

## Topic 0: PPE

- Initial recognition: *DR Asset, CR Cash*
- Depreciation: *DR depreciation expense, CR accumulated depreciation*
- Impairment loss: recoverable amount < book value
  - ***DR impairment expense, CR accumulated impairment***
- Reversal of impairment: if fair value increases
  - ***DR accumulated impairment, CR impairment expense***
- Subsequent measurement:
  1. Calculate the carrying amount before impairment
    - a. *Calculate annual depreciation = (cost – residual value)/useful life*
    - b. *Carrying amount = cost – accumulated depreciation*
  2. Impairment testing:
    - a. The recoverable amount is the higher of the net fair value and the value in use
    - b. *Net fair value = fair value – selling costs*
    - c. Carrying amount > recoverable amount there is an impairment loss
    - d. Under the cost model if the carrying amount < recoverable amount no impairment is required
    - e. *Impairment loss = carrying amount – recoverable amount*
    - f. ***DR impairment loss, CR accumulated impairment***
  3. Next test:
    - a. Depreciate further
    - b. New depreciable amount = carrying amount after impairment – revised residual value
    - c. *Carrying amount after impairment = BV – impairment*
    - d. *New annual depreciation = new depreciable amount / new useful life*
    - e. *New carrying amount = carrying amount – extra depreciation*
    - f. Impairment reversal: recoverable amount = higher of net fair value and value in use
    - g. Carrying amount < recoverable amount = reversal of impairment
    - h. *Carrying amount without previous impairment = original cost – original accumulated depreciation*
    - i. *Impairment reversal = carrying amount without impairment – current carrying amount (with depreciation originally and new depreciation)*
    - j. ***DR accumulated impairment CR impairment reversal***

## Topic 1: Corporate Financial Reporting

What is a company?

- Legal entity: Companies are established under the **Corporations Act 2001** and have the same legal powers as an individual (own property, contracts, sue, etc.).
- Capital Raising: Companies can raise capital through issuing shares.
- Limited Liability: Shareholders' liability is limited to their investment.

Types of Companies:

- **Public Companies:** Larger, with widespread ownership, can list on stock exchanges.
- **Proprietary Companies:** Limited to 50 shareholders, cannot issue shares to the public.
- **Large Proprietary Companies:** Must prepare financial reports if they meet two of these criteria:
  - Revenue > \$50M
  - Assets > \$25M
  - Employees > 100

Company Management:

- **Directors:** Elected by shareholders.
  - **Executive Directors:** Full-time, involved in day-to-day operations.
  - **Non-Executive Directors:** Involved in policy and planning, monitor executive performance.

#### Sources of Reporting Requirements:

- **Corporations Act 2001:** The primary legislation governing companies in Australia.
- **Australian Accounting Standards Board (AASB):** Sets accounting standards (e.g., AASB 101).
- **Australian Securities Exchange (ASX):** Imposes listing rules for listed companies.

#### Financial Statements Required (AASB 101):

- Statement of Financial Position (Balance Sheet)
- Statement of Comprehensive Income:
  - Can be a single statement OR separated into Profit or Loss and Other Comprehensive Income.
- Statement of Changes in Equity
- Statement of Cash Flows
- Notes to the Financial Statements

#### Enforcement of Accounting Standards:

- **Australian Securities & Investments Commission (ASIC):** Enforces compliance with the Corporations Act 2001.
- **Professional Bodies:** CPA Australia and CA ANZ require members to comply with professional standards (e.g., APS 1).

#### ASX Listing Rules:

- **Continuous Disclosure (Listing Rule 3.1):** Listed companies must immediately disclose information that a reasonable person would expect to have a material effect on the share price.

#### Key Legislation References:

- **Corporations Act 2001:** The fundamental law governing companies in Australia.
- **AASB 101:** Sets out the requirements for the presentation of financial statements.
- **ASX Listing Rule 3.1:** Mandates continuous disclosure for listed companies.

### Topic 2A: Introduction to Consolidation

- **Parent:** an entity that controls one or more entities (X above)
- **Subsidiary:** an entity, including a partnership, that is controlled by another entity (Y and Z above)
- **Group:** a parent and all its subsidiaries (X, Y and Z)
- **Consolidated financial statements:** the set of financial statements presented to show the results and financial position of a group as if it were operating as a single economic entity
- The economic entity is the entire group
- Each subsidiary can be its own legal entity – they are separate legal entities

#### Consolidated financial reports

##### Advantages of consolidated financial statements

- The group is reviewed as a single operating unit
- **Relevant information:** the investors have interest in the group as a whole, not just the parent entity
- **Accountability:** provides information on the group to stakeholders in the parent entity to allow assessment of the performance of management in operating all resources under their control
- **Reporting:** only practical means of reporting for large complex groups

##### Limitations of consolidated financial statements

- The group is not a legal entity capable of paying dividends
- Consolidated financial statements may have limited use to creditors and minority shareholders of the subsidiaries
  - Creditors have a claim against the subsidiary alone (unless debts are cross-guaranteed)
- Useful information and detail may be lost, for example:
  - Consolidated reports can mask poor performance / profitability issues with one or more subsidiaries
  - Financial ratios of the group may not be representative of the individual companies
  - The group may comprise of companies across diverse industries (eg retail and industrial in Wesfarmers group)

#### Accounting standards

- S295 of the Corporations Act states that the content of a financial report:
  - For a company, it is the financial statements required by accounting standards
  - However, if the accounting standards require the company to prepare consolidated financial statements, the required financial statements are the consolidated financial statements
  - This means that a parent entity only needs to prepare consolidated financial statements and does not need separate financial statements for the parent
- S297 requires the consolidated statements present a true and fair value
- AASB 10 requires parent entities to prepare consolidated financial statements for the group
- The parent does not disclose separate financial statements for itself. It must disclose:
  - Current and total assets and liabilities
  - Shareholders' equity
  - Profit or loss
  - Guarantees of debts and subsidiaries
  - Contingent liabilities
- Need to create a consolidated statement of changes in equity, balance sheet, profit and loss, and cash flow statements

#### Control

- An investor controls an investee when it is **exposed, or has rights, to variable returns** from its involvement with the investee and has the **ability to affect those returns** through its **power over the investee** (AASB 10 paragraph 6) (all 3 components must be satisfied)
- Focus is on the economic substance of the investor-investee relationship. Having more than 50% of the voting shares is not sufficient to determine the existence of control
- The investor needs to be able to use its power to affect the investor's returns from its involvement with the investee (AASB 10 para 17)
- **Voting rights:** Control also exists if an entity owns 50% or less of the voting power of an entity if:
  - The entity has power over more than half the voting rights by virtue of an agreement with other investors
  - The remaining shares are widely dispersed amongst numerous shareholders so that the other shareholders are unlikely to vote as a block
  - Due to apathy, the majority of other shareholders do not vote at general meetings
- **Passive:** Control definition depends on the 'power' over the investee - so control can be active or passive
  - Controlling entity may play a passive role by appointing a management company to run the day-to-day operations of the subsidiary
- **Substantive:** the right that the investor has the practical ability to exercise
  - The rights must be substantive
  - No barriers such as financial penalties, terms and conditions that make it unlikely for the holder to exercise the rights, etc
  - The right must be 'in the money'

	Debit	Credit
Dividend revenue	Subsidiary's dividends paid	
Dividends paid		Subsidiary's dividends paid

Entry to adjust for dividend declared by subsidiary:

	Debit	Credit
Dividend revenue	Subsidiary's dividends declared	
Dividend declared		Subsidiary's dividends declared
Dividend payable	Subsidiary's dividends declared	
Dividend receivable		Subsidiary's dividends declared

### Step 3: Consolidation worksheet

- Copy all above journal entry values into the table
- The consolidated amount is parent + subsidiary +/- adjustment
- Add adjustments in green, subtract adjustments in red
- Retained earnings accounts go to the opening retained earnings

Accounts (1)	Parent (2)	Subsidiary (3)	Adjustments		Consolidated (6)
			Debit (4)	Credit (5)	
Sales revenue	310,600	105,600			416,200
Dividend revenue	30,000	0			0
	-----	-----			-----
Total revenue	340,600	105,600			A
Less: Other expenses	236,000	48,200			B
Less: Impairment expense	0	0			C
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Profit for the year	104,600	57,400			<b>D = A - B - C</b>
Add: Retained earnings - op. bal.	156,000	92,000			E
Less: Transfer to general reserve		20,000			F
Less: Dividend paid	30,000	10,000			G
Less: Dividend declared	25,000	20,000			H
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Retained earnings - cl. bal.	205,600	99,400			<b>I = D + E - F - G - H</b>
Share capital	190,000	125,000			J
General reserve	18,550	20,000			K
Revaluation surplus	100	40			U
	-----	-----			-----
Shareholders' equity	414,150	244,400			<b>L = I + J + K + U</b>
	=====	=====			=====
Assets					
Dividend receivable	20,000	0			L
Goodwill	0	10,000			M
Less: Accumulated impairment	0	0			N
Other assets	545,650	364,400			O
Investment in Ride Ltd	244,000	0			P

**Business Combinations & Consolidation**

- Acquisition method is used to account for business combinations.
- Subsidiary's identifiable net assets are measured at fair value at the acquisition date (DOA).
- This may require fair value adjustments (FVA).
- Tax consequences of FVAs need additional consolidation adjustments.

**Tax Effect Accounting in Consolidation**

- Groups in Australia can prepare tax returns individually or on a consolidated basis (assuming individual returns).
- Parent and subsidiaries apply AASB 112 in their own financial statements, bringing forward DTAs and DTLs to the consolidation worksheet.
- The tax base of assets and liabilities for the group is the same as in individual financial statements.
- No deferred tax is recognized on the initial recognition of goodwill or subsequent impairment losses (AASB 112).

**Fair Value Adjustment (FVA)**

- Fair value is the price in an orderly market transaction at the measurement date (AASB 13).
- If the subsidiary's net assets are not at fair value at DOA (e.g., cost basis), an adjustment is needed on consolidation.
- **Fair Value Adjustment = FVA = (FV – CA) x 70%**

**Tax Effects of FVA Entries**

- Increase in asset carrying amount leads to a deferred tax liability (DTL).
  - Accounting carrying amount > tax base
  - Amount of increase x tax rate = DTL
  - Represents future tax payable (e.g., on sale).
- Decrease in asset carrying amount leads to a deferred tax asset (DTA).
  - Accounting carrying amount < tax base

**Inventory:**

- AASB 102 requires inventory at the lower of cost and net realisable value.
- If fair value of inventory is higher than carrying amount, adjustment can only be recognised on consolidation.

	DR	CR
<b>Date of acquisition:</b>		
Inventory consolidation adjustment (done in all years before a sale)		
Inventory	(FV – CA)	
FVA		(FV – CA) x 70%
Deferred tax liability		(FV – CA) x 30%
<b>Year of sale:</b>		
COGS	(FV – CA)	
FVA		(FV – CA) x 70%
Income tax expense		(FV – CA) x 30%
<b>Years after sale:</b>		
Retained earnings	(FV – CA) x 70%	
FVA		(FV – CA) x 70%

**Internally-generated intangible asset (eg x):**

- An asset is identifiable if it arises from a legal right or is separable.