Clarification – Key changes to definitions from the *New Zealand Equivalent to the IASB Conceptual Framework for Financial Reporting 2018 (NZ Conceptual Framework)*

Scholarship

Students should have an understanding of all aspects of the definition and recognition criteria of assets, liabilities, equity, incomes and expenses contained in the 2018 NZ Conceptual Framework.

NCEA Levels 1, 2 and 3

The current appendices for Levels 1, 2 and 3, Accounting include reference to the NZ Conceptual Framework:

> ***The NZ Conceptual Framework***
> *It is expected that teachers and students will use the New Zealand Equivalent to the IASB Conceptual Framework for Financial Reporting 2010 (NZ Conceptual Framework) as a reference. Definitions and explanations in the most recent version of NZ Conceptual Framework will guide assessment of accounting concepts where relevant.*

However, 2020 is the transition year to the updated Conceptual Framework for Financial Reporting (2018 NZ Conceptual Framework). This is now considered to be the most recent version of the NZ Conceptual framework and will guide the assessment of accounting concepts where relevant.

* The changes affecting external examinations at Level 1, 2 and 3 are minor.*

Please note that candidates using reference to the definitions found in the 2010 NZ Conceptual Framework will not be penalised in the transition year, 2020. In subsequent years, candidates should be familiar with the 2018 NZ Conceptual Framework as relevant to their Level.

The following information summarises the key changes and understandings expected of candidates:

1. Assets

Definition of an asset

4.3 An asset is a present economic resource controlled by the entity as a result of past events.

4.4 An economic resource is a right that has the potential to produce economic benefits.

Source: 2018 NZ Conceptual Framework

For the purposes of Levels 1, 2 and 3 accounting the definition of an asset will include:

Paragraphs 4.3 and 4.4 paraphrased as follows
An asset is a present economic resource (right), with potential to produce economic benefits, which is controlled by the entity as a result of past events.

Candidates at Levels 1, 2 and 3-are required to understand that an asset:

- is a present economic resource that has potential to (can) produce economic benefits for the entity in the future,

- is controlled by the entity, usually by ownership, so the entity can stop others from gaining economic benefit from the economic resource or the entity, alone, can gain economic benefit from the economic resource,
- is purchased or acquired in a past transaction.

Demonstrating understanding of the definition of assets at Levels 1, 2 and 3 may include:
Assessment of the following *economic resources*:

- property, plant and equipment (PPE) owned by the entity,
- inventory owned by the entity,
- the right to receive cash from accounts receivable,
- the right to receive services for example insurance (prepaid insurance), advertising (prepaid advertising).

Assessment of *potential to produce economic benefits* restricted to benefit from:

- PPE would arise from the use of the PPE in generating income and ultimately cash inflow for the entity. Note that gaining potential economic benefit by selling the PPE item(s) will not be assessed.
- inventory would arise from the sale of the inventory,
- prepayments, would arise from the services that entity has a right to receive in the future (because it has already paid for that right),
- **(Levels 2 and 3)** accounts receivable would arise from the sale of inventory or provision of services on credit which obligates the other party (accounts receivable/debtor) to settle the credit transaction.

Assessment of *control* of the economic resource will restricted to explaining:

- either that the entity, alone, can benefit in the future from the economic resource,
  or the entity can prevent all others from benefitting from the economic resource in the future.

Note: Assessment of control of the economic resource would require only one of the above to be provided as evidence of understanding of control.

Assessment of a *past event* will be restricted to assessment of a past transaction that gives rise to the entity having the economic resource in its control.

2. Liabilities

Definition of a liability

4.26 A liability is a present obligation of the entity to transfer an economic resource as a result of past events.

Source: 2018 NZ Conceptual Framework

Candidates at Levels 1, 2 and 3 will be required to understand that a liability:

- is a present obligation owed to a party other than the entity,
- is a present obligation/duty/responsibility to pay cash (Level One and Two) or deliver goods or provide services (Level Two only) to a party other than the entity,
- is a result of a past transaction or event involving a party other than the entity.

Demonstrating understanding of the definition of liabilities at levels 1, 2 and 3 may include:
Assessment of the following *present obligation to transfer an economic resource*:

- loans/mortgages owed to a financial institution or person requiring the entity to pay cash to the financial institution or person,
- accounts payable owed to creditors for goods and/or services purchased by the entity on credit, requiring the entity to pay cash to the accounts payable,
- accrued expense for wages owed to employees for work done in the current accounting period where the wages have not yet been paid, requiring the payment of those wages in the next accounting period,
- accrued expense for interest owing on a loan or mortgage requiring payment of cash to the financial institution or person to whom the interest is owed,
- **(Levels 2 and 3 only)** income in advance requiring the entity to provide a service or deliver goods to the party which has paid for the service or the goods in advance of receiving the service or goods from the entity (giving the party a right to receive the service or the goods in the future).

Assessment of a *past event* will be limited to:

- a loan or mortgage contract was signed (loans/mortgages/interest owing on balance day),
- the entity purchased goods or services on credit (accounts payable),
- employees have worked during the accounting period but not received wages for that work on balance day (accrued wages),
- cash received from an external party for the right to receive a service or goods from the entity in the future (income in advance).

3. Incomes and expenses

The new definitions are as follows:

4.68 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.

4.69 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.

4.70 It follows from these definitions of income and expenses that contributions from holders of equity claims are not income, and distributions to holders of equity claims are not expenses.

Source: 2018 NZ Conceptual Framework

For **Levels 1 and 2**, which apply to sole proprietor businesses, the words *"other than those relating to contributions from/distributions to holders of equity claims"* can be simplified to *"other than those relating to contributions from the owner/drawings by the owner"*.

4. Recognition criteria for Levels 2 and 3

Definition of Recognition criteria (abridged)

5.6 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.

5.7 … 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, ie 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 (…).

Source: 2018 NZ Conceptual Framework

Assessment of the recognition criteria for Levels 2 and 3 will be limited to the following:

An asset, liability, income or expense is recognized when it meets the definition, and the recognition of the asset, liability, income or expense will provide users of the financial statements with

(a) relevant information
(b) faithful representation.

Assessment of relevant information will be limited to:

From paragraph 5.17 (a)

- if an asset is acquired or a liability is incurred in an exchange transaction on market terms, its cost generally reflects the probability of an inflow or outflow of economic benefits. Thus, that cost may be relevant information, and is generally readily available.
  Source: 2018 NZ Conceptual Framework

For the purposes of assessment, the dollar amount of the past transaction or event giving rise to the financial element, will be considered to be relevant information related to the probability of an inflow or outflow of economic benefits.

Assessment of faithful representation will be limited to:

From paragraph 5.19

- for an asset or liability to be recognised, it must be measurable.

The faithful representation of the initial measurement of an asset, liability, income or expense will be limited to the historical cost of the transaction or event giving rise to the asset, liability, income or expense. This is a faithful representation based on a transaction on market terms that will have documentary evidence of the amount paid/received/owing that gives rise to the asset, liability, income or expense.

Further recognition of expenses such as depreciation, write down of inventory to net realisable value and doubtful debts will be based on the following extracted from Paragraph 6.7:

6.7 The historical cost of an asset is updated over time to depict, if applicable:

(a) the consumption of part or all of the economic resource that constitutes the asset (depreciation or amortisation) add watermark
(c) the effect of events that cause part or all of the historical cost of the asset to be no longer recoverable (impairment).

Source: 2018 NZ Conceptual Framework

Note the words amortisation and impairment will not be used in assessments at Level Two.