



Intermediate Financial Reporting

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1. a. What is the role of AASB with respect to harmonisation of Australian Standards?

The role of AASB with respect to harmonisation of Australian Standard is to change existing Australian Standards and influence the development of Australian standard, so that a reporting entity complying with Australian Standards will also comply with standards issued by the International Accounting Standard Board. (Policy Statement 6 .2.1 and .2.2)

1. b. What are the major factors driving the harmonisation process in Australia?

Factors driving the harmonisation process in Australia come from several sources.

- To increase the comparability of financial accounting on an international scale, in this context, AASB will have contribution on the participation and development of a single set of accounting standards for international use. (Policy Statement 5.1.3)
- To improve quality solution of Australian accounting standards by harmonising national accounting standards with international accounting standard. (ED. 102)
- To attract a significant additional inflow of foreign investment as result of less unique difference between Australian accounting standards and International accounting standards. (CLERP 1997 and Deegan, 2002)

1. c. What are the advantages of harmonisation for a country such as Australia?

The advantages of harmonisation for Australia are:

- Increasing the comparability of financial reports prepared in different countries and providing participants in international capital market with better quality information on which to base investment and credit decisions.
- Removing barriers to international capital flows by reducing differences in financial reporting requirements for participants in international capital markets and by increasing understanding by foreign investors of Australian financial reports.
- Reducing financial reporting costs for Australian multinational companies and foreign multinational companies operating in Australia and;
- Facilitating more meaningful comparisons of financial performance and financial position of Australian and foreign public sector reporting entities. (*Policy Statement 6 "International Harmonisation Policy"*)

1. d. Identify 1 accounting standard that has been reissued as a result of the harmonisation process.

In October 1998 the AASB and PSASB issued a revised *AASB 1008/AAS 17: Leases*. The revisions aim to make the standard consistent with *International Accounting Standard (IAS) 17: Accounting for Leases*.

The revised standard now incorporates leveraged leased entered into by lessors, requiring these to be treated the same as any other financing lease. The revisions also change the accounting for sale and leaseback transaction both in operating and financial leases. In operating lease, transaction based on the following three factors: the carrying value of the asset, the fair value of the asset, and the sales price of the asset. In financial lease, the essence of the sale and the leaseback transactions have not passed control of the asset over the lessor and, accordingly, are not really a "sale" but financing arrangement, hence there is no loss and profit on the transaction. Changes also occur in the leases of land and building, where the standard has removed the 25 % limit of the fair value of the land, where a lease involved both land and building. The revisions introduced a qualitative assessment as to the materiality of the value of the land, when determining whether to treat land and building as separate assets. In addition, the additional disclosure required in both lessees and lessors of specified commitments and present values.

2. a. Define (i) Cost and (ii) Fair Value.

(i) *Cost* means that the purchase consideration plus incidental cost directly attributable to acquisition. (Deegan, 2002)

For the purpose of recognition of asset within a class of non-current asset using the *cost basis*, the following measures constitute: (AASB 1041 .5.1.3)

- Their *cost of acquisition*, less any accumulated depreciation and accumulated recoverable amount write-downs or impairment losses
- In respect of monetary asset contributed to the entity, their fair value as at the date of contribution, less any subsequent accumulated depreciation and subsequent accumulated recoverable amount write downs or impairment losses; and
- Their *carrying amount* as the time that revaluation of that class was discontinued, less any subsequent accumulated depreciation and subsequent accumulated recoverable amount write downs or impairment losses.

(ii) *Fair Value* means the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. (AASB 1041)

- Under the standard in *AASB 1010 "Accounting for the revaluation of Non- Current Assets"*, an asset could not be carried at an amount that exceeded its "recoverable amount", does not apply to non-current assets measured at a fair value, net market value or net fair value.

2. b. Identify a company that has reverted back to the cost basis of valuation. Discuss:

(i) What is the impact on the financial performance and position of the firm as a result of this decision?

We identified that Woolworths Limited in reporting period June 2000 has early adopted the presentation and disclosure requirement of *AASB 1041: Revaluation of Non-Current Assets* and revert back to cost basis.

In reverting from a revaluation to a cost basis, the carrying amount as 27 June 1999 of all non-current assets other than development properties and leasehold improvement, has been deemed to be their cost. For development properties, retrospective adjustment was made to measure them at their cost of acquisition less any accumulated depreciation and recoverable amount write-downs.

The impact on the financial performance and position are:

- A reduction in the consolidated carrying value of development properties of \$13.8 million. This is due to carrying amount was adjusted or writes down from previous carrying value after revaluation which was higher than its cost to the carrying value before the last valuation (cost basis)
- An increase in consolidated retained profit of \$1.3 million is due to retrospective adjustment for depreciation expense for the period prior June 1999.
- A reduction in the consolidated assets revaluation reserve of \$15.1 million. This is due to the firm has reverted back its revaluation of the assets from fair value to the cost, need to write off the assets revaluation reserve that has been generated from previous revaluation. And;
- The change in accounting policy resulted in a reduction in the current year depreciation expense of \$ 0.1 million and increase in consolidated net profit of the same amount compared with the previous basis.

(ii) Why would a firm choose to revert back to the cost basis valuation?

The reasons of a firm choose to revert back to cost basis of valuation mainly because:

- Cost saving in the preparation and presentation of financial reports since it reduces the need of hiring independent firm to value its assets.

- The written off of assets revaluation reserve as an expense would decrease the profit in the current year but increasing the profit for the next following year (as a result of reverting back to the cost basis).
- The annual depreciation expenses will be reduced in conjunction with the reduction in the carrying amount of non-current assets.
- It also makes higher profit when a firm reporting a higher operating profit by creating additional gains on disposes of non-current assets.
- The decision to continue on the cost basis is probably also due to the uncertainty surrounding the practical application of the Standard in the first year of adoption.

2. c. Why would preparers of financial statements prefer the reissued AASB 1041?

The preparer of financial statement can take advantage of the following changes included in the revised AASB 1041 standard, as follows:

- AASB 1041 and AAS 38 required all non-current assets to be recognised using either the cost or the fair value basis. Under the original standards once the fair value had been selected, changing back to the cost basis was not permitted. The revised standard now permits this, provided that the change results in more relevant and reliable financial information.
- Change in relation to the disclosure requirements. The original standards brought in the requirement to include a reconciliation of opening and closing carrying amounts for each class of non-current assets in the notes to the financial statements. This requirement has now been limited to each class of property, plant and equipment and comparatives for this reconciliation are no longer required.
- The revised AASB 1041 is in relation to harmonise the Australian accounting standard with international standard will bring benefit to Australian entities.
- The revised AASB 1041 does not require the disclosure of restrictions on the distribution to owners of the balance of the asset revaluation reserve (which are specified in this standard for total non-current assets) to be made for each class of non-current assets.
- The revised AASB 1041 does not fully conform to IAS 1, IAS 8 and IAS 16 because, under the requirements of this standard, an entity can choose to discontinue the revaluation of non-current assets but not to revert to carrying amounts based on the cost of acquisition of the assets comprising the class. In some way, the revised AASB 1041 is less complicated to be applied.

Bibliography

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Ernst & Young Australia Web site

<http://www.ey.com/global/gcr.nsf/australia/home>

Woolworths Limited Website

<http://www.woolworths.com.au>