MODEL EXAM QUESTION

(a) What are the requirements for the initial recognition, and subsequent measurement of goodwill under Australian accounting standards? (5 marks)

Only purchased goodwill can be recognised (1 mark). Internally-generated goodwill is prohibited from being recognised (1 mark). Goodwill is to be initially recognised at ‘cost’—that is, the difference between the purchase price and the fair value of net identifiable assets acquired (1 mark). Goodwill must not be revalued (1 mark). At each reporting date, the timing and amount of benefits expected to accrue from goodwill must be reviewed (AASB 3, para.54) (impeachment test) and recognised as an expense to the extent that the future benefits are no longer probable. AASB136 requires goodwill to be tested for impairment at least annually. (1 mark)

(b) Prior to convergence with international accounting standards, Australian companies were required to amortise goodwill on a straight line basis over a period of no more than 20 years. Outline the arguments for and against the requirement to systematically amortise goodwill. (5 marks)

(b) Arguments concerning systematic amortisation:

● FOR - as for tangible assets, the depreciable amount of long lived assets should be allocated by some systematic method over the life of the goodwill (1 mark);

● AGAINST - systematic allocation of goodwill (or any other asset) is arbitrary; it is difficult/impossible to objectively justify the length of life and depreciation method chosen. Preparers should be required to use professional skill and judgement to amortise goodwill according to the period and pattern of expected benefits (that is, using whichever method and length of life that is most appropriate) (1 mark);

● FOR - systematic amortisation ‘smooths’ reported profits. Arguably, investors prefer smoother, less volatile reported profits (1 mark); and

● AGAINST - the using up of goodwill is inherently more difficult to estimate than for other assets. This is because changes in the ‘value’ of goodwill are more volatile and unpredictable (1 mark) Thus impairment is the most appropriate way to recognise changes in the value of goodwill (1 mark).

(c) Which accounting treatment for goodwill (amortisation or impairment) do you think managers would prefer? Explain your answer. (5 marks)

(c) Managers may prefer impairment testing because total assets are higher and there is no effect on profit in terms of a periodic amortisation charge (1 mark). However, if economic circumstances change and an impairment write down are required, systematic amortisation might be preferable as it has a smoothing effect on profit, rather than a large write off amount in one period (1 mark).

Systematic amortisation ‘smooths’ reported profits and arguably, investors prefer smoother, less volatile reported profits (1 mark). On the other hand, in times of a general economic down-turn, managers may use the impairment of goodwill as an “excuse” to take a bath and write down the goodwill asset more than needed so that future profits are less likely to be affected by further write-down charges (1 mark), Managers’ preferences are going to be mainly driven by effects on profits and their bonuses, and effects on shareholders’ perceptions of the company’s performance. (1 mark)

Q1 Assets – Revaluations & Impairment (tutorial question for practical test-non-current asset, between intangible and tangible assets, identifiable/unidentifiable (goodwill) distinction 15 marks

- in 2 parts
  - First part is practical and will be released 3 days before the exam – 12 marks
  - Second part is theoretical – 3 marks

Revaluation Revaluation is a technique used in accounting and finance that helps determine the true and fair market value of a fixed asset. When a revaluation is done, the asset’s recorded value (historical cost value in the ledger) will be adjusted to the market value. The historical values recorded in the books are not accurate since the market value of the asset will fluctuate and may be higher or lower over time. A revaluation will be done to establish the most accurate accounting information regarding the asset’s value.

The revaluation must be done by an IFRS licensed accountant who will have to study markets carefully where such assets are sold in order to determine the accurate market value. Besides determining the true market value of a fixed asset, revaluation can be used to set funds aside for the replacement of the asset, to negotiate prices in a merger or acquisition, for taking loans my mortgaging fixed assets, for regulatory reasons, etc.

Impairment There may be instances in which a fixed asset loses its value and needs to be written down in the accounting books of the firm. In such an instance, the value will be written down to its true market price or will be sold. An asset that loses its value and needs to be written down is referred to as an impaired asset. Once an asset has been impaired, there is very little possibility for the asset to be written up; therefore, the asset must be carefully evaluated before it is categorized as an impaired asset.
An asset can become impaired for a number of reasons, which include becoming obsolete, failing to meet regulatory standards, damages to the asset, changing market conditions, etc. Other company accounts such as goodwill and accounts receivable can also become impaired. Firms are required to conduct regular tests on asset impairment (especially on goodwill) and any impairment then will be written off.

**Revaluation vs Impairment** Impairment and revaluation are terms closely related to one another, with subtle differences. Revaluation and impairment both require the company to evaluate the assets for their true market value, and then take appropriate action in updating the accounting books. The major difference between the two is that a revaluation can be made upwards (to increase the value of the asset to market value) or downwards (to decrease the value). An impairment, on the other hand, only refers to one of the two; a fall in the market value which is then written down.

### Summary: Difference between Revaluation and Impairment
- Fixed assets are recorded in the books at their cost price and are then frequently updated to show their true and fair market value. There are two methods in which this can be done, called revaluation and impairment.
- Revaluation is a technique used in accounting and finance where an asset’s recorded value (historical cost value in the ledger) will be adjusted to the market value.
- An asset that loses its value and needs to be written down is referred to as an impaired asset.

**How does income measurement differ under alternative measurement models?**

- **Historical cost model**
  - Only realised and realisable revenues and expenses are recognised
- **Market value model (net realisable value)**
  - Both realised and unrealised revenues and expenses are recognised

**The tangible/intangible distinction**

- **Tangible asset**
  - A physical object which is tangible, i.e. capable of being touched
- **Intangible asset (AASB 138)**
  - Identifiable non-monetary asset without physical substance
  - Brand Name, computer software, patents, copyrights, customer lists, taxi licenses etc.

**Purchased/internally generated distinction**

- **Purchased Intangibles**
  - Usually recognized because have a cost that can be reliably measured
- **Internally Generated Intangibles**
  - Recognition problematic because in many cases cost/value cannot be reliably measured

**Characteristics of an intangible asset (AASB 138)**

- Intangible Asset is identifiable
- Entity controls the Intangible Asset
- Future economic benefits are expected to flow from the Intangible Asset

**Consistent with AASB Framework definition of asset?**

**The identifiable/unidentifiable distinction**

- **Identifiable**
  - Separable
    - Capable of being separated from the entity and sold, transferred, licensed, rented etc, individually or with a related contract, asset or liability
    - Arises from contractual or other legal rights (AASB 138.12)
- **Unidentifiable**
  - Assets which are not capable of being both individually identified and separately recognized
  - Collectively classified as Goodwill

**Measurement after recognition**

- **Choose to use either**
  - Cost model
  - Revaluation model

**Table 11.2 Requirements for subsequent measurement of intangible assets under AASB 138 ‘Intangible Assets’**
Cost model

<table>
<thead>
<tr>
<th>Carrying amount</th>
<th>Intangible asset carried at cost less accumulated amortization and any accumulated impairment losses.</th>
</tr>
</thead>
</table>

Revaluation model

<table>
<thead>
<tr>
<th>Subsequent impairment</th>
<th>Test for impairment in accordance with AASB 136.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Subsequent amortization</td>
<td>Not required if useful life is indefinite. Required if useful life is finite. Not required if useful life is indefinite.</td>
</tr>
</tbody>
</table>

---

**Revaluation model**

- **Fair value determined by reference to active market**
  - Active markets exist for freely exchanged assets such as taxi licences, but not for unique assets such as mastheads, trademarks, brands
  - Revaluation not permitted if no active market

**Goodwill**

- Only purchased goodwill recognised
- Measured as the excess of cost of acquisition over the fair value of identifiable net assets acquired
  - **Example**
    
    | Cost of acquisition | $500,000 |
    |---------------------|----------|
    | Fair value of identifiable net assets | 450,000 |
    | Goodwill | 50,000 |

  $50,000 recorded as an asset at purchase date

**Measuring purchased goodwill subsequent to acquisition**

- NOT amortised
- Subject to annual impairment test
  - as per AASB 136
- Measured at cost less accumulated impairment losses
- Cannot be revalued (as internally generated goodwill not allowed by AASB 138)

**Impairment of Goodwill**

- Need to identify the cash-generating unit to which the goodwill belongs
  - Lowest level at which goodwill is monitored for internal management purposes
  - Not larger than a segment (determined under AASB 114)
- Compare carrying amount of unit (including goodwill) with recoverable amount of the unit
- Recoverable amount of cash generating unit
  - Higher of fair value less costs to sell and value in use
- Impairment loss
  - Amount by which the carrying amount of a cash-generating unit exceeds its recoverable amount
  - Allocate to reduce carrying amount of the cash-generating unit
    - First to goodwill
    - Then to other assets
  - Reversal of goodwill impairment losses not permitted

**Research and Development (R&D)**

- Internally generated intangible assets
- **Components of R&D costs**
  - Research
    - Pursuit of new ideas/knowledge
  - Development
    - Commercial application of research findings prior to production

**Alternative methods of R&D recognition**
Expense method
Expense and reinstate method
Selective capitalisation method
Capitalisation

AASB 138 requirements
Research
  – Must be expensed in the period it is incurred
Development
  – May be recognized as an asset if it meets certain conditions

Economic consequences of adopting AASB 138
De-recognition of internally generated intangibles adversely affects ratios
  – E.g. debt/asset ratio
Impairment testing of goodwill rather than amortization generally has positive effect on ratios
Expensing rather than capitalizing research and development expenditures decreases current period and increases future period profits
  – Contracting and market effects
  – Impact of IAS38.pdf

Ch11 Q8.21 P 6.10
(a) The financial reporting requirements for initial recognition of intangible assets are summarised in Table 11.1:

Table 11.1 Requirements for initial recognition and measurement of intangible assets under AASB 138

<table>
<thead>
<tr>
<th>Accounting issue</th>
<th>Method of acquisition of intangible asset</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Purchased</td>
</tr>
<tr>
<td></td>
<td>Separately</td>
</tr>
<tr>
<td></td>
<td>Part of business combination</td>
</tr>
<tr>
<td></td>
<td>Internally generated</td>
</tr>
<tr>
<td></td>
<td>Research phase</td>
</tr>
<tr>
<td></td>
<td>Development phase</td>
</tr>
<tr>
<td>1. Definition and recognition</td>
<td>Meet definition of intangible asset (paras 8–17) and recognition criteria (paras 21–23) in AASB 138.</td>
</tr>
<tr>
<td></td>
<td>Meet definition of intangible asset (paras 8–17) and recognition criteria (paras 21–23) in AASB 138.</td>
</tr>
<tr>
<td></td>
<td>No intangible assets may be recognised as arising from research or the research phase of a project (para. 54).</td>
</tr>
<tr>
<td></td>
<td>Meet definition of intangible asset (paras 8–17) and recognition criteria (paras 21–23) in AASB 138 AND meet six additional criteria from para 57. Specific prohibition on recognition of internally generated brands, mastheads, publishing titles etc. (para. 63).</td>
</tr>
<tr>
<td>2. Initial measurement</td>
<td>Measured at cost (para. 24). Cost is measured as purchase price plus costs directly attributable to preparing the asset for its intended use.</td>
</tr>
<tr>
<td></td>
<td>Measured at cost (para. 24). Cost is measured as fair value at acquisition date.</td>
</tr>
<tr>
<td></td>
<td>Not applicable.</td>
</tr>
<tr>
<td></td>
<td>Measured at cost (para. 24). Cost is measured as the sum of expenditure incurred from the date the intangible asset first meets the recognition criteria</td>
</tr>
</tbody>
</table>

Q21 Outline the arguments for and against; systematic amortisation and periodic impairment testing of goodwill
The main argument for the systematic amortisation of goodwill is that, given the cost or other value of long-lived tangible assets is required to be systematically depreciated, why should goodwill be any different? The allocation process results in smoother, less volatile reported profits. The main arguments against systematic amortisation are the difficulties of estimating the useful life of goodwill and determining the pattern of consumption of future economic benefits. Any allocation is bound to be arbitrary. Arguably, impairment is better able to capture the unpredictable changes in value that goodwill is likely to suffer. However, measuring the recoverable amount of goodwill is likely to be extremely subjective (measurement difficulties and the lack of identifiability are the main
reasons for prohibiting the recognition of internally generated goodwill, presumably both arguments apply equally to the impairment testing of goodwill. AASB 3 gives no reason for requiring impairment but not systematic amortisation.

Q2 Liabilities and Financial Instruments
Liabilities-regulation
FI- convertible calculation journal entry, motivation of people, Woolworth, why people need these note?, manage the risk; I guess hedging, AASB101)  15 marks – in 3 parts
– First part is theory and standard based
– Second part is application & analysis – like decision cases
– Third part is practical

Ch4.19 What criteria must a liability meet before it is recognised?
The Framework deals with the criteria for the recognition of liabilities in paragraph 83. Liabilities are recognised only when the future sacrifice of economic benefits is probable and the amount of the liability is capable of reliable measurement.

21 How should a liability be treated if it fails either the probability or the reliability test? – sounds like contingent liability or provision

– should not be recognised,
– should be disclosed in a note to the financial statements.
– For example, an entity may, at the end of the reporting period, be engaged in litigation in defence of a claim for damages. While it may be probable that a future sacrifice of economic benefits will be required, it may be impossible for it to be reliably measured. Nonetheless, disclosure of the existence of the claim, if material, could assist users in making assessments of the present and expected future financial position of the entity.

Chapter 15 P7
On 30 June 2013, Greeen Ltd issued 55,000 convertible notes with a face value of $55 million for a term of five years. The coupon interest rate is 8% per annum, while the market interest rate for comparable non-convertible debt is 12% per annum. Due to its falling share price, Company expects that note holders will not exercise the note options and convert the debt outstanding under the convertible note issue to equity instruments.

(a) Prepare and effective interest schedule and distinguish between the allocation of interest payments and interest expense for each reporting period during the term of the note issue.
(b) Prepare the general journal entry to record the non-exercise of the conversion options in accordance with AASB132.

(a) In this case, the liability is measured as the present value of the annual coupon payments ($4 400 000) and principal repayment ($55 000 000) in five years’ time:

Using Present Value Tables (5 years, 12%): $1/1.12^5 = 0.56743 for the coupon, you need to use annuity formula where $r=12\%, n = 5$ 

\[ P(1-(1+r)^{-n})/r \]

\[ \text{PV}=4.4\text{million} \]

\[ \text{Int PV(1)} \times 3.6048 \]

\[ \text{Prin. PV(2)} \times 0.56743 \]

\[ \text{PV}\text{=4.4\text{million}} \]

\[ \text{= 15 861 120} \]

\[ \text{= 31 208 650} \]

\[ \text{= 47 069 770} \]

The conversion option has a value of $55 000 000 – $47 069 770 = $7 930 230. At the time the notes were issued, the following journal entry would be passed:

<table>
<thead>
<tr>
<th>30 June 2013</th>
<th>Cash at bank</th>
<th>Dr</th>
<th>$55 000 000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Convertible note liability</td>
<td>Cr</td>
<td>$47 069 770</td>
<td></td>
</tr>
<tr>
<td>Convertible note option</td>
<td>Cr</td>
<td>7 930 230</td>
<td></td>
</tr>
</tbody>
</table>
The following effective interest schedule is prepared to identify the fair value of the convertible notes liability outstanding at each reporting period during the term of the convertible note issue.

**Effective Interest Schedule**

<table>
<thead>
<tr>
<th>date</th>
<th>payment ($55m × 8%)</th>
<th>interest exp (col 5 × 12%)</th>
<th>fair value adjustment (interest expense – interest payment)</th>
<th>convertible notes liability ((col 3 – col 2) + col 5 op. bal)</th>
</tr>
</thead>
<tbody>
<tr>
<td>30-Jun-13</td>
<td>4 400 000</td>
<td>5 648 372</td>
<td>1 248 372</td>
<td>47 069 770</td>
</tr>
<tr>
<td>30-Jun-14</td>
<td>4 400 000</td>
<td>5 798 177</td>
<td>1 398 177</td>
<td>48 318 142</td>
</tr>
<tr>
<td>30-Jun-15</td>
<td>4 400 000</td>
<td>5 965 958</td>
<td>1 565 958</td>
<td>49 716 319</td>
</tr>
<tr>
<td>30-Jun-16</td>
<td>4 400 000</td>
<td>6 153 873</td>
<td>1 753 873</td>
<td>51 282 277</td>
</tr>
<tr>
<td>30-Jun-17</td>
<td>4 400 000</td>
<td>6 364 338</td>
<td>1 964 338</td>
<td>53 036 150</td>
</tr>
<tr>
<td>30-Jun-18</td>
<td>4 400 000</td>
<td></td>
<td></td>
<td>55 000 488*</td>
</tr>
</tbody>
</table>

* Rounding error

(b) Assuming that the non-exercise of the conversion options occurs on 30 June 2018:

<table>
<thead>
<tr>
<th>Convertible note liability</th>
<th>Dr</th>
<th>$55 000 000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>Cr</td>
<td>$55 000 000</td>
</tr>
<tr>
<td>Convertible note option</td>
<td>Dr7 930 230</td>
<td></td>
</tr>
<tr>
<td>Retained earnings</td>
<td>Cr</td>
<td>7 930 230</td>
</tr>
</tbody>
</table>

**15 Q12 – Additional question useful for decision case**

If convertible securities are recognized following the components approach required by AASB 132 ‘Financial Instruments: Presentation’. How should the equity component be measured? Give reasons.

**AASB 132 ‘Financial Instruments: Presentation’** requires an entity that issues a financial instrument with a financial liability and an equity element to classify the instrument’s components separately (para. 28).

The separate classification of the liability and equity components of compound instruments such as convertible notes requires measurement of the different components. Measurement of financial assets and liabilities is dealt with by **AASB 139 ‘Financial Instruments: Recognition and Measurement’** which is discussed in Chapter 14. A residual valuation approach for the equity component is required by paragraph 31 of **AASB 132**. That is, the equity component of a compound financial instrument ‘is assigned the residual amount after deducting from the fair value of the instrument as a whole the amount separately determined for the liability component’ (para. 31).

The issuer of a convertible bond would first determine the value of the liability component by measuring the fair value of a similar liability without the equity component (para. 32). This amount is then deducted from the fair value of the compound financial instrument as a whole to determine the carrying amount of the associated equity component (para. 32).

**27 Q17 AASB 139 ‘Financial Instruments: Recognition and Measurement’** refers to the ‘hedged item’ and the ‘hedging instrument’. What is meant by these terms? Provide an example of each using a foreign currency transaction.

A **hedged item** is defined in paragraph 9 of **AASB 139** as:

- An asset, liability, firm commitment, highly probable forecast transaction or net investment in a foreign operation that (a) exposes the entity to risk of changes in fair value of future cash flows and [emphasis added] (b) is designated as being hedged.

- A forecast transaction is an uncommitted but anticipated future transaction (para. 9) such as an expected future sale or purchase.

In the context of foreign currency transactions, hedged items include assets or liabilities expressed in a foreign currency that expose the entity to the risk of loss (or gain) if the exchange rate changes, and that are designated as being hedged.

A **hedging instrument** is defined in paragraph 9 of **AASB 139** as:
A designated derivative or (for a hedge of the risk of changes in foreign currency exchange rates only) a designated non-derivative financial asset or non-derivative financial liability whose fair value or cash flows are expected to offset changes in the fair value or cash flows of a designated hedged item.

To illustrate a hedging instrument in the context of foreign currency transactions, suppose that an entity borrows US$1 000 000. At the same time, the entity takes out a forward exchange contract to cover the risk of changes in the exchange rate between the date of negotiation of the loan and the date of its settlement. The loan payable is the hedged item and the forward exchange contract is the hedging instrument, providing both are designated as such.

Both the hedged item and the hedging instrument must be designated as such at the inception of the hedge. This requires a formal designation and documentation of the hedging relationship (para. 88(a)) that includes the following:

- the entity’s risk management objective and strategy for undertaking the hedge;
- identification of the hedging instrument and hedged item;
- the nature of the risk being hedged; and
- How the entity will assess the effectiveness of the hedge instrument in offsetting the exposure to changes in the hedged item’s fair value or cash flows attributable to the hedged risk (para. 88(a)

Example – Convertible notes
Flexi Ltd issued

• 2000 convertible notes on 1 July 2004.
• the notes have a three-year term and
• issued at par with a face value of $1000 per note,
• Total proceeds at the date of issue of $2 million.
• The notes pay interest at 6% annually in arrears.

The holder of each note is entitled to convert the note into 250 ordinary shares of Flexi Ltd at any time up to maturity. When the notes are issued, the prevailing market interest rate for similar debt (similar term, similar credit status of issuer and similar cash flows) without conversion options is 9%.

Required: Prepare the journal entries to account for the convertible notes for each year of their term assuming that all the holders exercise their conversion option at the expiration of the term of the notes.

Present value of the principal $2 million
Payable in three years time (9%: 0.7721835) $1,544,367
Present value of the interest:
$120 000 ($2 million × 6%) payable
Annually in arrears for three years (9%: 2.5312916) 303,755
Total liability component 1,848,122
Option (equity component) (residual) 151,878
Proceeds of the note issue $2,000,000

<table>
<thead>
<tr>
<th>Date</th>
<th>Payment (6%)</th>
<th>Interest expense (9%)</th>
<th>Change in liability</th>
<th>Notes liability balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>1/07/2004</td>
<td></td>
<td></td>
<td></td>
<td>1,848,122</td>
</tr>
<tr>
<td>30/06/2005</td>
<td>120,000</td>
<td>166,331(9%X1848122)</td>
<td>46,331(166331-120000)</td>
<td>1,894,453(1848122+46331)</td>
</tr>
<tr>
<td>30/06/2006</td>
<td>120,000</td>
<td>170,501</td>
<td>50,501</td>
<td>1,944,954</td>
</tr>
<tr>
<td>30/06/2007</td>
<td>120,000</td>
<td>175,046</td>
<td>55,046</td>
<td>2,000,000</td>
</tr>
</tbody>
</table>

1 July 2004 Dr Cash 2,000,000
Cr Convertible notes (liability) 1,848,122
What are FIs used for?
• Raise capital to finance business operations
• Investment to generate income
  – Assist with managing risk - E.g. interest rates, currency exchange rates
Why is accounting for financial instruments problematic?
• Diversity of financial instruments
• Diverse reasons for holding financial instruments
• Blurring of differences between legal form and economic substance
Accounting standards
• AASB 132 Financial Instruments: Presentation
  – Objective: to establish principles for presenting financial instruments as liabilities or equity and for offsetting financial assets and financial liabilities. It applies to the classification of financial instruments, from the perspective of the issuer, into financial assets, financial liabilities and equity instruments; the classification of related interest, dividends, losses and gains; and the circumstances in which financial assets and financial liabilities should be offset.
• AASB 9 Financial Instruments: Recognition and Measurement
  – Objective: to establish principles for the financial reporting of financial assets and financial liabilities that will present relevant and useful information to users of financial statements for their assessment of the amounts, timing and uncertainty of an entity’s future cash flows
Definitions
Financial instrument
• Any contract that gives rise to
  – a financial asset of one entity and
  – a financial liability or equity instrument of another entity (AASB 132, paragraph 11)
Primary FI- Receivables, payables, equity instruments
Derivative FI- Options, futures, forwards, interest rate swaps, and currency swaps
Hedging instrument

- A designated derivative or (for a hedge of the risk of changes in foreign currency exchange rates only) a designated non-derivative financial asset or non-derivative financial liability whose fair value or cash flows are expected to offset changes in the fair value or cash flows of a designated hedged item (AASB 9)

Introduction - The issue to be considered here is if Whatamess Mining Company Ltd needs to record a liability, a provision or a contingent liability? I do believe Whatamess needs to record a contingent liability

Context/Scene Setting

- Recognition Criteria - A liability is recognised in the statement of financial position when it is probable that an outflow of resources embodying economic benefits will result from the settlement of a present obligation and the amount at which the settlement will take place can be measured reliably. (AASB 137:91)
- Recognition Criteria - A provision (a) an entity has a present obligation (legal or constructive) as a result of a past event; (b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; (c) a reliable estimate can be made of the amount of the obligation. (AASB 137:14)
- Recognition Criteria - A contingent liability (a) a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or (b) a present obligation that arises from past events but is not recognised because: (i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or (ii) the amount of the obligation cannot be measured with sufficient reliability. (AASB 137:10)

Body - In this case, firstly, the mine has been in operation for more than thirty years and is exhausted now, so this is a past event. Secondly, as shown in the case, the conservation group is obviously an outside entity for Whatemess Mining Company Ltd. However, the original agreement did not include any provision for the restitution of the land, so there is not a present obligation for Whatemess Mining Company Ltd till now. In addition, as we can see that there are subsequent agreements include such provisions and the CEO just has agreed to a meeting with the president of the conservation group, so the obligation to restore the land may be or may not be agreed by the CEO, therefore, this obligation is a possible obligation has not been confirmed by Whatemess Mining Company Ltd and is an uncertain event in the future.

Conclusion - Base on the above analysis, I do believe that Whatemess Mining Company Ltd needs to record a contingent liability, as all the information shown in the case complies with characteristics of a contingent liability.

37. In preparing the financial statements for the year ended 30 June 2010 the accountant of Windsor Ltd, a tobacco manufacturer and wholesaler, have come to you with the following information and requested your advice on the appropriate accounting treatment in light of the Australian conceptual framework. Justify your answers.

(a) The company’s plant requires a major overhaul every five years. It has a five-year contract with Zappa Ltd to undertake these overhauls. The next overhaul, which is expected to cost $500,000, will take place during 2011.

- The requirement to pay Zappa to undertake the next plant overhaul in 2011 could be recorded as a liability
- the right to have the plant overhauled by Zappa could be recorded as an asset.
- In practice, the corresponding debit is usually treated as an expense (deferred plant maintenance expense).

The first task is to determine whether the plant overhaul satisfies the liability definition.

- a present obligation to Zappa for the future sacrifice of economic benefits.
  - will depend on the provisions of the agreement with Zappa.
  - If the agreement is firm and enforceable, then Windsor is required to sacrifice economic benefits for Zappa to overhaul the plant.
  - Alternatively, the agreement may be merely a statement of intent which is not enforceable, in which case Windsor is not required to sacrifice economic benefits.

If it is concluded that the agreement with Zappa meets the definition of a liability,

- it will then be necessary to consider whether it meets the liability recognition criteria.
• As the amount of $500 000 specified in the agreement can be reliably measured, the answer will depend on whether it is probable that the agreement would be enforced in the event of non-performance by Windsor.
• If it is probable that the agreement would be so enforced, then it is probable that there will be a future sacrifice of economic benefits.

It may be concluded, therefore, that
• if the agreement is firm and enforceable and
• it is probable that Zappa would enforce the agreement in the event of non-performance by Windsor,
• then the agreement should be recognised as a liability by Windsor.

By similar reasoning it may be concluded that an asset, ‘right to plant overhaul’, should be recognised.

Does deferred plant maintenance satisfy the expense definition in the Framework? For there to be an expense there should be:
• outflow of future economic benefits – as the plant overhaul has not been performed by Zappa, there has been no consumption or loss of future economic benefits.
• reduction in assets or increase in liabilities – there has been an increase in liabilities.
• decrease in equity – the increase in liabilities is exactly offset by an increase in assets, in the form of the right to have the plant overhauled by Zappa.

(b) In February 2010 the State government announced that it would increase its Tobacco licence Fee (TLF) for the July 2010 licence (payable in June 2010) from 50% to 75%. The TLF is collected by tobacco wholesalers, including Windsor, from Tobacco retailers in the month preceding the month in which the TLF has to be paid. In Windsor’s case the TLF is based on total sales of $1 million in each month.

Windsor has an obligation to pay the fees collected to the State Government.

Definition of a liability
• Present obligation
• Past event
• Outflow of economic benefits

Recognition
• Reliably measured
• Probable that an outflow of economic benefits will occur

This amount should be recorded as a liability.
The cash collected by Windsor should be recorded as an asset.

(c) Early retirement packages

Windsor has offered an early retirement package to 500 of its employees. The union representing the employees has agreed to the terms of the package and the offer has been made public and communicated to its employees. The issue is whether the early retirement package should be recognised as a liability and an expense in this reporting period. Students should analyse the offer of early retirement packages and conclude that, because the offer has been made public and is therefore unlikely to be withdrawn, the packages satisfy the definition of a liability. In this question, however, the issue is whether the liability can be measured reliably. To measure the liability it will be necessary to estimate the proportion of employees receiving the offer who will accept it, the salary levels of those employees who are expected to accept the offer and the length of service of those employees who accept the offer.

If Windsor has no past experience, then it may be difficult to measure the liability reliably. In this case, the early retirement packages should not be recognised as a liability. If Windsor has made an offer of early retirement packages in the past (and the present packages are similar to those offered in the past), then Windsor has the evidence from past experience on which to base the measurement of the liability.

Students should then go on to analyse the expense definition and recognition criteria. Their conclusions should be consistent with those they reached in respect of the liability definition and recognition criteria.

Chapter 12

8 The management of a corporate advisory service is considering the effects of leasing transactions on the ‘return on total assets’ and ‘interest cover’ ratios in the accounts of a lessee.

Prepare a short report for management stating the effects on the ‘return on assets’ and ‘interest cover’ of operating and finance leases in the books of the lessees. (Note: the ‘interest cover ratio is profit before interest and taxation divided by interest expense)

In relation to interest coverage
Entering into an operating lease:
- no effect on interest expense
- Lease rental payment will reduce profit before tax.
- Interest coverage is calculated as follows:

\[
\frac{\text{Profit before interest and tax}}{\text{Interest expense}}
\]

- Therefore, entering into an operating lease will lower the numerator without changing the denominator.
- The interest coverage will fall (this ignores any positive effects the availability of the leased resource may have on profit).

In the case of a finance lease,
- The interest expense will increase as part of each lease payment is recognised as lease interest expense.
- The profit before interest and tax will decrease as the amortisation of the asset ‘lease rights’ is recognised in the statement of comprehensive income.
- So, the numerator will decrease and the denominator will increase causing interest coverage to fall.

Comparing the two treatments, in most circumstances, the interest cover will fall by a larger amount if the lease is treated as a finance lease than with an operating lease because of the effect on both the numerator and denominator in the case of the finance lease.

In relation to return on total assets,
- entering into an operating lease will not change total assets,
- But will reduce profits by the amount of the lease payments (ignoring any positive effects on profit from the use of the leased resource).
- a reduction in return on assets is expected.
- Entering into a finance lease increases total assets (and interest bearing liabilities)
- Reduces profit by the sum of the interest component of the lease payments, plus the amount of the depreciation on the leased asset.
- a reduction in return on total assets is expected.

In comparative terms both operating and finance leases have similar effects on profit, but finance leases increase total assets and hence must result in a lower return on total assets.

9 **Managers are not indifferent to the differences between the capitalisation and expense methods of accounting for leases. Outline managers’ incentives to favour one form of lease accounting over the other.**

- the capitalisation treatment will result in an increased debt ratio (implying higher financial risk, an increase in the rates of interest on debt, and a reduced credit rating) and
- lower return on total assets (implying inferior operating performance and possibly reduced management incentives such as bonuses).

Managers will not be indifferent to the choice between these treatments.
- have strong incentives to favour the expense treatment and to ensure that leases are classified as operating leases.
- Empirical accounting research shows that following the introduction of accounting standards that mandated the operating/finance lease distinction, many lessees restructured their leases to ensure that they could be classified as operating leases and qualify for off-balance sheet treatment.

(a) **Distinguish between primary financial instruments and secondary or derivative financial instruments.**
Financial instruments may be classified as:
- *primary*, such as accounts receivable, accounts payable, loans receivable, loans payable and equity securities, or as
- *Derivative* (secondary) financial instruments, such as forward contracts, futures contracts, options, and interest rate and currency swaps.
- Derivative financial instruments - those that ‘create rights and obligations that have the effect of transferring one or more of the financial risks inherent in an underlying primary financial instrument, and the value of the contract normally reflects changes in the value of the underlying financial instrument’.
For example, an entity with accounts payable in a foreign currency may take out a forward currency exchange contract to reduce the risk from fluctuations in currency exchange rates.

- **Derivative financial instruments do not result in a transfer of the underlying primary financial instruments when the contract is entered into.**
- nor do they necessarily result in a transfer of the underlying primary financial instruments when the derivative financial instruments mature.

**b) Distinguish between simple and compound financial instruments.**

- **Simple** financial instruments comprise a single financial asset, financial liability or equity instrument, such as a loan receivable, loan payable or ordinary share,
- **Compound** financial instruments comprise a combination of characteristics of financial assets, financial liabilities and equity instruments.
- For example, a debt security convertible into ordinary shares comprises two components.
  - They are an arrangement to deliver cash or other financial assets and
  - an option granting the holder the right, for a specified period, to convert the debt security into the ordinary shares of the issuer.

**a) What is the purpose of hedge accounting?**

The purpose of hedge accounting is to recognize the offsetting effects on profit or loss of changes in the fair values of the hedging instrument and the hedged item.

**b) Paragraph 86 of AASB 139 ‘Financial Instruments: Recognition and Measurement’ identifies three types of hedging relationships. Identify and explain these relationships.**

The three types of hedging arrangements identified in paragraph 86 of AASB 139 are:

(i) **Fair value hedge**, hedge of an exposure to the changes in the fair value of an asset, liability or unrecognised firm commitment.

(ii) **Cash flow hedge**, a hedge of an exposure to variability in the cash flows of a recognised asset or liability, or a highly probable forecast transaction.

(iii) **Hedge of a net investment in a foreign operation** as defined in AASB 121 ‘The Effects of Changes in Foreign Exchange Rates’.

**Question) AASB 139 ‘Financial Instruments: Recognition and measurement’ refers to the ‘hedged item’ and the ‘hedged instrument’. What is meant by these terms? Provide an example of each using a foreign currency transaction.**

A **hedged item** is defined in paragraph 9 of AASB 139 as:

- An asset, liability, firm commitment, highly probable forecast transaction# or net investment in a foreign operation that
  - (a) exposes the entity to risk of changes in fair value of future cash flows and
  - (b) is designated as being hedged.

#A forecast transaction is an uncommitted but anticipated future transaction (para. 9) such as an expected future sale or purchase.

In the context of foreign currency transactions:

- hedged items include assets or liabilities expressed in a foreign currency that expose the entity to the risk of loss (or gain) if the exchange rate changes, and
- that are designated as being hedged.

A **hedging instrument** is defined in paragraph 9 of AASB 139 as:

- A designated derivative or
- (for a hedge of the risk of changes in foreign currency exchange rates only) a designated non-derivative financial asset or non-derivative financial liability whose fair value or cash flows are expected to offset changes in the fair value or cash flows of a designated hedged item.

**Types of Liabilities**

- **Very low Uncertainty**
  - Borrowings
  - Accruals
  - Accounts payable
- **Very high**
  - Provisions
  - Contingent liabilities
Recognition Criteria more likely to be satisfied where the obligation is mature or unconditional and settlement is certain.

Measurement of Liabilities

**General Principles:**

- **Current liabilities**
  - Recognized at face value of the obligation to be settled in the future
- **Non-Current liabilities**
  - Recognized at present value (NPV)
- **Market value**
  - May differ from NPV because the market uses current interest rates

Why is lease accounting important?

- Concerns about the off-balance sheet nature of leases and diversity in accounting practices
- Difficulties in classifying and measuring leases

**Lease agreement**

- Specifies the rights and obligations of contracting parties
- Typically includes:
  - Lease period
  - Timing and amount of lease payments
  - Who bears the cost of maintenance
  - Contingent rentals e.g. payments based on future sales
  - Options e.g. cancellability, asset purchase, renewal
  - Lease term termination penalties/conditions

Should Operating Leases be capitalized?

- Satisfy AASB Framework definition and recognition criteria for assets and liabilities
- Quality of financial information may be impaired without capitalization
- Operating leases are value-relevant in risk assessment but are not often included in debt covenant ratio constraints

**Foreign currency transactions - Long-term monetary items**

- Entities that borrow or lend in a foreign currency are also susceptible to foreign exchange gains or losses
  - AASB 121 requires all gains and losses to be recognized in the income statement in the period in which they arise

**Purposes of (derivative financial instruments)**

- **Hedging**
- **Speculation**

**Example – Foreign currency transactions with Hedging (FV)**

NG Ltd enters into an agreement to purchase air conditioning plant with a value of OS$100,000 from Cool Air Manufacturing, an OS company, on 1 March 2012. The air conditioners are shipped (and title passes) on 31 March 2007. The transaction is settled on 31 July 2007 and the financial year end is 30 June.

The transaction is settled on 31 July 2007 and the financial year end is 30 June.

The AUD/OSD exchange rates are as follows (AUD$1):

<table>
<thead>
<tr>
<th>Date</th>
<th>AUD/OSD Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 March 2012</td>
<td>0.7500</td>
</tr>
<tr>
<td>31 March 2012</td>
<td>0.7200</td>
</tr>
<tr>
<td>30 June 2012</td>
<td>0.7000</td>
</tr>
<tr>
<td>31 July 2012</td>
<td>0.6700</td>
</tr>
</tbody>
</table>

NG Ltd is concerned about changes in the exchange rate. Accordingly, NG enters into a forward exchange agreement on the date that the goods are shipped to cover this payment. The AUD/OSD forward rate at this time is 0.7100

**Required:**

Prepare journal entries to account for the purchase of the air conditioning plant assuming the forward exchange agreement is designated as a fair value hedge.

31 March 2012

Dr Air conditioning plant 138,889
Cr Accounts payable \(=100,000/0.72\) 138,889
Dr Foreign Currency Receivable (Right to receive OSD) 138,889
Dr Foreign Exchange Loss 1,956
Cr Foreign Currency Payable (obligation to bank) 140,845
(140,845 = 100,000/0.71)

30 June 2012
Dr Foreign Exchange Loss 3,968
Cr Accounts payable 3,968
Dr Foreign Currency Receivable 3,968
Cr Foreign Exchange Gain 3,968
(3,968 = 142,857(100,000/0.70) - 138,889

Note: Loss on underlying primary financial instrument (Accounts payable) is offset by gain on hedge (Foreign Currency Receivable)

31 July 2012
Dr Foreign Exchange Loss 6,397
Cr Accounts payable 6,397
(149,254(100,000/0.67) - 142,857

Dr Foreign Currency Payable (obligation to bank established 31/3/07) 140,845
Cr Cash 140,845

31 July 2012
Dr Foreign Currency Receivable 6,397
Cr Foreign Exchange Gain 6,397

Dr Cash (OSD 100,000) 149,254
Cr Foreign Currency Receivable (Right to receive OSD) 149,254
Dr Accounts payable 149,254
Cr Cash (OSD 100,000) 149,254

<table>
<thead>
<tr>
<th>Date</th>
<th>Accounts Payable</th>
<th>FC Receivable</th>
<th>FC Payable</th>
</tr>
</thead>
<tbody>
<tr>
<td>31/03/2012</td>
<td>Balance</td>
<td>138,889</td>
<td>138,889</td>
</tr>
<tr>
<td>30/06/2012</td>
<td>Change</td>
<td>+ 3,968</td>
<td>+ 3,968</td>
</tr>
<tr>
<td></td>
<td>Balance</td>
<td>142,857</td>
<td>142,857</td>
</tr>
<tr>
<td>31/07/2012</td>
<td>Change</td>
<td>+ 6,397</td>
<td>+ 6,397</td>
</tr>
</tbody>
</table>
Consequences of Financial Instruments accounting standards

‣ Meet framework objectives?
‣ Useful for decision-making?
Address the risks?

Q3 Extractive Industries (different costing method, conceptual framework, revenue recognition for long term calculation) 채취 산업(공업,농업,어업) 10 marks

DE – Revenue Recognition – in 2 parts First part is theoretical and deals with costing methods
Second part is application & analysis – like decision cases

Extractive industries defined
Extractive industries engage in the search for natural substances of commercial value such as minerals, oil and natural gas, and in extracting these substances from the ground

Phases of the extractive industries
Five phases can be identified
1. Exploration
2. Evaluation
3. Development
4. Construction
5. Production
And lastly restoration

AASB 6 only relates to accounting for the exploration for and evaluation of mineral resources. The subsequent stages of development and construction are covered by other standards, including:

– AASB 116 Property, Plant and Equipment
– AASB 138 Intangible Assets
– AASB 102 Inventories
– AASB 118 Revenue
– AASB 136 Impairment of Assets
– AASB 137 Provisions, Contingent Liabilities and Contingent Assets
– And Interpretation 20 Stripping Costs

Major problem of accounting for extractive industries

‣ How to account for costs incurred in exploration and evaluation:
  – Part of preproduction costs?
  – An asset or an expense?

Alternative methods to account for preproduction costs
Potentially five major alternative methods of accounting for preproduction expenditure in the extractive industries:

Expense method (cost written-off method)

Arguments for

– Low probability of exploration and evaluation activity leading to the discovery of a commercial deposit
– Companies in producing phase commonly expense pre-production costs
– Exploration and evaluation costs represent the costs of replacing current reserves and therefore should be matched with current sales revenue
– All exploration and evaluation costs written off as incurred

Arguments against

– Inconsistent with Framework

Expense-and-reinstate method (cost written off and reinstated method)

Arguments for

– Defers recognition of an asset until the future economic benefits are probable
– Matches pre-production costs with associated revenues
– Exploration and evaluation costs written off as incurred, and reinstated if economically recoverable reserves are carried forward

Arguments against
– Understates profit when expensed and overstates profit when reinstated

**Full-cost method**

*Arguments for*
– All exploration and evaluation costs are part of an overall effort to discover reserves and should be recognised as assets
– Matches all exploration and evaluation costs incurred against revenue from the total economically recoverable reserves across all sites— one cost centre.
– Recognised assets closer to the ‘true worth’ of the deposit

*Arguments against*
– Nexus between expenditure on unsuccessful exploration and future economic benefits
– Unlikely to satisfy the asset definition and recognition criteria of the Framework

**Successful-efforts method**

*Arguments for*
– Costs recognised as an asset are matched with revenues from ‘successful effort’
– Only exploration and evaluation costs resulting in the discovery of economically recoverable reserves are carried forward

*Arguments against*
– Arbitrary specification of a ‘cost centre’
– Inconsistent with the Framework

**Area-of-Interest Method prescribed by AASB 6**

> • Area of interest
> Area of interest is an individual geological area which is considered to constitute a favorable environment for the presence of a deposit or field
> - Will usually comprise a single mine or deposit, or a separate oil or gas field—each to be considered separately
> - Area of interest underpins AASB 6

> • Usually comprises a single mine or deposit or a separate oil or gas field

**Abandoning an area of interest**

If an area is abandoned, costs carried forward relating to that area should be written off in the period in which the decision to abandon is made

**Capitalization of exploration and evaluation expenses**

> • Consistent with Framework recognition criteria?
> • Consistent with other accounting standards?
> - E.g. Accounting for R&D expenditure under AASB 138

**Costs to be carried forward**

> • Exploration and evaluation asset to be initially measured at cost
> - Apply either the cost model or revaluation model subsequent to initial recognition
> • Exploration and evaluation assets must be assessed for impairment when carrying amount exceeds recoverable amount

**Amortization and depreciation of costs carried forward**

> • Most common method is units-of-production method:
> - Amortisation rate is calculated by relating costs carried forward to the ‘reserve base’
> - Amount charged against sales revenue for a period is the rate multiplied by the period’s production

> • Changes in estimates of recoverable reserves will necessitate the calculation of a new amortisation rate

**Restoration costs**

> • May be either a legal or moral obligation to restore area after cessation of operations. Required:
> - Estimate total restoration costs at commencement of project
> - Provision for this cost throughout operations
> - Restoration costs are to form part of the cost of the respective phases of operations
> - Once production commences, restoration costs to be treated as cost of production
> • Arid Recovery Team
Dealt with under:
– AASB 137 Provisions, Contingent Liabilities and Contingent Assets
– AASB 116 Property, Plant and Equipment

Revenue recognition
‣ As per AASB 118 Revenue
  – Discovery of reserves do not give rise to revenue recognition
  – Revenue recognised only at point of sale

Does the area-of-interest method provide a realistic value of reserves?
Reasons for not recognising expected fair values of resources
  – Uncertainty regarding the value of reserves
  – Extractive companies subject to high levels of political scrutiny
  – Revaluation credit cannot go to income

Other developments in extractive industry reporting
‣ Many mineral and energy companies presently making disclosures about their social and environmental performance
‣ Public social and environmental performance reporting subject to limited statutory regulation (reasons?)
‣ Guidance documents released by international industry associations
  – For example, GRI Guidelines
  – Revised and reissued in 2000, with further changes in 2006

Ch20 Q1 outline the five phases of a company’s operations in the extractive industries
It has been suggested that there are five identifiable phases in the discovery and recovery of minerals, oil and natural gas. Four of these phases are ‘pre-production’ phases, which means that they occur before production begins. The pre-production phases are exploration, evaluation, development and construction. The exploration phase covers the process of finding the deposit. It includes the geological, geophysical and geochemical studies made over wide areas to obtain information and the acquisition of exploration rights in the most promising areas. Evaluation is work undertaken to determine whether the prospect is commercially viable. It includes evaluation of the extent and quality of the deposit, and a consideration of the technical feasibility of extracting and selling it economically. Development involves the establishment of access roads, drilling wells, driving shafts, the removal of overburden, and the supply of water and power. Construction is a separate phase in which facilities are constructed for the extraction, treatment and transportation of product from the production areas. The fifth phase is production.

(a) What is the main accounting issue for entities involved in the extractive industries?
The main issue is how to account for the significant costs incurred during both the pre-production and production phases. Should the costs be recognised as expenses or as an asset? What criteria should be used in answering this question? Differences in opinion relate mainly to the treatment of pre-production costs and in particular exploration and evaluation costs. By the time development commences, the deposit is obviously considered by management to be worth exploiting. Variations in opinions on how to account for these costs are likely due primarily to differing interpretations of the degree of risk inherent in the extractive industries.

(b) Briefly outline the four broad approaches to accounting for pre-production costs, identifying the approach advocated in AASB 6
Broadly speaking, there are four approaches to accounting for pre-production costs:
1. the expense (or costs written-off) method, which recognises the costs as expenses in the period in which they are incurred;
2. the expense-and-reinstate method, which recognises the costs as expenses in the period in which they are incurred, but reinstates them as assets if subsequently those costs give rise to economically recoverable reserves;
3. the full-cost method, which recognises the costs as an asset irrespective of the likely success of the exploration program; and
4. the successful-efforts method, which limits asset recognition to those, costs that are likely to result in the discovery of economically recoverable reserves (the other costs are recognised as expenses).

The current approach advocated in AASB 6, the area of interest method, is a special case of the successful-efforts method.
The board of directors of Northern Mining Ltd (NML) has a policy of restoring the company’s mine sites on completion of mining operations at those sites. The company has a partially developed lease to mine brown coal in Victoria. NML’s board estimates that restoration costs for the lease will be $1 million in ten years time when the coal deposit is expected to have been exhausted. The board of directors has proposed the recognition of a liability of $1 million in its statement of financial position dated 30 June 2012. The company’s cost of capital is 10% per annum.

(a) In the context of the framework, provide an opinion as to whether NML should recognise the estimated costs of restoration in its statement of financial position as at 30th June 2012. Advise the board of directors of ways of measuring the restoration costs, and identify the preferred method. Give reasons.

NML should recognise the estimated costs of restoration in its statement of financial position as at 30 June 2007. The restoration will require an outflow of economic benefits to those undertaking the restoration. NML has a constructive obligation to restore the company’s mine sites based on community expectation and company policy, and the need for restoration has arisen because of site development work. Assuming that the $1 million of future work is necessitated by development at the mine site that has already occurred for restoration is probable and the costs can be measured reliably. The obligation would be measured at either:

(i) face value of expected future outlays = $1 million or
(ii) present value of expected future outlays = \( \frac{\$1,000,000}{(1.1)^{10}} \approx \$385,543 \)

Students may prefer to measure restoration costs in accordance with existing practice (option i) or to recognise that restoration is deferred for a considerable time (option ii).

(b) How should the restoration costs be treated under AASB 6 and AASB 137

The need for restoration has arisen as a result of development activities. Because AASB 6 only deals with exploration and evaluation, the accounting standard does not specify requirements in relation to this issue. Instead, the obligation for restoration costs would be recognised in accordance with AASB 137 ‘Provisions, Contingent Liabilities and Contingent Assets’. Also, consistent with the treatment in AASB 6, the $1 million should be included in development costs and amortised over the life of the deposit once production commences.

In brief, AASB 137 requires that a provision for removal and restoration to be recognised when ‘(a) an entity has a present obligation (legal or constructive) as a result of a past event; (b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and (c) a reliable estimate can be made of the amount of the obligation’ (para. 14). As discussed in the answer to part (a) of this question, these three recognition criteria have been met. Therefore, the provision for restoration costs would be recognised as follows:

<table>
<thead>
<tr>
<th>Development assets</th>
<th>Dr</th>
<th>Provision for restoration costs</th>
<th>Cr</th>
</tr>
</thead>
</table>

Paragraph 36 of AASB 137 requires that a provision be measured as ‘the best estimate of the expenditure required to settle the present obligation at the end of the reporting period.’ In addition, if the effect of the time value of money is material, the amount of the provision is measured as the present value of the expected future expenditures (para. 45). The appropriate discount rate is a pre-tax rate that reflects the current market assessment of the time value of money and the risks specific to the liability (para. 47). Since the time value of money is likely to be material in the extractive industries, the provision for provision for restoration costs should be reported a net present value – i.e. \( \frac{\$1,000,000}{(1.1)^{10}} \approx \$385,543 \)

Ch20 Q14

In reporting the results of companies in the extractive industries, the immediate recognition of exploration costs as expenses in the period in which they are incurred may give a misleading picture to potential investors and discourage their support of this essential industry. An important factor to consider is the need to attract capital into the industry. Furthermore, one should not ignore the considerable information which accrued from exploration activities.

Critically evaluate the above statement with reference to the question of carrying forward exploration costs.
These arguments have been used to justify the use of the full-cost method. The first argument is that recognising as expenses all exploration costs will result in reported losses during the exploration period even though some of the exploration activity may be successful and lead to future revenue. Other things being equal, the expensing of all costs also means that the reported net assets of the entity declines over the exploration period. Advocates of the full-cost method argue that expensing all costs understates reported profits because it fails to indicate that there will probably be some future economic benefits as a consequence of those costs. The low reported profits and falling net assets make the entity an unattractive investment opportunity and will impede any efforts to raise new capital. It is argued that this is not in the best interests of the entity, the industry or the country’s economy. The contrary argument is that it is not the purpose of accounting to attract capital into an entity. Its purpose is to report an entity’s performance and financial position so as to give a ‘true and fair’ view. The full-cost method overstates profits and net assets with a possible misallocation of scarce resources to the mining industry. To the extent that exploration costs are unproductive, they should be recognised as expenses.

The second argument is that all exploration costs add to the general expertise and knowledge of the entity, thereby increasing the probability of successful exploration outcomes in the future. The entity’s management learns from its mistakes. A variation of this argument is that looking in the wrong place is a necessary prerequisite for looking in the right place. In very few cases is a deposit found at the site where exploration is first commenced. Looking in the wrong place eliminates it as a possible site. These arguments lead to the conclusion that while the costs of unsuccessful exploration may appear to be wasted; they do provide significant benefits which should be shown as assets in the balance sheet. The counter argument is that these vague benefits do not satisfy the definition of and recognition criteria for assets as specified in the Framework and therefore they should not be recognised as assets.

Case Study 07

Introduction-
The issue to be considered here is if the statement that exploration and evaluation costs related to an area of interest should be recognized as expenses in the period in which they are incurred is comprehensive? I do not think the statement is comprehensive.

Context/Scene Setting-
- AASB6: Exploration for and Evaluation of Mineral Resources
- AASB1022: Accounting For The Extractive Industries

Area of interest - an individual geological area which is considered to constitute a favourable environment for the presence of a mineral deposit or an oil or natural gas field, or has been proved to contain such a deposit or field.

Body-
As shown in AASB6 para 7.1, for each area of interest, exploration and evaluation costs shall be:
(a) Expensed as incurred; or
(b) Partially or fully capitalized, and recognized as an exploration and evaluation asset if the requirement of AASB6 para 7.2 are satisfied.

On one hand, as specified in AASB6 para 7.2, exploration and evaluation costs related to an area of interest shall be recognized as asset and be carried forward if:
(a) Rights to tenure if the area are current; and
(b) At least one of the following is also met:
  ▪ Costs are expected to be recouped; and
  ▪ Exploration and evaluation has not yet reached a stage permitting a reasonable assessment of the existence of reserves and operations are ongoing.

On the other hand, as illustrated in AASB1022 para 11, exploration and evaluation costs related to an area of interest shall be written off as incurred, except that they may be carried forward provided that rights to tenure of the area of interest are current and provided further that at least one of the following conditions is met:
(a) Such costs are expected to be recouped through successful development and exploitation of the area of interest, or alternatively, by its sale; and
(b) Exploration and evaluation activities in the area of interest have not at balance date reached a stage which permits a reasonable assessment of the existence or otherwise of economically recoverable reserves, and active and significant operations in, or in relation to, the area of interest, are continuing.

Conclusion-
Base on the above analysis, I do not think that the statement in this case is comprehensive. As shown in AASB6 and AASB1022, exploration and evaluation costs related to an area of interest should be recognised as either expenses or assets based on different requirements. In addition, it is should be notice that Each area of interest...
shall be considered separately when deciding whether, and to what extent, exploration and evaluation costs are carried forward or written off.

Q4 Mixed Topics – short theory answers 10 marks – in 3 parts

Superannuation plan:
- A scheme to provide retirement benefits to a specified group of employees
- Money contributed by employee and/or employer is paid into a trust fund
- Trustees invest the money paid into the trust fund to earn revenue
- Eligible members receive a pension (periodic payments or lump sum) on retirement:

Most plans also pay an amount on the death or disability of eligible members before retirement

Nature of superannuation plans

- **Defined benefit plan:**
  - Specifies the benefit to be received by plan members
  - Trustees ensure that the contributions to the fund and its earnings are sufficient to meet the defined benefits

- **Defined contribution plan:**
  - Specifies the contributions to be made by employees and/or employer
  - Amount of benefits depends on amount of contributions and investment earnings

- **Self-managed plan:**
  - Trustees manage their own plan; i.e. determine the contributions and investment policies

- **Externally managed plan:**
  - Trustees pass management responsibilities to professionals; e.g. banks, life insurance companies
  - External managers’ report to the trustees at regular intervals about the earnings performance, assets and future prospects of the plan

- **Contributory plans:**
  - Employees bear part of the cost of the benefits or make voluntary payments to increase their benefits

- **Non-contributory plans:**
  - When the employer bears the total cost i.e. the 9.5% of salary, however it is often considered to be part of the salary package

- **It can be a combination of both contributory and non-contributory, i.e. the police force**

- **Portable benefits:**
  - Transfers to other approved plans. A valuable right. Also gives rise to a large amount of “lost super”

- **Vested**
  - Members rights are to the benefits are not conditional on any factors

- **Ch23.5 Portable benefits means**

  5. the insured (전직) benefits (퇴직한 근로자의 건강 보험·연금제 등의 자격 유지))
  
  that if a member transfers to another plan approved by the trustees, then the (actuarial value 보험계리적 가치) of the benefits accrued by the member can be transferred to that plan.

6 Vested benefits are defined 기득이익, 여건변화와 관계없이 고정적으로 발생하는 이익을 말한다 in paragraph 10 of AAS25 as benefits, the members’ rights to which are not conditional on continued plan membership or any factor other than resignation from the plan.

12 Why is there no AASB accounting standard corresponding to AAS25? AAS25 does not have a corresponding AASB Accounting Standard because when the accounting standard was prepared, the AASB only prepared standards for entities within the jurisdiction of the Corporations Act 2001. However, the reconstituted AASB now has the power to prepare accounting standards for public sector and non-corporate entities. Further, the AASB has undertaken a fundamental review of AAS25 as part of the process of adopting Australian equivalents of International Financial Reporting Standards (IFRSs), while maintaining Australian standards on issues that are significantly influenced by domestic institutional arrangements.

In the interim, 중간의 잠정적인, AAS25 has been retained. At the time of writing, a proposed new standard on general purpose financial reporting by superannuation plans and approved deposit funds in the form of ED179
had been issued for public comment. This has been replaced by ED223, but no further developments have taken place.

26 Why has the AASB not revised AAs25 as part of the program to issue Australian Accounting Standard that is equivalent to IFRSs? While AAS25 has not been revised to take account of the requirements of IAS26 ‘Accounting and Reporting by Retirement Fund Benefits’, as part of the process of adopting Australian equivalents of International Financial Reporting Standards (IFRS), the AASB is currently undertaking a fundamental review of AAS25. The review has been prompted by the growing economic significance of superannuation within Australia, the existence of a relevant international accounting standard, IAS26 ‘Accounting and Reporting by Retirement Benefit Funds’, and developments in the superannuation industry since the issue of AAAS25 that are not reflected in the standard.

In the interim, AAS25 has been retained as part of a suite of existing standards that deal specifically with not-for-profit entities that are considered by the AASB to be of particular relevance to the Australian environment. At the time of writing, Exposure Draft (ED) 223 'Superannuation Entities' was issued in December 2011 in response to feedback received on an earlier exposure draft ED179 'Superannuation Plans and Approved Deposit Funds' that had been issued in May 2009 by the AASB to seek public comment on a proposed new standard to supersede AAS25.

Justifications for incurring CSR costs:
- ‘enlightened self-interest’
- stakeholder management
- corporate legitimacy
- product differentiation

Impetus for change and recent reporting practice

Global Reporting Initiative (GRI) formed in 1997 GRI is a internationally recognized initiative to promote the development and dissemination of sustainability reporting guidelines.

- In 1999 the Dow-Jones launched a new index (DJ Sustainability Index) that ‘tracks financial performance of the leading sustainability firms worldwide’ (www.sustainability-index.com)

- Since 2005 the Australian SAM Sustainability Index (AuSSI) tracks the performance of Australian companies that lead their industry in terms of corporate sustainability (www.aussi.net.au)

Stakeholder management

Stakeholder theory
- Company is part of a broader environment with complex and dynamic relationships with its many stakeholders:
  - E.g. environmentalists, consumer advocates, media, governments and global competitors
  - Major role of management is to assess the importance of meeting stakeholder demands to achieve the company’s strategic objectives

Stakeholder importance derives from the power to control critical resources

Earnings per share (EPS) 주당순이익
- Enables inter-period comparisons of earnings
- Has become standard practice to disclose EPS
- AASB 133 requires disclosure of 2 measures of EPS on face of income statement
  - Basic earnings per share 기본주당이익
  - Diluted earnings per share 화석주당이익

기업간의 경쟁경고나 투자가치를 평가하는데 있어서, 당기순이익을 비교하는 것은 의미가 없다. 1억을 투자해서 10억을 벌게 되고 100억을 투자해서 10억을 벌게 되는 경우가 발생할 수 있다. 이러한 점을 보완하기 위해서 투자에 대한 이익의 비율로 나타낸 것이 주당순이익(Earnings Per Share). 보통 EPS 라 한다. 이는 당기순이익을 보통주당이익토록 계산한다. 이는 기업의 경쟁력을 보여주는 중요한 지표로, 기업의 경쟁력이 뛰어난다면, 이는 주당이익이 높아지게 됩니다. 이러한 점을 고려하여 주당순이익은 보통주당이익과 유사한 개념입니다.

기본주당이익 = 보통주 당기순이익(또는 보통주 세후경상이익)/유통보통주당이익

문자에 당기순이익이 들어가면 주당순이익이므로, 경상이익이 들어가면 주당상당이익. 이때 유통보통주당이익은 단순히 기말현재의 주식수를
How should EPS be calculated?

- Simplest form: divide amount available for distribution to ordinary shareholders by the number of issued ordinary shares.
- Difficulty arises from actual or potential changes in the number of ordinary shares outstanding.
- Basic EPS: based on earnings that include profit or loss from continuing operations after deducting preference dividends; and
- Diluted EPS: calculated and disclosed only if a ‘trigger test’ is satisfied.
- Trigger test applied to potential ordinary shares: a financial instrument or other contract that may entitle its holder to ordinary shares.
- Potential ordinary shares treated as dilutive when their conversion to ordinary shares would decrease earnings per share or increase loss per share from continuing operations.

Is disclosure of EPS useful?

- Arbitrariness: 'appropriate' measure of performance by inclusion in price/earnings ratio.

Q18.22 Outline the arguments for and against the mandatory disclosure of earnings per share. What is your view?

A reason for including earnings per share figures in highlights statements is that they provide data for statement users in a way that is more readily understood than in conventional financial statements. Earnings per share data are useful for inter-period comparisons. There are, however, some arguments against their inclusion in published financial reports.

(a) The calculation of earnings per share adds arbitrariness and estimates beyond those already contained in the published profit figure. In spite of this increased subjectivity, earnings per share figures are usually shown ‘accurate’ to the nearest hundredth of a cent. This combination of more estimation and more apparent accuracy may not be in the best interests of some statement users who do not appreciate the judgements involved.

(b) Earnings per share figures may be useful for comparisons over time of the performance of a particular company, but they are no improvement on profit for comparing the performance of different companies. Earnings per share figures are independent of both the market and nominal value of the shares. For example, two similar companies, with shares trading at widely differing prices, could have identical earnings per share but they would have different earnings yields.

(c) Earnings per share figures are often included in financial statement analysis through the price-earnings ratio. There is a risk that accounting support for earnings per share calculations may imply support for the price-earnings ratio. It would be dangerous if implicit support for the price-earnings ratio detracted from other measures of corporate performance.
(d) Also, there is some doubt about the usefulness of the price-earnings ratio. **It is widely used as an indication of the reasonableness of a company’s share price compared with the industry average.** Such a use implies that earnings alone determine share prices. Clearly, there are many other factors such as dividends, growth and expectations about future performance that are relevant.

**Identify four corporate stakeholders and explain how they can affect a business’s operation.**

Stakeholders are people or groups that are affected by your company’s operations. Shareholders or owners are a commonly recognized stakeholder group. However, you also need to consider how your customers, community, employees and business partners impact your business. A well-rounded approach that shows understanding of each stakeholder normally increases your long-term viability and success.

**Shareholders**

Company owners usually have a strong voice in the direction your company takes. In a partnership, each owner-partner has a financial interest in the profit potential of the business. Commonly, owners participate in the daily operation of the business or vote on critical decisions. In a corporate set-up, shareholders own a piece of the company. They also vote on major company decisions and serve as a source of financial accountability driving company leaders to make logical decisions.

**Customers and Community**

In the long run, your ability to meet the needs of your customers and community is the key to success. Customers provide the revenue and cash flow that your business needs to operate and ultimately earn a profit. You must understand customer wants and needs and meet them on an ongoing basis. Community leaders and activists also hold your company accountable to act with social and environmental responsibility. This means that if you don’t participate in community activities and give to charities, you could face negative public sentiment and backlash.

**Employees**

In the early 21st century, companies tend to place greater value on the contributions employees make to business operations. If you operate a service-based business, your employees provide the consistent service that helps you attract and retain customers. Motivating your employees with fair compensation, proper training and empowerment helps you deliver a better customer experience. Empowering employees at all levels to make more decisions and take on more responsibilities not only makes them feel valued, but it can also improve your efficiency in responding to customer needs.

**Business Partners**

**Business partners and suppliers** can also significantly influence your business. Partners are companies that you collaborate with in joint ventures or shared investment opportunities. Suppliers are companies you rely on for key resources used inside your company and for products to resell. If you have strong, trusting relationships with key suppliers, you can normally negotiate more reasonable costs and get more efficient replenishment when your inventory runs low.

- **Explain the term social costs or externalities.**

  **Social costs** 생산자가 직접 부담하는 비용을 사적(私的) 비용이라고 한다. 이것은 영국의 경제학자 A.C.피커스가 정의하여 중요성을 분명히 한 개념으로, 오늘날 각종 환경오염 문제와 관련하여 재현장되고 있다.사적 비용과 사회적 비용은 반드시 일치하는 것은 아니며, 후자가 전자보다 많은 때도 있고 적을 때도 있다. 적은 경우에는 외부경제가 있다고 말하며, 많은 경우에는 외부불경제(external diseconomies)가 있다고 한다. 이 같은 외부경제 또는 외부불경제는 시장을 통하여 거래되지 않는 것이 특징이다. 외부경제를 만드는 자는 이들 중 자에게 그 부문에 대한 대상(對象)을 지불하지 않으며, 외부불경제를 받는 자는 이를 준 자로부터 대상을 받을 수도 없다. 예를 들어 어떤 사람의 석림(樹林)에 의하여 강 하류의 사람들은 수해를 입지 않게 된 경우에는 외부경제가 존재한 것이지만, 거기에 대한 대가를 하류 사람들이 식림한 사람에게 지불하는 일은 없다. 이와는 반대로 어느 공장으로부터 배출되는 대인이나 배수에 의하여 공기나 하천이 오염되어 시민 보건을 위로 시달리거나 재해비 등이 여분으로 드러난 경우에는 외부불경제가 존재하였지만 시민이 그 비용을 공정에 청구할 수는 없다. 외부경제가 존재하는 경우 생산액은 사회적으로 보아 가장 바람직한 상태보다도 과소하게 되고, 외부불경제가 존재하는 경우, 생산액이 그것보다도 과량이 있다.

  **Externalities** 경제주체의 생산,소비 또는 문제행동이 시장교환과정에 참여하지 않고 있는 다른 소비자 또는 생산자에게 유리 또는 불리한 영향을 미치는 것을 말한다. 외부성(外部性), 파거효과(spillover effects) 또는 이웃효과(neighborhood effects)라고도 한다. 외부효과에는 타인에게 손해를 줄으므로 개인적인 비용이 사회적인 비용보다 작은 외부불경제(external diseconomies)가 이와 반대로 타인에게 이득을 줄으므로 생산활동의 진척이 생산활동자에 의해 증폭하게 흘러나지 않는 외부경제(external economies)의 두 가지 유형이 있다.

**Definition of social cost** -- Social cost is the total cost to society. It includes both private costs plus any external costs. The social costs of smoking include the passive smoking that other people experience. The social cost involved in building and running an airport can be split up into:

- **Private costs of airport**
  - Cost of constructing airport.
  - Cost of paying workers to run airport

- **External Cost of airport**
• Noise and air pollution to those living nearby.
• Risk of accident to those living nearby.
• Loss of landscape.

Reporting Environment

‣ Discuss theoretical arguments for and against accounting regulation
‣ Describe the institutional arrangements for regulating private sector financial reporting in Australia
‣ Identify the key regulatory bodies and their respective roles in regulating financial reporting
‣ Review the conceptual framework

1. Regulatory approaches
   • Free-market approach: market system in which the prices for goods and services are set freely by consent between vendors and consumers
   • Regulatory approach: applying the legal regulation, obligation ...

Is financial reporting regulation necessary?

Questions
1. Do we need more accounting rules?
2. Do we need better accounting rules?
3. Do we need more prescriptive accounting rules?

Reporting and Disclosure

‣ Full disclosure Objective
‣ Review company annual reporting requirements
‣ Limitations of annual financial reports and ways they have been addressed
  – Retrospective focus
  – Understand ability
  – Lack of timeliness
  – Narrow view of stakeholders

Reporting and the CF

‣ Aim of the CF is to provide useful information
  – to satisfy the decision-making needs of users who cannot command preparation of general purpose financial reports
‣ To be useful, information must be relevant, reliable, understandable, comparable & timely
‣ Does annual and half yearly reporting meet those requirements?

Timeliness

To address this issue we have:
‣ Interim Financial Reporting
‣ Continuous Disclosure

Issue of Choice in Accounting

‣ Understand that accounting standard setters and the preparers of financial statements have to make choices between alternative accounting policies
‣ Identify alternative approaches to the choice of accounting policies by accounting standard setters
‣ Examine the origins of contracting theory and the role of accounting in contracting
‣ Discuss the economic consequences of accounting policy choices and factors influencing those choices
‣ Examine creative accounting methods and their implications for financial reporting

Assets

‣ Reviewed accounting for non-current assets
‣ Considered:
  – The various bases used to measure assets
  – Depreciation as a process of cost allocation
  – Revaluation of non-current assets
  – Impairment of non-current assets
  – The financial statement effects of depreciation, revaluation, and asset impairment

What are assets?
‣ Definition
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 (AASB Framework, para. 49 (a))

- Characteristics
  - Future economic benefits expected to flow to the entity
  - Benefits are controlled by the entity
  - Control over benefits arises from past events

Accounting for Non-Current Assets

Major Accounting Issues

1. Measuring cost of acquisition
2. Allocation of costs of assets (depreciation/amortisation)
3. Revaluation of assets
4. Impairment of assets

Intangible assets

- Considered the nature of intangible assets
- Distinguished between identifiable and unidentifiable intangibles
- Examined the accounting treatment for
  - Goodwill
  - Research and development expenditure

Characteristics of an intangible asset (AASB 138)

- Intangible Asset is identifiable
- Entity controls the Intangible Asset
- Future economic benefits are expected to flow from the Intangible Asset

Consistent with AASB Framework definition of asset?

The identifiable/unidentifiable distinction

- Identifiable - Separable
  - Capable of being separated from the entity and sold, transferred, licensed, rented etc, individually or with a related contract, asset or liability
  - Arises from contractual or other legal rights (AASB 138.12)

- Unidentifiable
  - Assets which are not capable of being both individually identified and separately recognised
  - Collectively classified as Goodwill

Internally generated intangible assets NOT recognized

- Expenditure on items that cannot be distinguished from the cost of developing the business as a whole, including; Brands, Mastheads, Publishing titles, Customer lists. (AASB 138, paragraphs 63 and 64)

- Internally generated goodwill

Extractive Industries

- Identify
  - various phases of extractives industries operations
  - alternative methods of accounting for pre-production costs
- Develop an understanding of the application of the area-of-interest methods
- Discuss the economic consequences of extractive industries accounting requirements

Major accounting issue

Major problem of accounting for extractive industries

- How to account for costs incurred in exploration and evaluation:
  - Part of preproduction costs?
  - An asset or an expense?

Capitalization of exploration and evaluation expenses

- Consistent with Framework recognition criteria?
- Consistent with other accounting standards?
  - E.g. Accounting for R&D expenditure under AASB 138

Superannuation

1. Understand the nature of superannuation
2. Distinguish between various types of superannuation plans and, in particular, defined benefit plans and defined contribution plans

3. Identify the reports prepared by superannuation plans

4. Apply the requirements of AAS25 ‘Financial Reporting by Superannuation Plans’

5. Read and understand the general purpose financial statements of defined contribution plans

6. Read and understand the general purpose financial statements of defined benefit plans

7. Understand the changes to existing reporting requirements proposed in ED223 ‘Superannuation Entities’

Liabilities and Equity
- Reviewed definition and recognition criteria of liabilities and equity
- Distinguished contingent liabilities and provisions and discuss their accounting treatment
- Discussed the basis for the recognition and measurement of equity
- Discussed how liabilities and equity are distinguished

Liabilities defined
- AASB 137 defines a **liability** as:
  - 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
- **Key characteristics**
  - Existence of present obligation
  - Obligation involves sacrifice of economic benefits in the future
  - Obligation arises from past transaction or event

Equity
- The residual interest in the assets of the entity after deducting all its liabilities
  \[ E = A - L \]
- Amount assigned to equity is always the difference between assets and liabilities
- Recognition criteria for assets and liabilities are also (by default) criteria for equity recognition
- Measurement of equity also depends on the measurement basis for assets and liabilities

Financial Instruments
- the nature and types of financial instruments (FIs)
  - Primary and secondary (derivative)
  - Hybrid
- how financial assets and financial liabilities are required to be measured and recognised
- the nature and types of futures, options, swaps, hedges, and associated accounting issues

What are FIs used for?
- Raise capital to finance business operations
- Off-balance-sheet financing
- Investment to generate income
- Assist with managing risk
  - E.g. interest rates, currency exchange rates

Why is accounting for financial instruments problematic?
- Diversity of financial instruments
- Diverse reasons for holding financial instruments
- Blurring of differences between legal form and economic substance

Revenue Recognition and the Income Statement
- Concepts of income and revenue
- Earnings cycle and revenue recognition
- Reviewed accounting measurement models and points of revenue recognition
- Revenue recognition issues associated with long-term construction contracts
- Presentation requirements for the income statement and statement of changes in equity
- Discussed the use of profitability measures in assessing financial performance

Alternative approaches to measuring profit
What should be reported in profit?

– Revenues and expenses relating to previous periods (e.g. accounting policy change)?
– R & E arising from activities outside ordinary operations (e.g. sale of part of the business)?

3 Approaches

– Operating Profit (traditional): profit is measure as income from operations minus expenses from operations.
– All-inclusive: profit for the period is measured as the result of ordinary operations plus income and expenses relating to prior periods, the effects of some accounting policy changes and the result of extraordinary transactions and events. It is easier to prepare because it avoids the need for an accountant to exercise judgment in deciding whether an item is ‘operating’ or ‘non-operating’.
– Comprehensive Income (clean surplus): an approach to periodic profit measurement in which profit for the period includes all income and expenses as defined in framework. All changes in net assets or equity, other than transactions with owners, are included in the measurement of profit.

AASB 101

– A Statement of Comprehensive Income (SoCI) is required (paragraph 81)
– Prohibits use of the term extraordinary
– Allows preparers to produce a single SoCI or an Income Statement and a Statement of Comprehensive Income displaying components of other comprehensive income

However:

– Effects of prior errors and policy changes are allowed to bypass the Statement of Comprehensive Income and be included in the Statement of Changes in Equity

Corporate Social Responsibility

– Defined social and environmental reporting, and discussed the measurement of social costs (or externalities)
– Identified different stakeholder groups and the reasons for their interest in a firm’s environmental and social performance
– Explained the existing reporting practices and guidelines for social and environmental reporting
– Discussed the influence of social and environmental reporting on the financial performance and share price

Possible Exam questions

What information are firms likely to provide if they use triple bottom line reporting and does it affect the share price

Benefits of TBLR

– The business case for TBL reporting centres on improved relationships with key stakeholders such as employees, customers, investors and shareholders. Specific commercial advantages include:
  – Enhancement of reputation and brand
  – Securing a ‘social licence to operate’
  – Attraction and retention of high calibre employees
  – Improved access to investors
  – Reduced risk profile
  – Identification of potential cost savings
  – Increased scope for innovation
  – Aligning stakeholder needs with management focus
  – Creation of a sound basis for stakeholder dialogue

Limitations of TBLR

– Difficult to verify qualitative information
  – Who audits?
  – How audited?
– Difficult to define and measure the benefits
– Too much trivial information may be given that makes a report hard to read and interpret
– It may become merely a public relations or similar self-justifying exercise

Triple bottom line reporting

– TBL reporting has taken these forms:
Environmental and social section within a company’s annual report
Separate report, either on the environment or on the community
Two separate reports, one with an environment focus and the other with a social focus
Combined social and environment report
Full TBL report

Explain the difference between eco-justice and eco-efficiency, and explain how both might relate to business activities.

Environmental justice (eco-justice) is the fair treatment and meaningful involvement of all people regardless of race, color, national origin, or income with respect to the development, implementation, and enforcement of environmental laws, regulations, and policies. EPA has this goal for all communities and persons across this Nation. It will be achieved when everyone enjoys the same degree of protection from environmental and health hazards and equal access to the decision-making process to have a healthy environment in which to live, learn, and work.

Other definitions include equitable distribution of environmental risks and benefits; fair and meaningful participation in environmental decision-making; recognition of community ways of life, local knowledge, and cultural difference; and the capability of communities and individuals to function and flourish in society.

Eco-Justice holds together commitments for ecological sustainability and human justice. It sees environmental issues and justice issues not as competing agendas, but as intertwined elements of how humans are called to relate to God’s creation. It asserts that it is not possible to care for the earth without also caring for humanity, and that seeking human justice must involve care for the environment.

Chapter 4. ASSETS

12 Why do accountants still measure the historical cost of assets when there seems to be a general agreement that it is inappropriate?

- It is argued that the measurement of historical cost is relevant to the stewardship objective of financial reporting,
- but it is probably of less relevance for the decision-usefulness objective of financial reporting.
- However, there is some doubt whether it is more reliable than other measures.
- The crucial question in deciding the appropriateness of measuring historical cost is the relative importance attached to the stewardship objective of general purpose financial reporting.
- If stewardship is relegated to a relatively minor role in the conceptual framework, then the measurement of historical cost is also likely to be less relevant.

Chapter 8. 4 Why should valuation increments be credited to a revaluation surplus while revaluation decrements are recognised as expenses?

- Standard is silent on the reasons for the different treatments of upwards and downwards revaluations.
- Probably a residual of the doctrine of conservatism which did not allow the recognition of revenue until it was virtually certain.
  - An increase in the value of an asset does not guarantee that revenue would eventually be realised.
  - value may fall and the revenue may never be realised.
  - doctrine of conservatism would not allow the recognition of revenue in these circumstances.

On the other hand, the doctrine of conservatism required that expenses should be recognised as soon as there was a chance that they would be incurred.

- A fall in the value of an asset would be interpreted as a clear indication that an expense could be incurred and conservatism would require that it should be recognised.

5 (a) what is fair value?
Fair value is defined in paragraph 6 of AASB 116 as:
The amount for which an asset could be exchanged between knowledgeable, willing parties in an arm’s length transaction.

(b) Does AASB 116 set fair value as the ceiling for the carrying amount of assets? Discuss

AASB 116 does not specifically state that fair value is the ceiling for the carrying amount of property, plant and equipment when the revaluation model is chosen, but that is the effect of applying the standard.

Assume that the Brisbane Broncos has signed up 5 promising young players on a 5 year player’s contract. These players were also being pursued by other clubs and so the Broncos also paid each of the players a substantial sign-on fee. Do you think these players or the associated economic benefits that they generate will be assets of the Brisbane Broncos? How would your account for the transfer fee?

- Firstly, why would they be prepared to pay the substantial sign-on fees?
  - Probably because the skills of these players are such that they are expected to increase the likelihood of the Broncos winning games and winning further premierships.
  - Arguably, winning games will increase the patronage of people at local games (which will increase gate receipts and hence, the cash flows of the club) and at the Broncos Leagues Club (which should increase the cash takings of the club).
  - Hence, good player signings will, through winning more games, conceivably lead to increased earnings for the Broncos; that is, to future economic benefits.

If there is a link between the payments related to the signings and the future economic benefits, are the sign-on fees paid to the players to be treated as assets?

the definition of an asset requires that there has been a past transaction and that the reporting entity controls the associated economic benefits.

- Does control exist in this situation; that is, does the football club control the players?
  - Some may argue that the terms of the contracts would probably mean that the club can restrict the players from playing for other clubs and that the contract would require the individuals to go on to the field and play football—hence, in a sense, the football club does control the benefits.
  - Others may not agree with this perspective and could argue that the club cannot force the players to play and, hence, would not control the associated economic benefits.

It is the recognition criteria of assets which would most likely not be met in the case of player sign-on fees.

  - As we know, for an asset to be recognized the associated economic benefits must be measurable and probable.
  - As it would be difficult to assign a value to the economic benefits being generated by the expenditure (that is, the benefits are not measurable with reasonable accuracy) this in itself would typically be a reason not to record the expenditure as an asset, but instead to treat the expenditure as an expense.
  - This would be a similar argument to one that would typically be used when arguing for advertising expenditure to be written-off as incurred, rather than being capitalized as an asset.
  - However, if the players were paid in advance, then such ‘prepayments’ could be treated as assets.

ACDC Holdings has the following assets in it statement of financial position for the year ended 30 June 2011.

<table>
<thead>
<tr>
<th>Equipment, at independent valuation</th>
<th>$3,000,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less Accumulated Depreciation</td>
<td>1,000,000</td>
</tr>
<tr>
<td>Net Book Value</td>
<td>2,000,000</td>
</tr>
</tbody>
</table>

The equipment had originally cost ACDC Holdings $1,400,000 in 2009. The directors of ACDC Holdings are concerned about the effect that the higher book value of the equipment is having on profits and the ability to pay
They ask you as CFO to reverse the revaluation to restate the asset at historical cost. What would you do?

- The act of reversing the revaluation would result in a debit to the revaluation surplus, a debit to accumulated depreciation, and a credit to the asset account.
- As the debit entry will be to the existing revaluation surplus, no expense will be recognized at the time of recognizing the revaluation decrement.
- The effect of this entry would be to reduce future depreciation charges and, therefore, to record higher profits in subsequent periods.
- As the motivation for reversing the previous revaluation entry is to increase reported profits, this is hardly an objective approach to accounting.
- Hence is not consistent with the ‘objectivity’ recommendations embodied within the AASB Framework. It would be a case of ‘creative accounting’.
- Being ethical, the accountant should resist the pressure to perform the adjusting entry.

**Freedman Ltd has 2 identical pieces of equipment. The first it acquired in 2010 for $6,000,000. The second was acquired at a cost of $3,000,000 in a forced sale situation in 2011. Freedman Ltd is under substantial pressure from the union which represents 80% of its workforce to increase wages and is anxious to reduce its reported profits. They write down the value of the first piece of equipment to $3,000,000. Is this an appropriate course of action?**

- No, this is not appropriate action.
- The cost of machinery acquired in a liquidation sale is not a fair reflection of the recoverable amount of the machinery acquired in 2010.
- The price paid might not be a true reflection of ‘fair value’.
- If it were a fair reflection, then a write-down would be appropriate.
- An impairment loss is to be recognized when the carrying amount of the asset exceeds its recoverable amount and unless this is the case, no impairment loss should be recognized.