9.3 This is an issue on which students may have different views. Issues which should be considered include whether the requisite degree of control exists in relation to heritage assets and whether heritage assets are expected to generate future economic benefits that are probable and measurable. The text describes a number of factors which may indicate that heritage assets are not clearly assets as defined in the IASB/AASB Conceptual Framework. These factors are:

- Heritage assets often do not provide economic benefits.
- Determination of ‘control’ is problematic.
- The benefits are difficult to quantify in monetary terms.

At a broader level, another issue is whether there is actually a demand for financial information pertaining to heritage assets. Is such information useful for assessing the performance of those responsible for managing or maintaining the heritage assets? Should those in charge of looking after heritage assets be accountable for the financial performance of such assets, or should they be accountable for other non-financial aspects associated with the heritage asset’s use? Valuation of heritage assets can be a costly exercise and, as such, the activity should only be undertaken if there are some associated benefits. To date, demand for financial information about heritage assets has not been clearly established.

9.5 The IASB/AASB Conceptual Framework defines liabilities 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.

There are three key components in this liability definition, these being:

(i) There must be an expected future disposition of economic benefits to other entities.
(ii) There must be a present obligation.
(iii) A past transaction or other event must have created the obligation.

At issue here is whether there is a present obligation to transfer funds in the future. Arguably, there is no such obligation, and although the heritage ‘asset’ may be likely to generate negative net cash flows in the future this in itself would not be sufficient to say that it is a liability.

9.9 Again, there is no right or wrong answer to this question. Alternative arguments are provided in the chapter. If it was considered that the accountability of managers of heritage assets is best demonstrated by numbers generated by conventional financial accounting procedures (for example, profits) then valuations of the heritage assets would be appropriate. Such valuations would enable the generation of such performance indicators as return on assets. Increases or decreases in the valuations of the assets would also be included in reported profits.

If we consider that the accountability of such managers is not well demonstrated by financial numbers then we may question the necessity of requiring periodic valuations.
9.10 AASB141 Agriculture defines a biological asset as a ‘living animal or plant’. Biological assets would include:

* trees held as part of a forestry operation
* animals held as part of a livestock operation
* orchards and vineyards
* aquaculture and fishery holdings.

9.15 The basis of their argument would appear to be that the process of financial accounting is being applied to issues where such application is not suited, or perhaps is illogical. They argue that heritage assets are not really assets consistent with the definition provided in the Conceptual Framework and that the information produced by valuing heritage assets in a financial accounting sense is of very limited use. They argue that the accountability of managers of heritage assets would be better assessed by using measures of a non-financial nature; measures which amongst other things might indicate how the existing use of the heritage assets provides social, cultural or environmental benefits to the community. There is also an argument that if heritage assets are to be accounted for in financial terms, then the managers of the heritage assets might be persuaded to utilise the assets in a way that maximises the financial results associated with the assets, rather than perhaps using them in ways which benefit the community. Instructors should encourage students to indicate whether they agree or disagree with Carnegie and Wolnizer.

10.3 Where the recognition criteria for a liability are not satisfied (that is, the future outflow is perhaps not probable and/or reliably measurable), the item should not be included within the statement of financial position (that is, a liability should not be recognised). However, if it is possible that the firm will be obliged (although not currently obliged) to transfer resources in the future as a result of an agreement that has already been entered into—and the possibility is not deemed to be ‘remote’—and the amount is potentially material, disclosure in the notes to the financial statements is appropriate. Further, if there is an existing obligation, but the obligation cannot be measured with reasonable accuracy, as might be the case with some obligations pertaining to contaminated sites, then while the item cannot be disclosed in the statement of financial position it would be appropriate to disclose it in the notes to the financial statements to the extent it is potentially material.

In terms of the required disclosures relating to contingent liabilities, paragraph 86 of AASB 137 requires:

\[
\text{Unless the possibility of any outflow in settlement is remote, an entity shall disclose for each class of contingent liability at the end of the reporting period a brief description of the nature of the contingent liability and, where practicable:}
\]

\[
(a) \text{ an estimate of its financial effect, measured under paragraphs 36-52;}
\]

\[
(b) \text{ an indication of the uncertainties relating to the amount or timing of any outflow; and}
\]

\[
(c) \text{ the possibility of any reimbursement.}
\]

10.4 AASB 137 defines a provision as a liability of uncertain timing or amount. Paragraph 11 states that provisions can be distinguished from other liabilities such as trade
payables and accruals because there is uncertainty about the timing or amount of the future expenditure required in settlement. According to paragraph 14 of AASB 137, a provision shall 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.

If these conditions are not met, no provision shall be recognised.

If there is a legal requirement that $15 million must be paid to clean up the contamination, and if the amount is deemed to be a reliable estimate of the clean-up costs, then a provision should be recognised. However, even if there is not a legal obligation then it is possible that there is a constructive obligation to undertake the clean-up, and a provision would also be recognised. A constructive obligation is defined in AASB 137 as:

an obligation that derives from an entity’s actions where:

(a) by an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities; and

(b) as a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities.

10.5 (a) **Provision for repairs**

Until recent years, a provision for repairs had been disclosed as a liability, possibly classified into current and non-current portions. However, from the perspective of the IASB/AASB Conceptual Framework, future repairs would not qualify as liabilities as they do not involve a present obligation to an external party. AASB 137 also acts to exclude many planned future expenditures from being classified as liabilities, and indeed, from being shown anywhere within the financial statements if they do not create obligations to make future sacrifices of economic benefits to parties external to the entity.

It would now be appropriate to call the future commitment for repairs an ‘allowance for repairs’. It would not be shown as a liability.

(b) **Provision for long-service leave**

Under generally accepted accounting principles, a provision for long-service leave would be shown as a liability, broken up into current and non-current portions. As a future obligation exists to an employee (that is, to an external party) which could be measurable with some accuracy (perhaps using various actuarial assumptions), and it relates to work performed by the employee in the past, the liability would also be recognised pursuant to the IASB/AASB Conceptual Framework and other accounting requirements.

(c) **Dividends payable**

Dividends payable is an interesting issue. Previously, under generally accepted accounting principles, a provision for dividends would have been shown as a current liability at the time they were proposed, rather than subsequently when
they were approved (typically at an annual general meeting held after the end of the reporting period). This was the case even though the reporting entity did not ratify the dividend until the annual general meeting which is typically held a number of weeks after the end of the reporting period (and after reporting date event). This seemed to be a reasonable thing to do if it was probable that the dividend would be paid at a future date (that is, ratification appeared a formality), and the dividend did relate to earnings made prior to year end. However, pursuant to AASB 110 *Events After the Reporting Period*, a liability for dividends payable can only be recognised once the ultimate payment has been approved by the appropriate parties.

(d) **A guarantee for the debts of a subsidiary**

Under generally accepted accounting principles, and consistent with AASB 137, this would be classified as a contingent liability, and if it is potentially material, then it should be disclosed in the notes to the financial statements. If the guarantee has become enforceable then the liability would be included in the statement of financial position as either a current or non-current liability. The guarantee would not be classified as a liability for inclusion in the statement of financial position (unless it had become enforceable) as the entity would not be obliged to transfer resources as at the end of the reporting period.

10.13 Expectations relating to future refits and refurbishments are not of the nature of liabilities because there is no present obligation to an external party. No provision would be recognised at the end of the reporting period because no obligation for refurbishment exists independently of the entity’s future actions. The intention to undertake the refit/refurbishment depends upon the entity deciding to continue using the assets. Rather than recognising a provision, the depreciation recognised each period should take account of the consumption of the economic benefits inherent in the asset. When the refurbishment/refit occurs such expenditure would be capitalised consistent with AASB 116 *Property, Plant and Equipment*—to the extent that the refurbishment increases the capacity of the asset to generate future economic benefits in excess of what it previously was—and then depreciated over subsequent periods.

Some organisations might elect to transfer an amount away from profits to another account which might be referred to as an allowance for future repairs. Such an ‘allowance’ account could be disclosed as part of equity

10.15 This really depends upon the intentions and/or business practices of Elwood Ltd. Although there might be no legal obligation, this does not mean that Elwood will not recognise a liability, as a constructive obligation might be deemed to exist. A constructive obligation is defined at paragraph 10 of AASB 137 as:

> an obligation that derives from an entity’s actions where:

(a) by an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities; and

(b) as a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities.

Hence, if the entity has a history of disregarding its responsibilities to the environment and there is no legal requirement to decontaminate the land, then no liability might be
recognised. However, the organisation might have publicly released policy statements that state that the organisation takes its environmental responsibilities very seriously—if so, a constructive liability might be deemed to exist and disclosure would be appropriate.

10.17 Provisions are to be recorded at present value, pursuant to paragraph 45 of AASB 137 *Provisions, Contingent Liabilities, and Contingent Assets*, which states:

> Where the effect of the time value of money is material, the amount of a provision shall be the present value of the expenditures expected to be required to settle the obligation.

Therefore, we firstly need to determine the present value of the liability as at 30 June 2015. It is:

$10\,500\,000 \times 0.2584 = $2\,713\,200$

The next issue to determine is what account shall be debited. That is, is it an expense, or is an asset? Paragraph 16 of AASB 116 states that the cost of property, plant and equipment is to include:

> the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.

Before establishing the nuclear power plant there would be an expectation that the plant would be removed at the completion of the project and any environmental disturbances rehabilitated. These expected future costs would be estimated at the commencement of the project and a liability would be recorded in accordance with AASB 137 *Provisions, Contingent Liabilities, and Contingent Assets*. The expected costs would be measured at their expected present value and the amount would be included as part of the cost of the asset. The total amount of the asset, including the estimated costs for dismantling and removal, would be depreciated over the expected useful life of the asset.

The journal entry on 30 June 2015 therefore would be:

| Dr | Nuclear power plant $2\,713\,200 |
| Cr | Provision for restoration costs $2\,713\,200 |

On 30 June 2016 we have to again calculate the present value of the obligation. In this case there has been a change in discount rate to 6 per cent (and the discounting period is now 19 years rather than 20 years). The obligation is now:

$10\,500\,000 \times 0.3305 = $3\,470\,250$. This represents an increase in the provision by $757\,050$. The increase in the amount of the provision is treated as a borrowing cost. The entry on 30 June 2016 would be:

| Dr | Interest expense $757\,050 |
| Cr | Provision for restoration costs $757\,050 |

10.19 In this question, the interest payments of 10% are made each 6 months for 5 years. Therefore, we will treat the debentures as offering a coupon rate of 5% over 10 periods. Similarly, the market rate will be calculated as 4% for 10 periods.
(a) The issue price is equal to the present value of the interest annuity and the principal repayment. The discount rate is the market’s required rate of return: in this case, 4%.

Issue price:
- PV of principal = 1 000 000 x 0.6755642 = 675 564
- PV of annuity = 50 000 x 8.1108957 = 405 545
- Total = 1 081 109

Because the market rate is less than the coupon rate of the debentures, the debentures are issued at a premium as shown above.

(b)  
(i) 1 July 2014

Dr Cash 1 081 109  
Cr Debenture liability 1 081 109

To determine interest expense using the effective-interest method, we may use the following table. Within the table, the interest expense is determined by multiplying the opening liability (which is measured at present value) by the required market rate of interest, in this case 4% per annum.

<table>
<thead>
<tr>
<th>Period</th>
<th>Opening liability</th>
<th>Interest expense</th>
<th>Cash payment</th>
<th>Reduction in liability</th>
<th>Closing liability</th>
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<td>50 000</td>
<td>6756</td>
<td>1 074 353</td>
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<td>40 385</td>
<td>50 000</td>
<td>9615</td>
<td>1 000 000</td>
</tr>
</tbody>
</table>

(ii) 30 June 2015 (which is the second 6 month period)

Dr Interest expense 42 974  
Dr Debenture liability 7026  
Cr Cash 50 000

(iii) 30 June 2016 (which is the fourth 6 month period)

Dr Interest expense 42 401  
Dr Debenture liability 7599  
Cr Cash 50 000