

Intermediate Financial Reporting



Lecturers name G. Frost, L. Iuff and N. Arthur
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Student's Name S.I.D. Number:

Antonius Andrianto Touw **0151837**
adrian2000_id@yahoo.com

Ananto Prabowo **0166307**
kalemguy@hotmail.com

Jimmy F. Fakhrudin **0144212**
Jfak3767@mail.usyd.edu.au

Faculty of Economics and Business
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1. Prepare measurement of revenue in relation to sale of airline tickets as part of their on-line travel booking and advisory service. Refer to relevant Australian accounting standards and other authoritative pronouncements.

According to AASB 1001.4.1, accounting policy must be selected and apply in a manner which ensures that the resulting financial information satisfies the concept of relevance and reliability to ensure that the substance of the underlying transactions or other events is reported in the financial report. Where substance and form are different, the standard required the substance rather than the form of a transaction or other event to be reported. (Para 4.1.8) The substance of a transaction or event is usually be determined by the incurred changes in legal rights and obligations. (Para 4.1.9)

The substance of the travel-with-us.com business, according to AASB 1001 above, involve with an agency relationship between costumer and airline company and/or hotel management. The company acted similar to traditional travel agent and they earns commission and do not own the ticket they sell. The substance of the business is merely to act on behalf of the customer to purchase the ticket. The company has no any legal control of the airline ticket before the sale, in other words, the airline tickets are not a part of the company's inventory. Therefore the company never disposes an asset during the transaction. The transaction should only be categorized *as a service* rather than a sale. The substance of its operation should be classified as *rendering of services* instead of sale of goods because the accounting treatment for each category will be different.

Actually, the payment collected by the company comprises of two parts. That is part of ticket price that is payable to the airline and the *commission* received by providing the services to the customers. In pursuant to AASB 1004 (Para 15.1.1) states that an *agent's revenues are the commissions, not the amount collected on behalf of the principle*. In addition, commentary in the Standard AASB 1004 also indicates that where agency relationships exist, the entity does not receive a gross inflow of benefit on its own account, but collects fund on behalf of the principal. The revenue that is recognized therefore, is *only the commission* that is earned by the agent. As soon as the payment received by the company, it becomes immediately payable to the airlines and *never* under effective control of the company. Therefore, the amount collected on behalf of another party (principal) *cannot* be recognized as revenue for the company.

Based on the analysis above mentioned the substance of the company business should adopt the *net method* instead of the gross method in accordance with the Australian accounting standard. The gross method cannot be applied because against the Australian accounting standard.

Alternatively there is a *grey area* in the application of the AASB 1004, which can be found in revenue recognition of Internet Company. In the case of Priceline.com, even though the company purchases the ticket on behalf of the client and receives commission, it recognizes all payment as revenue because it has assumed the full risk of ownership of the merchant of record (control) and can determine the size of its spread (commission). So far the SEC has given approval to the Priceline.com logic. In relation of the grey area AASB has no clear regulation as regards with this kind of case and the company can exaggerate their true revenue with gross method. (Fortune 2000).

2. Prepare recognition and measurement of revenue in relation to advertising on the company's web site. Refer to relevant Australian Accounting standards and other authoritative pronouncements.

According to AASB 1004.11.1, transactions that involve in exchanges and barter of goods or services will *not* generate revenue only when; the goods or services are the same in *nature and value*; and the transactions does *not involve cash* consideration

In the other circumstances, the transactions when goods and services, which are *not* the same in *nature and value*, it will be recognized as revenue (AASB 1004.11.1.2). Hence, in the circumstances the goods and services exchanged are homogenous. Such transaction may occur in restricted circumstances such as exchanges of commodities like oil. Under AASB 1004 11.1.1, these transactions do not involve any cash consideration. Thus, such kinds of transactions do *not* give rise to *revenue*.

The standard does not clarify the meaning of "same nature", and therefore induces greater uncertainty and ambiguity. Additionally, if any cash involve on transactions, it would appear that the entire transaction is considered to be generating as revenue, regardless of how small the *cash* component was. This is contradictory to other countries such as US, where *only* the cash component creates revenue, regardless the value of the transaction.

The revenue that caused by barter transaction is measured at the fair value of goods or services received adjusted for cash or cash equivalents transferred (AASB 1004.11.1.2). If the fair value on this basis cannot be measured reliably the revenue is estimated by reference to the fair value of the goods, services, cash and cash equivalent given up. Since AASB do not provide clear guidance on how to reliably measure fair value on the exchange transaction, we need to look further to other pronouncement authorities (IAS and SIC).

According to IAS 18 .15, Revenue and related expense on the exchange advertising in internet entities, should be recognized only if the *fair value* of the advertising surrendered in the transaction is *determinable*. Fair value can be based on the entity's own historical practice of *receiving cash* or *other consideration readily convertible to a known amount of cash* for similar advertising from buyers unrelated to the counterparty in the barter transaction. If the fair value of the advertising surrendered in the barter transaction is not determinable, the barter transaction should be recorded based on the carrying amount of the advertising surrounded, which likely will be zero. Moreover, IAS 18.27 explains that the revenue is recognized *only* to the extent of *cost incurred* that are expected to be recoverable (AASB 1010), and as the outcome of the transaction cannot be estimated reliable, **no** profit is recognized.

Furthermore, SIC states that revenue from barter transaction involving advertising cannot be measured reliably at the fair value of advertising serviced received. However, a *seller* can reliably measure revenue at the fair value of advertising services it provides in barter transaction, by reference *only to non-barter transaction that: involve advertising similar to the advertising in barter transaction; occur frequently; represent a predominant number of transactions and amount when compared to all transactions to provide advertising that is similar to the advertising in the barter transaction; involve cash and/or another form of consideration that has a reliably measurable fair value and; do not involve the same counterparty as in the barter transaction.*

Disclosure must be made where accounting policies adopted for the recognition of revenues, including the methods adopted to determine the *stage of completion of contracts* involving the rendering services (AASB 1004.12.1.(a)).

3. Explain whether the Statement of Financial Performance will be affected by unhedged foreign currency transaction and, if so, the source of this accounting exchange rate risk for the company.

Yes, the financial performance will be affected by un-hedged foreign currency transaction.

- Pursuant to AASB 1012 ‘Foreign Currency Translation’:
 - The application of AASB 1012 is consistent with the requirements of AASB 1034 4.1 that requires the financial reports be presented in *Australian currency*. (Deegan.C 2002)
 - Foreign Currency transactions should *initially* be translated at the spot rate in place at the *date of transaction*. (Deegan.C 2002)
 - As at *reporting date*, according to AASB 1012 any changes in the Australian dollar equivalents of foreign currency monetary amounts (such as foreign currency receivables, foreign currency payables and foreign currency monetary deposits) shall, be recognized as gain or loss in the statement of *financial performance*, whether or not the amounts have been realized. However there are some *exceptions* in regards with this issue for the accounting treatment of *qualifying assets* and *hedged of specific commitments*. (Deegan.C 2002)
 - AASB 1012 requires foreign operations to be categorized as either *self-sustaining* or *integrated*; the classification determining the appropriate translation method to be used. The self-sustaining foreign operation is to be translated using the *current rate* method and the integrated foreign operation is to be translated using the *temporal* method. (Radford J, Journal of Financial Reporting)
 - Travel-with-us company is financially and operationally independent, and its day to day operations normally expose the company to foreign exchange gains and losses. Travel-with-us meets the criteria as *integrated* foreign operation and must apply the *temporal method* in pursuant to AASB 1012. Thus, any exchange differences arising from translation are to be brought to account in the *Statement of Financial Performance*. (Radford J, Journal of Financial Reporting)

- Under the temporal method of translation, monetary items are translated at the balance date exchange rate, non-monetary items are translated at historical rates, revenues and expenses are translated at transaction date except for items which relate to non-monetary assets and liabilities which are translated at the rates used for those assets and liabilities, and pre-acquisition equity is translated at the date of acquisition rate. The use of historical exchange rates in temporal method means that the translated accounts will reflect the results of the transactions undertaken by the foreign operations as if they had been undertaken by the parent entity (AASB 1012, paragraph 7.2.9 and 7.2.10). (Radford J, Journal of Financial Reporting)
- Following from the above point (AASB 1012), gains or losses on foreign currency receivables and payables are **not** to be offset against related purchases or sales amounts in the asset of *Statement of Financial Position*.

The sources of this accounting exchange rate risk for the company are;

- There is *no* natural hedging because the transaction dealing with different currencies. The company is liable to pay the airline company in *US dollar* and bills the customers in *Australian dollar*.
- Moreover the transaction is also exposed with the time gap in between, when the *company bills the customer and receiving the payment*, which is subject to the foreign exchange fluctuation.
- Accounting exposure, this arises from *translation mechanism*. There is a time difference in between transaction date and reporting date of currency translation as *AASB1012* requirements. Whereas, during this time gap the foreign exchange is fluctuating.
 - This transaction is *un-hedged* so the transaction cannot minimize the risk of exchange rate exposure. The foreign exchange rates are varied form time to time. If the transaction charges the customers and pays the airlines on the same date and same spot rate, it would have no exchange exposure, which means no risk for the company. Unfortunately, as a matter of fact the transaction is un-hedged.

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