

MAA261- Financial Accounting

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Deakin University

Assignment 2 Part B

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Introduction

This report is divided into seven sections that provide an assessment report of Gym Pty Ltd to non-current assets, expense, and previous records. This report shows that the distribution costs of newly acquired land buildings etc. and the uses the annual depreciation method to prove whether the company needs to make changes to its previous depreciation method and points out the pros and cons of the previous method. Therefore, uses the annual depreciation to prove whether the depreciation method before the change is needed. Second, we discussed the recoverable amount of the company by analysing and certifying the revaluation and loss of assets. Finally, we analysed the rules of the company and give the methods suitable for the company.

Question 1: Acquisition of Non-Current Assets

The allocated cost of newly acquired land, building and machinery are shown as the table below:

			Price of assets: \$800,000
	Fair Value	% allocated	amount that allocated
Land	\$540,000	= \$540,000/\$960,000 =0.5625	= 0.5625*\$800,000 = \$450,000
Building	\$320,000	= \$320,000/\$960,000 =0.3333	= 0.3333*\$800,000 = \$266,667
Machinery	\$100,000	= \$100,000/\$960,000 =0.1042	= 0.1042*\$800,000 = \$83,333
Total	\$960,000		\$800,000

General journal for purchase of the assets on 2 January 2011

General Journal			
Date	Account	Debit (\$)	Credit (\$)
2/1/2011	Dr Land	450,000	
	Dr Building	266,667	
	Dr Machinery	83,333	
	Dr GST receivable	80,000	
	Cr Cash at bank		300,000
	Cr Bank loan		580,000
	(purchase assets by cash and bank loan)		

With the additional costs which are relating to assets are considered below:

A / Legal fees for the land purchase \$2,500 (plus GST): this fee should be included in the costs as directly attribute cost (according to AASB 16, para 17)

B / Installation cost of the Machinery \$3,300 (plus GST): this fee should also be included in the cost as directly attribute cost (according to AASB 16, Para 17)

C / Renovating cost \$10,000 (plus GST): this fee should not be included in the cost of assets. AASB 16, para 19-20 stated that the cost sustained whereas an item qualified for functioning in the plan of management has yet to be gotten into use are not included in the cost of assets. The renovating costs are not qualified to

involve.

D / Employees' training fees \$1,200 (plus GST): this fee should not be involved in the cost of assets.

According to AABS 16, Para 19-20, the cost for staff training is not considered as a cost of an item of equipment/machinery.

E / Shipping fee \$700 (plus GST): this fee should be included in the cost of directly attribute cost due to the state of AABS 16, para 17 that this cost is considered as the delivery cost.

Therefore, the cost should be recorded in the balance sheet is:

Land (cost + legal fees) (\$450,000 + \$2,500)	\$452,500
Building	\$266,667
Machinery	\$79,000

The machinery cost is calculated as below:

Machinery (net price excludes GST)	\$83,333
Add: Gross up GST	\$8,333
	<hr/>
	\$91,666
Less: Trade discount 10%	(\$9,166)
	<hr/>
	\$82,500
Less GST	(\$7,500)
	<hr/>
	\$75,000
Add Installation fees	\$3,300
Add Shipping fee	\$700
	<hr/>
Machinery price	\$79,000

Question 2: Annual Depreciation

A / Annual Depreciation of building by straight-line method for each year from the financial year 2011 to the financial year 2014

B / Annual Depreciation of machinery by the diminishing-balance method

Year	Carrying amount at beginning of the year		Rate	Annual depreciation expense	Carrying amount at end of year
2011	\$79,000	x	20%	\$15,800	\$63,200
2012	\$63,200	x	20%	\$12,640	\$50,560

2013	\$50,560	x	20%	\$10,112	\$40,448
2014	\$40,448	x	20%	\$8,090	\$32,358

C / According to AABS 1021, para 6, the depreciation rate and depreciation method has to be assessed annually (at least). Besides that, assets will be reassessed for remaining useful life. Therefore, depreciation need to be adjusted or reassessed as well.

In accounting, the depreciation of machinery will become more accuracy when company use Units-of-production method. However, in the data of Gym Life Pty Ltd, the owner did not mention about the number of useful life hours of machinery was used in years. Therefore, Trendy Accounting cannot verify this solution for Gym Life Pty Ltd.

Question 3.Revaluation of the building and land

Gain on revaluation is accounted for in equity, under the revaluation reserve. This holds unless the revaluation gain reverses the revaluation losses which were previously recognized on the same asset in the income statement. When the gain reverses the previous loss attributed to the asset it is shown in the income statement. Revaluation gain is also referred to as unrealized gain that becomes released after disposal of the asset (recognized) (Schroeder, et al 2009).

The revaluation losses are supposed to be charged against any related revaluation surplus to the extent that the loss or the decline in value does not exceed the total revaluation reserve in respect of the same asset. Any also exceeding the total reserve should be charged as an expense in the company's income statement (Weygandt, et al 2010).

Revaluation of land and building on 30th June 2014

Land

Carrying value of land at revaluation date	\$266667
Valuation	<u>\$500,000</u>
Loss on revaluation	<u>-\$40,000</u>

Double entry

	Dr.	Cr.
Revaluation reserve	0	
Income statement	\$40,000	
Land account		\$40,000

Building

Carrying value of building at revaluation date	
$320000 - (320000 - 50000) / 10 * 3$	\$239,000

Valuation	\$350,000
Gain on revaluation on revaluation	\$111,000

Double entry:

	Dr.	Cr.
Building cost (\$350,000 - \$320,000)	\$30,000	
Accumulated depreciation (\$320,000-\$50,000)/10*3	\$81,000	
Revaluation reserve		\$111,000

Revaluation of building on 30 June 2016

Building

Carrying value of building at revaluation date	
350000 -(350000-80000)/5*2	\$242,000
Valuation	\$150,000
Loss on revaluation	<u>-\$92,000</u>

Double entry

	Dr.	Cr.
Revaluation reserve	\$124,000	
Income statement	-\$32,000	
Building account		\$92,000

Question 4. Gym Life Pty Ltd Non-current Asset

Gym Life Pty Ltd excerpt of the balance sheet 30-Jun-14			
Asset	Cost	Accumulated depreciation/Devaluation	Net value
Land	\$540,000	-\$40,000	\$500,000
Building	\$320,000	\$30,000	\$350,000
Machinery	\$79,000	-\$46,642	\$32,358
Total noncurrent assets			\$882,358

Calculations

Land

Fair value 2nd Jnuary 2011	\$540,000
Loss on revaluation (\$540000 - \$500000)	\$40,000
Net value	<u>\$500,000</u>

Building

Fair value 2nd Janaury 2011	\$320,000
Depreciation (\$320,000-\$50,000)/10*3	\$81,000
Revaluation gain	<u>\$239,000</u>
Net value	\$350,000

Machinery

Machinery (net price excludes GST)	\$83,333
Add: GST	\$8,333
	\$91,666
Less: Trade discount 10%	(\$9,166)
	\$82,500
Less GST	(\$7,500)
	\$75,000
Add Installation fees	\$3,300
Add Shipping fee	\$700
Machinery price	\$79,000

Depreciation

2011	\$79,000	x	20%	\$15,800	\$63,200
2012	\$63,200	x	20%	\$12,640	\$50,560
2013	\$50,560	x	20%	\$10,112	\$40,448
2014	\$40,448	x	20%	\$8,090	\$32,358

Question 5a.Revaluation and Impairment

The revaluation model of an asset in the company initially record the carrying cost, but the carrying cost can be increased to account for inflation changes and the changes in the fair value of the asset (Herrmann, 2006). At the cost model, fixed asset within the company are carried at their historical costs decrease both the accumulated depreciation and impairment loss. In the case Rebecca and Dario, after the fire destroyed the building and machinery in the Gym Life business the business suffered a loss. They failed to record any of the loss as the revaluation of the business building was lower than previously recorded. By July 2014 the revaluation of the building had a surplus; according to the revaluation model the surplus recorded will first be utilized to offset the deficit recorded after the occurrence of the fire, the result is a fund reduction. In the case of the Gym building the reservation reserves fail to cover the loss, thus a record of the excess fund that cannot be covered reported as the impairment loss in the income statement. For the machinery, it has a downward value due to the impairment loss after the fire. The loss affects the income statement as an impairment loss.

The Gym Life business cannot change from the revaluation model to cost model for the building as the cost model does not account for any appreciation in value for assets. The cost model allows only downward adjustment due to impairment loss, as opposed to the revaluation model that allows for both upwards and downward adjustments. The failure to record the revaluation and impaired loss violate the

relevant characteristic of the financial statements. The records presented should be free from any error and bias, eliminating any uncertainties through the proper disclosure. It also violates the comparability aspect; the information presented within the accounting period should be comparable. It enables the user to identify trends in the financial position.

Question 5b.Revaluation and Impairment

Revaluation on building

The building has a revaluation surplus of \$ 30,000. The revaluation after the fire, the carrying cost \$ 315,000. The carrying cost exceeds the fair value of \$ 150,000 by \$ 165,000 thus reducing the account balance. The result is an impairment loss on the building.

	Debit	Credit
Revaluation Surplus	165,000	
Building Account		165,000

Impairment loss on machine

If the Carrying cost exceeds the recoverable amount an impairment loss is recorded.

The carrying cost for the machine is the fair value less depreciation which amounts to \$ 14,104 minus \$ 2764.24 which is \$ 11,339.76. Its recoverable amount is the higher of fair value less costs to sell and value in use amounting to \$ 752. Thus an impairment loss of \$ 10,587.76.

	Debit	Credit
Impairment Loss	10,588	
Accumulated impairment loss		10,588

Question 6. Preparation of general- purpose Financial Reports

The general-purpose financial statement includes accounting reports such as the income statement, cash flow statement, balance sheet and retained earnings. Through the accounting period the general-purpose financial statement aid both creditors and investors in the decision making process (Elliott, 2017). Although the business transforms into a service industry, it will be guided by the framework as it is a profit making entity, generating its income and incurring its expenses. The framework sets out the concepts underlining the preparation and ultimately the presentation of the financial statement for the external users.

It is evident that there is a going concern in the Gym service business as it provides a maximum membership of twenty-four months. The membership fee represents the income generating factor in the business enterprise; income forms an element in the framework thus the need for the general purpose financial statements. It is also noted some cost such as administrative costs is catered for from the income generates from joining fees. The administrative cost as an expense represents another vital element of the conceptual framework.

Question 7. Revenue Recognition for the Fee

The Gym life offers annual membership on its terms and conditions. There are two types of fees payable to the gym, a once-off non-refundable joining fee, and a monthly membership fee. Under Revenue from contracts with customers, there is a five-step process for the recognition of revenue. The steps must identify the contracts with a customer; identify the separate performance obligation in the contract, determination of the transaction price. Once determined it's allocated to the separate performance obligation. Lastly, the revenue is recognized once the entity satisfies each of the performance obligations (Lamoreaux, 2012).

For performance obligation to be met over time, some certain criteria must be met. The customer must receive the benefits, there exists a creation of an asset and there is no creation or enhancement of an asset with an alternative use to the entity and it enjoys an enforceable right to payment for the completion of performance. Considering the two sets of income- the joining fee and monthly subscription there is a distinct performance obligation between the two sets of income. Each of the set of income has its discrete benefit to the customer as well as the creation of its asset. They both also have different enforce ability right as the joining fee is paid once while the monthly fee payment is enforceable for a monthly period.

General ledger entry of revenue as at 30th June 2017

	Debit	Credit
Cash($40 \times 600 + 40 \times 80 = 27200$)	27,200	
Sales		27,200

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