assets
- Liabilities
- Owner's Equity
- Revenue
- Expenses

## Assets

### As it appears in Units 1 - 4

The definition of an asset stipulated in the Study Design is:

*'An asset is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity'.*

In simple terms assets are those items the business owns or is owed that it will use to help it earn revenue.

When discussing assets it is important that students are aware of the different classifications of assets. The two classifications are:

- Current Assets – these assets are resources controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity. The benefits will flow to the entity within the next 12 months.

  Examples of Current Assets include:

  Cash at Bank, Debtors, Stock and Prepaid Expenses

- Non-Current Assets – these assets are resources controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity. The benefits will not flow to the entity until some future period, generally after the next 12 months.

  Examples of Non-Current Assets include:

  Motor Vehicle, Fixtures & Fittings, Shop Equipment and Premises.

- A further 'classification' of Assets in Units 2-4 is a negative Non-Current Asset. This is related to a Non-Current Asset but it results in a reduction in the inflow of future economic benefits. The example is Accumulated Depreciation.

## Review Questions

**1.** Explain the key difference between a Current and a Non-Current Asset.

**2.** On 1 May 2011 the owner paid $6,000 for an advertising campaign for the next 6 months. The owner is confused about the reporting of Advertising as an Asset, believing it to be an Expense. Explain, with reference to the definition of the relevant accounting element, how Advertising can be reported as a Current Asset.

**3.** The following ledger account was prepared at 30 June 2011. Explain why this account would be classified as a Current Asset in the Balance Sheet as at 30 June 2011.

**GST Clearing**

| Date 2011 | Cross Reference | Amount | Date 2011 | Cross reference | Amount |
|---|---|---|---|---|---|
| Jul 1 | Balance | 3 400 | Jun 30 | Bank | 3 400 |
| Jun 30 | Creditors Control | 19 100 | | Bank | 15 200 |
| | Bank | 12 600 | | Debtors Control | 13 600 |
| | | | | Balance | 2 900 |
| | | **35 100** | | | **35 100** |

# Liabilities

## As it appears in Units 1 - 4

The definition of a liability stipulated in the Study Design is:

*'A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits'.*

In simple terms liabilities are those items the business owes that it is required to pay back at some point in the future. When discussing liabilities it is important that students are aware of the different classifications of liabilities. The two classifications are:

- Current Liabilities – these liabilities are obligations of the entity as a result of past events the settlement of which will see an outflow of economic benefits within the next 12 months.

  Examples of Current Liabilities include:

  Bank Overdraft, Creditors, GST Clearing (in most situations), some portion of a Loan and Accrued Expenses

- Non-Current Liabilities – these liabilities are obligations of the entity as a result of past events the settlement of which will see an outflow of economic benefits at some point after the next 12 months.

  Examples of Non-Current Liabilities include:

  Mortgage and some portion of a Loan.

### Review Questions

**4.** Explain the key difference between a Current and a Non-Current Liability.

______________________________________________________________________

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**5.** At 1 January 2010 the business owed $3,600 to the Australian Tax Office for GST. Explain, with reference to the definition of the appropriate accounting element, your classification of the GST Clearing in the Balance Sheet at 1 January 2010.

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## Solutions to Review Questions

1. The key determinant of whether an Asset is a Current or Non-Current Asset is the time over which economic benefits will flow. For a Current Asset the benefit will flow within 12 months, for a Non-Current Asset the benefit will flow over a period longer than 12 months.

2. Advertising has been paid for in advance of any economic benefit being gained. Resources have flowed from the business (decrease in Bank) and an obligation has been earned [illegible] flow to the business in the next reporting period. Hence the Prepaid Advertising [illegible] be reported as a Current Asset.

3. The GST Clearing account will be classified as a Current Asset as it represents a future inflow of economic benefit in the form of a refund from the ATO. [illegible] occurs because the amount of GST paid and incurred on purchases and expenses exceeds the amount collected and owing from sales.

4. The key determinant of whether a Liability is a Current or Non-Current Liability is the time over which the obligation will be met. For a Current Liability the obligation will be met within 12 months, for a Non-Current Liability the obligation will [illegible] over a period longer than 12 months.

5. GST Clearing represents a [illegible] outflow of economic benefits to the ATO in the form of a decrease in Assets (Bank). Hence it is [illegible] as a Liability. As the outflow will occur with the next 12 months it is appropriate to classify GST [illegible] Current Liability

6. A Liability represents a future obligation to sacrifice economic resources. In the case of the Loan, some of the obligation ($[illegible]) will be met in the next 12 months, while the remainder ($24,000) will be met in future reporting periods. Hence the Loan is reported as both a Current and Non-current Liability.

7. Capital at start + contributions + Profit – Drawings = Capital at End
   135,4[illegible] [illegible]500 – [illegible]9,500
   135,450 + 71,000
   Capital at end = $206,45[illegible]

8. Discount Revenue represents a savings in outflows of economic benefits that results in a decrease in liabilities (Creditors) that lead to an increase in owner's equity, except capital contribution.

**9.**

| **Transaction** | **Revenue type** |
|---|---|
| Sold stock on credit to M. Lawson | Credit Sales |
| Sold an asset that had a Carrying Value of $3,200 for $3,600 | Profit on Disposal of Asset |
| Interest received on cash at bank | Interest Revenue |
| A customer paid a deposit of $700 on goods to be delivered in 2 months | Prepaid Sales Revenue |
| The business rents part of its store to another business | Rent Revenue |