

STATEMENT OF PRINCIPLES ASB, 1999

- **A draft document, but similar to IASB and FASB**
- **the principles for general purpose (not specialised) statements**
- **principles are bound up with concept of "true and fair"**
- **principles only one factor which determine accounting standards**
 - the law
 - cost-benefit aspects
 - the need for evolutionary change
 - industry-specific needs

Objectives of financial statements (Ch1)

- **for a wide class of user**
 - related to stewardship
 - related to making decisions
- **users are**
 - investors
 - lenders
 - trade suppliers
 - employees
 - customers
 - government
 - the general public
- **all users can be proxied by investors**

Classes of investor information needs

- **Financial performance**
 - stewardship by management
 - "the entity's capacity to generate cash flows from its existing resource base" (1.14)
 - feedback on past assessments, eg
 - revaluation of fixed assets
 - change in provisions for bad debts
- **Financial position**
 - the economic resources the company controls
 - financial structure (eg debt-equity)
 - liquidity
- **Generation and use of cash**
 - liquidity and solvency
 - link between profits and cash
- **Financial adaptability**
 - raise new or adapt existing capital
 - important since it helps to mitigate risk

The boundary of the reporting entity (Ch2)

- **determined by control**
 - the ability to deploy resources, AND
 - the ability to benefit (or suffer)
- **control need not imply ownership of the majority of shares**
 - different in US
 - off balance sheet items because no ownership
- **how control is operated in practice, rather than theoretical level of influence**
- **distinguish day-to-day management from control**

Desirable characteristics of information (Ch3)

- **relevance**
 - is it important to investors?
- **relevant, if**
 - predicts, OR
 - confirms
- **reliability**
 - does the item exist?
 - can it be reliably measured?
- **reliable, if**
 - is a faithful representation of the event
 - eg sale and lease back is a loan
 - AND free from material bias or error (deliberate or otherwise)
 - AND complete
 - AND prudent
 - more evidence needed about assets than about liabilities
 - more measurement reliability needed about assets

- **comparable, if**
 - consistent measurements, AND
 - measurement practices disclosed in the accounting policies

- **understandable**
 - eg the level of aggregation is suitable
 - format is appropriate

- **material, if**
 - might affect decisions or perception of company

- **there can be conflicts between these desirable properties**
- **relevance vs. reliability**
 - needs to be sufficiently reliable
 - ie reliability more important
 - eg the value of R&D in the balance sheet is at cost
- **neutrality vs. prudence**
 - since prudence (or conservatism) is a bias
 - does not treat assets in the same way as liabilities, profits in the same way as losses
- **relevance vs. understandability**
 - relevance more important
 - should not exclude just because some users may not understand

Elements of financial statements (Ch4)

- **assets**
 - access to future benefits by the company, AND
 - as a result of past event
- **liabilities**
 - obligation to transfer benefits, AND
 - as a result of past event
- **ownership interest**
 - assets less liabilities
- **gains and losses**
 - changes in ownership that are not due to either
 - contributions from owners, or
 - distributions to owners
- **notice that event cannot be recognised as gain (loss) unless it can be classed as an asset (liability)**

Recognition (Ch5)

- **3 stages:**
- **(i) initial recognition**
 - reliability is important here
 - when is the event certain enough to be recognised?, eg
 - a pending law suit
 - revenue from a long term contract
 - types of uncertainty
 - element uncertainty, does the item exist?
 - measurement uncertainty, can it be reliably measured?
- **(ii) subsequent remeasurement**
 - typically to recognise a decrease in asset value and or increase in liability value
- **(iii) derecognition**
 - because asset (liability) is eliminated
 - because recognition criteria are no longer met

- **Recognition and matching**
 - starting point for recognition is the effect on assets and liabilities, but
 - *matching* will help to identify the effects
- **matching has two forms**
 - time matching,
 - eg allocation of expenses, such as rent, over time
 - revenue expenditure matching
 - eg matching of costs of stock in P&L when revenue is generated
 - stock costs are treated as assets in the period between cost being incurred and revenue being generated
 - but, the asset definition needs to be satisfied
 - matching is not a main driver
 - matching used to allocate the cost of an asset (which satisfies the definition) over time

Measurement (Ch6)

- **historical cost**
- **current value**
- **mixture of HC and CV**

- **measurement assumes going concern**
 - eg a fixed chemical plant is at HC and not at exit value (near zero)

- **current value is "value to the business"**
 - how much company would suffer if deprived of it
- **= lower of**
 - replacement cost
 - recoverable amount, being the higher of
 - value in use
 - net realisable value

- **Examples**
 - value to the business (VB)
 - replacement cost, RC
 - value in use (VI)
 - net realisable value (NRV)
 - $VB = \text{lower of } \{RC, \text{higher of } (VI, NRV)\}$

- **RC=100, VI=120, NRV=5**
if lost, would replace
VB=100

- **RC=140, VI=120, NRV=5**
if lost, would not replace, so lose VI
VB=120

- **RC=100, VI=120, NRV=140**
if lost, would replace (and then sell)
VB=100

Presentation (Ch7)

- **disclosure (in notes) no substitute for measurement in primary statements**
- **disclosure cannot compensate for misrepresentation or omission in primary statements**
 - this motivates the "true and fair override"
 - can ignore standards if would lead to misrepresentation
 - no international agreement on this
 - eg US, apply standards come what may and then put a note of the effect of not applying standards (ie, the appropriate treatment)
- **accompanying information (eg 5yr trend, operating and financial review) should not be inconsistent with primary statements**

Interests in other entities (Ch8)

- **Single entity statements**
 - the boundary of the entity is the assets (liabilities) over which the company has *direct* control
- **Consolidated statements**
 - the boundary of the entity is the assets (liabilities) over which the company has *direct and indirect* control
- **The difference between direct and indirect control depends on degree of influence**
 - direct control
 - joint direct control
 - significant influence (but short of joint or full control)
 - lesser or no influence