CHAPTER ONE

INTRODUCTION

"The truth is that livestock possesses some of the characteristics both of a fixed asset and a trading (or current) asset. Although an animal may be acquired primarily for breeding or wool growing purposes, its ultimate sale is in many cases by no means a minor consideration. The life of any stock is limited to a few years and it must be eventually replaced."

Report of the Royal Commission on Taxation, Australia, 1934, paragraph 800.

"Because of the factors of natural growth and increase, the production of joint products, and the length of biological production cycles, the use of the cost based methods of valuation is inappropriate, in respect of primary products."

Wolnizer, P.W., (1978) "The Accounting Valuation Of Primary Production Inventories" *The Accountants' Journal (New Zealand)*, October, p.338.

1.1 Statement of the Problem

In Australia at the present time there is no professional guidance from an accounting standard covering the valuation of livestock by reporting entities. In fact livestock is specifically excluded from the accounting standards on inventory [1] and depreciation of non-current assets.[2] This has led to the use of a wide variety of different methods for livestock valuation in the general purpose financial reports of reporting entities.

The purpose of accounting standards is to reduce differences in disclosure, measurement and presentation of financial information in financial reports among business entities, and to improve the quality of information in published financial reports. Hendriksen (1982 p.116) points out that the effect of accounting standards should be to "limit the number of choices and the amount of discretion available to individual firms in their financial statements and reports". The problem with livestock valuation currently is that the number of choices of valuation method is not limited by an accounting standard, with the resulting possibility of widely divergent results being published for what is ostensibly similar data.

1.2 Background to the Problem

Livestock is excluded from the accounting standard on measurement of inventory on the grounds that "different principles are involved in the valuation of livestock" (Roberts (1988 p.74)). This is because livestock both grows and regenerates, and under existing accounting standards no provision is made for accounting for accretion. If it is acknowledged that different principles apply for the valuation of livestock and other self-generating and

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1 AASB 1019 "Measurement and Presentation of Inventories in the context of the Historical Cost System" para.02(b)(i), and AAS2 "Measurement and Presentation of Inventories in the context of the Historical Cost System" para.3(c)(i):

> "This standard does not apply to inventories that are (i) forests, livestock or similar regenerative natural resources;".

2 AASB 1021 "Depreciation of Non-Current Assets" para.02(c)(i), and AAS4 "Depreciation of Non-Current Assets" para.3(c)(i):

> "This standard does not apply to inventories that are (i) forests, livestock or similar regenerative natural resources;".

regenerating assets, then it should also be agreed that a separate standard is required, and that such reporting has unique characteristics. If this is the case, then the starting point for a search for the most appropriate method of valuing livestock in general purpose financial reports should be the underlying objective of general purpose financial reporting and, following from that, the qualitative characteristics required of financial information.

According to Statement of Accounting Concepts No.2 "Objective of General Purpose Financial Reporting" (SAC2) (para 43) the objective of general purpose financial reports is to "provide information useful to users for making and evaluating decisions about the allocation of scarce resources", and general purpose financial reports should "disclose information relevant to the assessment of performance, financial position, and financing and investing ...." (para 45). SAC2 also states (para 11) that general purpose financial reports are "a means of communicating relevant and reliable information about a reporting entity to users", those users being identified primarily as resource providers, parties performing a review or oversight function, and recipients of goods and services (para 16).

Resource providers are identified as investors and contributors, lenders, creditors, suppliers and employees (para 17), as parties performing a review or oversight function such as analysts, labour unions, employer groups, regulatory agencies and government (para 19), and as recipients of goods and services such as customers and others who benefit from the goods and services provided by the reporting entity (para 18).

Houghton and Tan (1995) in a recent survey of Australia's largest businesses (members of the Group of 100) found that these companies also perceive financial analysts (42.24%) and shareholders (40.7%) to be the principal users of their general purpose financial reports. They believe that the objectives of these principal users in using the annual reports are primarily to monitor and/or evaluate company performance (40.7%), to forecast or determine future profitability (12.7%), and to analyse the accounts and make economic and

business decisions (12.7%). In addition Chang and Most (1980) identified potential users of general purpose financial reports as investors (both individual and institutional) and financial analysts. For this reason, shareholders of companies owning livestock and financial analysts will be surveyed to ascertain their perceptions.

In order to ascertain user perceptions about information contained in general purpose financial reports, it is important to firstly assess what their objectives are when using those reports, and in addition consider what qualities that information should possess in order to be "useful" (as per the definition in the Statement of Accounting Concepts (SAC2 para 43)). Statement of Accounting Concepts No.3 "Qualitative Characteristics of Financial Statements" (SAC3) suggests that general purpose financial reports should include "all financial information which satisfies the concepts of relevance and reliability, and which passes the materiality test" (para 48) and "... shall be presented on a timely basis and in a manner which satisfies the concepts of comparability and understandability".

Therefore in addition to assessing the relevance and reliability of the various models, consideration should also be given to the issues of the comparability and understandability of financial reports. That is whether the different available methods lead to a failure of existing practice to produce general purpose financial reports that comply with the comparability criteria, which states that users of general purpose financial reports should be able to compare aspects of an entity at one time and over time, and between entities at one time and over time (SAC3 para 31), and whether users can understand them.

This gives rise to a query about the decision usefulness of existing practice - does existing livestock valuation practice fulfil the above criteria (relevance, reliability, comparability and understandability) especially given that a number of valuation methods are permitted, which will each result in different reported asset values? In an attempt to answer this question this study will look at the most common valuation methods:

* **historical cost;**
* **modified historical cost;**
* **current replacement cost;**
* **net current market value** (referred to as net realisable value or net market value among some writers); and
* **net present value.**

The study will also consider **deprival value** (or 'value to the business') a hybrid or compromise valuation method which the Valuation Sub-Committee of the Steering Committee on National Performance Monitoring of Government Trading Enterprises recommended as the appropriate basis of measurement for the valuation of the non-financial assets of Commonwealth, State and Territory Government trading enterprises. This study will consider its applicability to the valuation of livestock.

This investigation will be done in terms of the reliability and relevance of the valuation methods to the valuation of livestock, and in terms of comparability of the reports (general purpose financial reports) from one period to the next, and from company to company, and the understandability of those reports from the point of view of the users.

1.3 Objectives of the Study

This research study will attempt to identify the valuation method for the valuation of livestock which the users of general purpose financial reports perceive to be the most useful, and which fulfils the requirements of the Statements of Accounting Concepts (SACs).

The study will look at the perspectives of two different groups of users of general purpose financial reports. A survey of companies dealing in livestock was undertaken by Roberts et al (1995) to determine the valuation methods used. This survey found that three (3) companies (33.33%) used net current market value (one of which used directors' valuation amortised over operable life for its stud stock), two (2) companies (22.22%) used average cost, one (1)

company (11.11%) used cost, one (1) company (11.11%) used lower of cost and net realisable value, one (11.11%) used lower of standard value or market value and one (11.11%) used directors' valuation.

Here the Top 60 shareholders of selected publicly listed companies which own livestock will be surveyed, along with a randomly selected sample of financial analysts.

The results of each of these surveys will be compared and contrasted to ascertain whether the perceptions of these groups differ significantly, and whether they have different views regarding the valuation of livestock compared to the valuation of other assets. A pilot study was undertaken first to ensure the understandability and comprehensiveness of the survey instrument, and a number of changes made to the initial survey form.

1.4 Significance of the Study

There has been a number of surveys of current practice to determine livestock valuation methods currently in use (Roberts et al (1995), Frost (1993)). However no research has been undertaken to determine users' perceptions about the usefulness of the general purpose financial reports prepared using those various methods.

In terms of the significance of livestock, the agricultural sector represents a substantial portion of the Australian economy, particularly in terms of its contribution to Australia's exports. The contribution of the rural sector to Australia's Gross Domestic Product (GDP) was $13.4 billion (3.1%) in 1993-94. Whilst this may appear to be a relatively unimportant proportion of GDP, the farm sector utilises 470 million hectares or 61% of land available in Australia, and farm sector products accounted for 11% of exports in 1993-94 ($7.1 billion), and 10% of exports in 1994-5 ($7 billion), a year when

Australia was experiencing serious drought conditions, with the wool industry contributing the greatest proportion, followed by the beef industry.[3]

With regard to the issue of valuation methods, there is currently some debate about accounting valuation or measurement systems, with a number of different models being put forward. This issue will be addressed by the accounting profession over the next few years, with an accounting theory monograph likely to be released in the next twelve months (this monograph was due to be issued in late 1994, however as at June 1997 it had not been issued and is now expected in late 1997).

Currently four (4) accounting standards in Australia allow assets and/or liabilities to be valued at a value other than historical cost. AASB 1008 (AAS 17) "Accounting for Leases" and AASB 1028 (AAS 30) "Accounting for Employee Entitlements" state that the valuation of liabilities should be based on the **net present value** of future commitments (para .20 and para 12 respectively). AASB 1023 (AAS 26) "Financial Reporting of General Insurance Activities" requires that investments which are "integral to the general insurance activities" of general insurance companies should be stated at their **net market value** (para 23). Finally AAS 25 (no equivalent AASB) "Financial Reporting by Superannuation Plans" requires <u>all</u> superannuation plan assets to be stated at "**net market value**" (para 37) and states that where there is no market (or a 'thin' market) the **discounted present value** of future cash flows may be used to determine net market value (para 38), indicating that **discounted present value** may be used as a surrogate for **net market value** where no market exists. In addition Exposure Draft ED59 "Financial Instruments" permits financial assets and financial liabilities to be measured at **net market value** as one alternative (para 85).

In this study the various measurement bases will be considered both in the context of measurement theory, and in terms of their application and relevance

[3] Source: Australian Bureau of Statistics Yearbook Australia 1996.

to the valuation of livestock in the general purpose financial reports of companies with livestock assets.

1.5 Scope of the Study

The study will be limited to the valuation of livestock in the statement of financial position in general purpose financial reports, that is financial reports intended to meet the information needs of users who are not in a position to demand reports tailored to satisfy their needs, as these reports are governed by accounting standards. In addition, companies which prepare special purpose financial reports only, e.g. tax returns or reports to management (internal users), are likely to be influenced by those users in their choice of valuation method.

1.6 Implications of the Study

Despite the issue of the valuation of livestock being debated for over thirty years, at this stage there is still no accounting standard. The work of the Australian Accounting Research Foundation and the International Accounting Standards Committee on Agriculture in recent times has opened up the debate. To date the users of general purpose financial reports have not been asked for their views on this issue. This research study adds to the work undertaken by Roberts et al (1995) for the Australian Accounting Research Foundation by looking at the topic from the point of view of the users of the financial reports.

1.7 Definitions

Livestock

Assets are defined in Statement of Accounting Concepts No.4 "Definition and Recognition of the Elements of Financial Statements" (SAC4) (para 14) as "future economic benefits controlled by the entity as a result of past transactions or other past events". Under SAC4 the criteria for recognition of assets are that an asset should only be recognised in financial statements when

"it is probable that the future economic benefits embodied in the asset will eventuate; and the asset possesses a cost or other value that can be measured reliably." (para 28) Livestock are part of the group of assets classified as Self-Generating and Regenerating Assets (SGARA). These are defined by Goyen and Roberts (1991 p.9) as

> "... non-human living assets which, due to (an) inherent capacity for growth, production, procreation and degeneration, contain economic benefits and service potential which are subject to continual variations during their lifetime."

Included in this classification are ruminants such as sheep, cattle (both dairy and beef), buffalo, goats, deer, horses, alpacas, and llamas; non-ruminants such as pigs and poultry (including ostriches and emus); and any other livestock which is farmed for commercial purposes, such as fish, yabbies, crayfish, worms, crocodiles, etc. Livestock includes livestock acquired for resale, breeding livestock, and productive livestock.

Measurement bases:

Historical Cost: The amount of cash (or cash equivalent) paid or payable for an asset at the time of acquisition less, where applicable, accumulated depreciation (cost allocated over estimated useful life). Historical cost also includes standard cost and average cost where livestock asset values are determined by aggregating the inventory value at the beginning of the year, cost of purchases, and a nominal value for natural increase, and dividing the aggregate amount by the total number of livestock to which those values relate.

Modified Historical Cost: Asset purchases are recorded at their original acquisition cost (historical cost). In subsequent periods assets may be revalued and reported at their revalued amounts, e.g. inventories should be recorded at the lower of cost and net realisable value, and non-current assets may be

revalued and must not be reported at values greater than their recoverable amount.

Current Replacement Cost: The amount of cash (or cash equivalent) that would currently be required to replace the asset with a similar asset. This represents the cost of replacing the asset's productive capacity with an efficient asset of equivalent capacity. This is the current entry (buying) value.

Net Current Market Value: The estimated proceeds of sale less all costs to be incurred in marketing, selling and distribution to customers (this is sometimes referred to as net market value/current net selling price/net realisable value). This is the current exit (selling) value.

Net Present Value: The discounted present value of the future net cash inflows that the asset is expected to generate either from its use and subsequent sale, if applicable, or from its sale.

Deprival Value: The minimum amount that the entity would need to receive to compensate it for losing the asset. This could be either net current market value, current replacement cost or net present value, depending on the relationship between them and whether or not the entity would replace them.

1.8 Outline of the Study

Following from the above overview of the research, the research study will be presented as outlined below.

Chapter Two will describe the reporting environment, and more specifically general purpose financial reporting and who the users of such reports are. This discussion will focus on the statement of financial position and the valuation of assets on that statement.

Chapter Three will develop further the discussion on measurement/valuation of assets on the statement of financial position, focusing on the valuation of livestock and the need for livestock to be treated separately from other assets.

Chapter Four will discuss the research questions and propositions, and the expected findings.

Chapter Five will show the research methodology adopted for this study, including sample selection, limitations, and statistical analysis employed.

Chapter Six will present an analysis and an interpretation of the results of the study.

Chapter Seven will summarise the study and present the conclusions which have arisen from it, as well as suggesting possible further research required in this area.

CHAPTER TWO

THE REPORTING ENVIRONMENT

"Accountants are specialists in the preparation and presentation of economic (financial) information. What this information includes and how it is presented is dependent on the demands of those who want and need this information - other members of society."

Gaffikin, M.J., (1993) *Principles of Accounting*, 3rd Edition, Harcourt Brace Jovanovich, p.4.

2.1 Introduction

This chapter will describe in Section 2.2 the reporting environment, with particular reference to the conceptual framework for general purpose financial reporting, the financial reporting environment and the preparation of general purpose financial reports, as these reports are prepared for users who are not in a position to demand their own special purpose financial reports. Attention will be given to the identity of the users of general purpose financial reports, their objectives in using these reports, and the qualities which information should possess in order to be useful to their decision making.

In order to do this Section 2.2 will provide an analysis of the requirements of Statement of Accounting Concepts No.2 "Objective of General Purpose Financial Reporting" (SAC2) and Statement of Accounting Concepts No.3 "Qualitative Characteristics of Financial Statements" (SAC3).

It will be shown that a key financial report is the statement of financial position. As assets are a major element of that statement, Section 2.3 will deal specifically with the issue of valuation of assets in the statement of financial position. Section 2.3.1 will concentrate on self-generating and regenerating assets as a class of asset, and Section 2.3.2 will focus on valuation of the self-generating and regenerating asset livestock. There is no guidance currently provided by Australian accounting standards on this issue, although both the Australian Accounting Research Foundation and the International Accounting Standards Committee are looking at the whole issue of accounting for agricultural pursuits, including livestock valuation, at the present time.

2.2 The Reporting Environment

This research study is attempting to identify the most appropriate method for the valuation of livestock in the financial position segment of general purpose financial reports by analysing the requirements of the statements of accounting concepts, and by testing the results of the this analysis against what users perceive to be the most useful for decision making.

Statement of Accounting Concepts No.2 "Objective of General Purpose Financial Reporting" (SAC2) (para 43) states that the objective of general purpose financial reporting is to "provide information useful to users for making and evaluating decisions about the allocation of scarce resources". People need economic information to help them to make decisions and judgements about businesses. Accounting is concerned with the collection, recording, analysis and communication of this economic information. Such information can be used to assist decision-making, planning and control. The major purposes of financial reports then are to assist in decision making and to evaluate performance.

Therefore financial information is useful to those who need to make decisions and plans about businesses, and to those who need to control those businesses. Accounting is often referred to as the 'language of business'. Accountants prepare and present reports for managers, owners, lending institutions, government authorities and other users in order for them to make informed decisions about the allocation of scarce resources. Whilst managers working within a particular business will almost certainly be significant users of accounting information, they are by no means the only people who are likely to use such information.

Managers, lending institutions and government authorities are in a position to demand their own special purpose reports, designed to meet their needs. However there are many other users who are not in such a position.

According to SAC2 (paras 17-19) these users include:

1) resource providers, including shareholders, creditors, suppliers and employees;

2) parties performing a review or oversight function, including financial analysts, labour unions, employer groups; and

3) recipients of goods and services, including customers and others who benefit from the goods and services provided by the reporting entity.

As these users are not in a position to demand their own special purpose financial reports, they must rely on general purpose financial reports to obtain their information. General purpose financial reports are financial reports intended to meet the information needs common to users who are unable to command the preparation of reports tailored so as to satisfy, specifically, all of their information needs. These reports are governed by accounting standards, and are the focus of the conceptual framework for general purpose financial reporting.

As discussed in Section 1.2, a recent survey (Houghton and Tan (1995)) found that Australia's largest companies perceive financial analysts and shareholders to be the principal user groups of their general purpose financial reports. Similarly, Chang and Most (1980), also identified investors (both individual and institutional) and financial analysts to be potential users of general purpose financial reports. For this reason it was decided to survey these two groups of users for this research study.

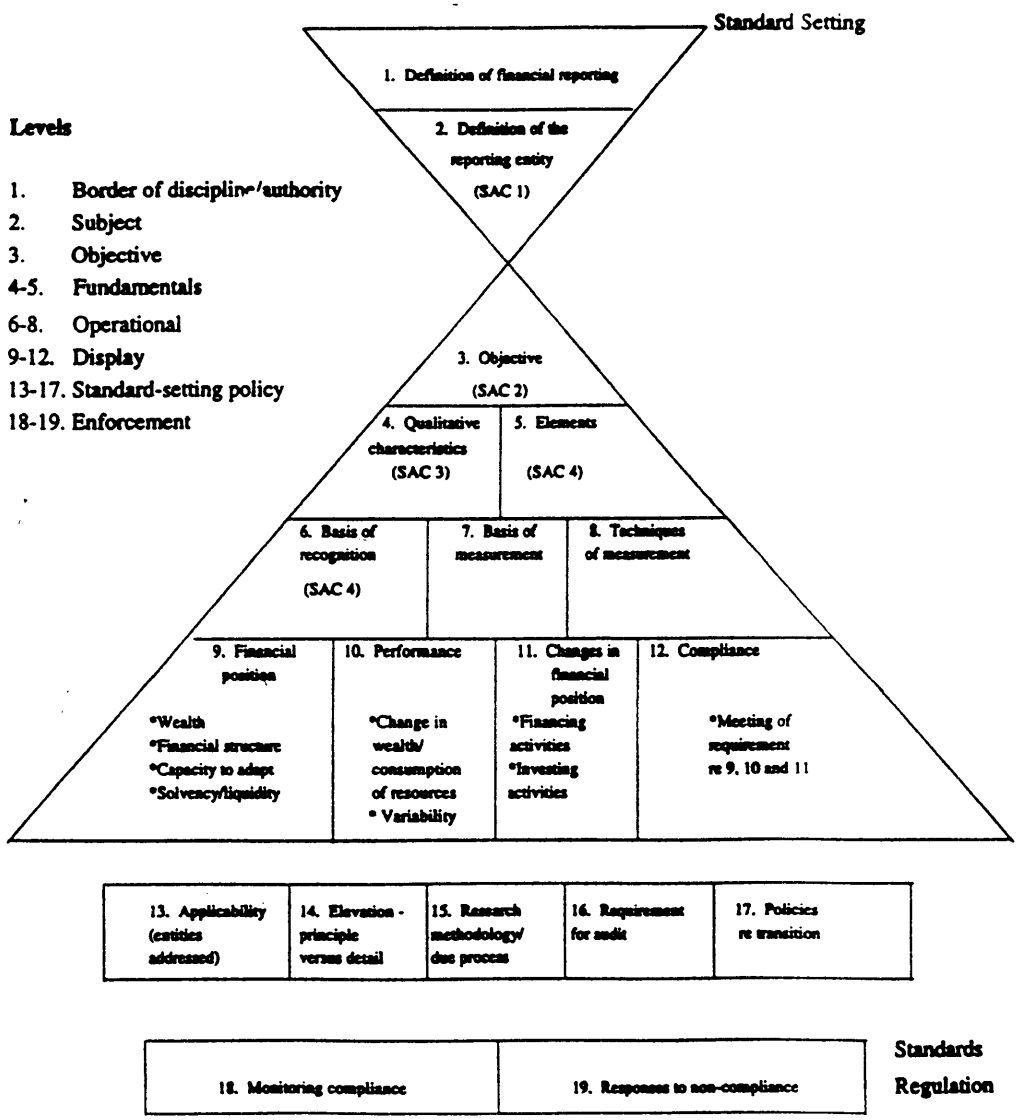
Recipients of goods and services are not considered to be primarily interested in the two major issues of this research, but are considered to be more likely to use general purpose financial reports to gauge the likelihood of continued supply of their needs (for goods and services), and are therefore not included in the population of interest (see Chapter 5).

2.2.1 The Financial Reporting Environment

The Australian Accounting Research Foundation (AARF) and the Australian Accounting Standards Board (AASB) are currently developing a comprehensive conceptual framework for general purpose financial reporting. **Figure 2.1** shows the tentative building blocks of the framework. The framework comprises a series of Statements of Accounting Concepts (SACs) which set out the general concepts which guide the preparation and

presentation of general purpose financial reports. They define the nature, subject, purpose and broad content of general purpose financial reporting. To date four SACs have been issued (relating to blocks 2 to 6 of Figure 2.1), dealing with the definition of the reporting entity (SAC 1 - block 2), the objective of general purpose financial reporting (SAC 2 - block 3), the qualitative characteristics of financial information (SAC 3 - block 4), and the definition and recognition of the elements of financial statements (SAC 4 - blocks 5 and 6).

Figure 2.1 Building Blocks of a Conceptual Framework for General Purpose Financial Reporting [4]



[4] Australian Accounting Research Foundation (1997) "The Nature and Purpose of Statements of Accounting Concepts", Policy Statement 5.

The AARF and AASB are currently working on the development of a statement on the measurement of the elements of financial statements. However this is not expected to be completed and a monograph issued until late 1997. It should be noted that compliance with the SACs is not mandatory. They provide a "source of guidance to which members (of the Institute of Chartered Accountants of Australia [ICAA] and the Australian Society of Certified Practising Accountants [ASCPA]) should make reference if there is no Accounting Standard dealing with an accounting treatment or disclosure issue" (APS1, para 21).

General purpose financial reports consist of a statement of financial position, which shows the financial position of the entity as at balance date, i.e. the assets, liabilities and shareholders' equity of the entity at balance date; a profit and loss account, which shows the results of operations for the relevant period, including all items of revenue earned and expense incurred for that period; and a statement of cash flows, which provides information about the cash flows of the entity during the reporting period.

This study deals with the first of these statements, the statement of financial position, as it is on this statement that livestock is valued and disclosed.

2.2.2 The Objective of General Purpose Financial Reporting

Anderson & Epstein (1995 p.25) believe that the purpose of general purpose financial reports is "to make information available to the corporate shareholders and other shareholders (or potential shareholders). The reports should contain information about the financial condition of the enterprise, and other information that would be of interest to the user".

In order to ascertain user perceptions about information contained in general purpose financial reports, it is important to firstly assess what their objectives are when using those reports. According to the conceptual framework for general purpose financial reporting the objective of general purpose financial reporting is to "provide information useful to users for making and evaluating

decisions about the allocation of scarce resources" (SAC2 para 43), and general purpose financial reports should "disclose information relevant to the assessment of performance, financial position, and financing and investing ...." (SAC2 para 45).

What qualities should information possess in order to be 'useful' as stated in the objectives? Statement of Accounting Concepts No.3 "Qualitative Characteristics of Financial Information" (SAC3) suggests that general purpose financial reports should include "all financial information which satisfies the concepts of relevance and reliability, and which passes the materiality test" (para 48) and "... shall be presented on a timely basis and in a manner which satisfies the concepts of comparability and understandability". Assuming materiality, SAC3 identifies "relevance and reliability as the primary qualitative characteristics which financial information should possess in order to be the subject of general purpose financial reporting" (para 7). SAC3 (paras 8 and 9) states that to be 'relevant' financial information must "assist (users) in making predictions about future situations and in forming expectations and/or it must play a confirmatory role in respect of their past evaluations. ... e.g. financial information about the current level and structure of asset holdings will have value to users when they endeavour to assess an entity's ability to take advantage of opportunities in the market place."

How 'reliable' financial information is will be determined by "the degree of correspondence between what that information conveys to users and the underlying transactions and events that have occurred and been measured and displayed. Reliable information will, without bias or undue error, faithfully represent those transactions and events." (SAC3 para 16)

Given this analysis of the statements of accounting concepts, the study will investigate the perceptions of users of general purpose financial reports regarding their objectives in using those reports, as per SAC2 and the Houghton & Tan (1995) study **(Research Question 2.1, Survey Question 2)** and whether the existing methods of valuing assets, as outlined, assist in

achieving these objectives **(Research Question 2.2, Survey Question 4)**. It will also ascertain the importance users place on these qualitative characteristics (reliability, relevance, comparability and understandability) both in terms of decision making in general (**Research Question 2.4, Survey Question 10(i)**) and with reference to livestock in particular (**Research Question 2.5, Survey Question 10(ii)**).

2.3 Valuation of Assets

As Neilson points out (1986 p.7): "Faulty valuation of assets will cloud the picture and give a distorted perspective of the business."

The basis and techniques of measurement in accounting (blocks 7 and 8 of **Figure 2.1**) will be addressed by the accounting profession over the next few years, with an accounting theory monograph likely to be released in the next twelve months.

Solomons (1978) likens the accounting process to financial map-making. He believes that an accounting report should be judged by how well it represents the facts, in the same way as a map is judged. How the reader will react should be of no concern for the cartographer or the accountant. The role of financial statements is to present, as objectively as possible, the individual 'elements', including assets, liabilities, revenues and expenses of the enterprises.

As regards objectivity, Stone (1972 pp.14-15) argues that whilst it is a desirable attribute, it "must not override other principles of equal importance. Unfortunately, the accountant's preoccupation with objectivity has tended to act as blinders (sic). It is these blinders which cause normally utilitarian-minded men (sic) to produce financial statements based on cost, when cost is often as meaningless a statistic as the temperature on the date of acquisition." He further points out (p.14) that whilst accountants "shudder at the non-objectivity of current values", they seem to "forget just how many subjective judgements permeate the financial statements that we now prepare - calculation of a bad debt provision, determination of an inventory's saleability,

determination of the period during which benefits will be derived from research and development expenditures, the status of long-term contracts in process, even the extent and maturity of liabilities. All of these items and many more as well require the exercise of subjective judgements, making cost-based financial statements much less objective than their proponents claim."

Sprouse & Moonitz (1962 p.28) support this view, and argue that "in centering their attention on 'verification', accountants frequently select less useful instead of more useful procedures. Verifiability (definiteness, objectivity) is a necessary condition for the use of any procedure, but it is not a sufficient condition. Other attributes need to be considered and a choice made from the array of all procedures which meet the test of objectivity."

This study will investigate users' perceptions about the importance of reliability, relevance, comparability and understandability (as per SAC2) in assessing the usefulness of accounting information in general **(Research Question 2.4, Survey Question 10 (i))**, and whether they perceive that the valuation methods outlined satisfy these criteria **(Research Question 2.6, Survey Question 11)**.

2.3.1 Self-Generating and Regenerating Assets

The AASB and the PSASB (AARF (1994 para 11)) have been "requested to develop measurement concepts which address perceived deficiencies of the historical cost basis in respect of .... self-generating and regenerating assets."

The first part of this program was the issue of Discussion Paper No.23 "Accounting for Self-Generating and Regenerating Assets" (Roberts et al 1995) which recommended (p.90) that:

a) "SGARAs should be reported as "Self-Generating and Regenerating Assets" as (sic) a category separate from current assets and non-current assets and identified by sub-categories or "types" of SGARAs (such as plants and animals)."

b) "... a valuation method should be adopted for SGARAs that best estimates the current market value of the assets. There are alternative views as to whether entry prices or exit prices should be used in identifying current market value. It is recommended that this issue be resolved in the context of the more general question of the measurement of all assets and liabilities. In the absence of reliable current market prices, an appropriate surrogate for current market value should be adopted."

The use of entry prices (entry value) means valuing assets at their current purchasing price, i.e. current replacement cost. The use of exit prices (exit value) means valuing assets at their current market selling price, i.e. net current market value.

Livestock

Why is livestock excluded from the standards on inventory and depreciation of non-current assets? According to Roberts (1988 p.74) it is because "different principles are involved in the valuation of livestock".

If it is acknowledged that different principles apply for the valuation of livestock, then the starting point for a search for the most appropriate method of valuing livestock in general purpose financial reports should be the conceptual framework for general purpose financial reporting, starting with the definition of an asset, the underlying objective of general purpose financial reports and the qualitative characteristics required of financial information.

Statement of Accounting Concepts No. 4 "Definition and Recognition of the Elements of Financial Statements" (SAC4) defines an asset as "the future economic benefits controlled by the entity as a result of past transactions or other past events" (para 15). The criteria for recognition are that "an asset should be recognised in the statement of financial position when and only when

a) it is probable that the future economic benefits embodied in the asset will eventuate; and

b) the asset possesses a cost or other value that can be measured reliably." (para 38)

Given the above definition, livestock fulfils the criteria for definition and recognition as an asset. However there is one area where livestock differs from other assets, and that is accretion, or natural growth.

Livestock both grows and regenerates, and under existing accounting standards no provision is made for accounting for these events. To date, accounting standards in Australia have, to a great extent, failed to deal with the effects of price changes, and the effect of accretion on self-generating and regenerating assets, and issues following from the use of different methods of valuation in general purpose financial reports. AASB 1010 (AAS 10) "Accounting for the Revaluation of Non-Current Assets" allows for the revaluation of non-current assets, however no specific valuation method is recommended.

2.3.2 Valuation of Livestock

Accounting policies should be selected and applied so that the financial statements in general and the statement of financial position in particular are relevant to the decision-making needs of users, and that they are reliable.

The objective of accounting standards is to address accounting method choice issues, including measurement issues (inventory valuation, etc). Because there is no accounting standard covering the valuation of livestock a wide variety of different methods are used for valuing livestock in reporting entities' general purpose financial reports, as outlined in Section 1.3.

As questioned in Section 1.2, existing livestock valuation practice may not fulfil the primary qualitative criteria, i.e. relevance, reliability, comparability and understandability. In view of this, the recommendations of the Australian Accounting Research Foundation's Discussion Paper No 23 "Accounting for

Self-Generating and Regenerating Assets" and the interest of the International Accounting Standards Committee in accounting for agriculture, it was considered timely to ascertain the opinions of the users of general purpose financial reports.

As outlined in Section 1.2, the most common methods of valuing livestock: **historical cost, modified historical cost, current replacement cost, net current market value, net present value** and **deprival value**, will be considered in terms of their reliability and relevance to the valuation of livestock, and in terms of comparability of the reports (general purpose financial reports) from one period to the next, and from company to company, and in terms of their understandability for users. Their acceptability as measurement systems and the debate in the literature regarding their suitability for the valuation of livestock will be discussed in Chapter 3.

The study will investigate which valuation method users consider to be the most useful for the valuation of livestock in general purpose financial reports **(Research Question 2.3, Survey Question 8)**. In addition the views of users will be sought about criteria they consider important in assessing the usefulness of accounting information in general purpose financial reports with respect to livestock **(Research Question 2.5, Survey Question 10 (ii))**, and their perceptions about whether the valuation methods outlined satisfy these criteria with respect to the reporting of livestock **(Research Question 2.7, Survey Question 12)**.

Although the issues of asset valuation and income/revenue recognition are inexorably linked, for discussion purposes they are decidedly separate issues. This study will look specifically at the issue of valuation of assets on the statement of financial position. The issue of the treatment of any increase in value and thus revenue recognition, whilst an interesting and challenging issue in its own right, is beyond the scope of this study.

Despite a long-running debate about livestock valuation both in Australia and overseas, which will be reviewed in Chapter 3, there is still no Australian

accounting standard. The Australian Accounting Research Foundation and the International Accounting Standards Committee on Agriculture have recently entered debate, but users of financial statements have not been asked for their views on this issue. This study adds to the work undertaken by Roberts et al (1995) by looking at the topic from the perception of the users of the financial reports.

2.4 Conclusion

This chapter described the reporting environment, with particular reference to the financial reporting environment and the preparation of general purpose financial reports, as these reports are prepared for users who are not in a position to demand their own special purpose financial reports. Attention was given to the identity of the users of general purpose financial reports, their objectives and the qualities which information should possess in order to be useful for decision making purposes.

Section 2.3 dealt specifically with the issue of valuation of assets on the statement of financial position, with the focus of Section 2.3.1 being on valuation of the asset livestock as no guidance is currently provided by Australian accounting standards on this issue.

The substantial debate in the literature about this issue will be discussed in Chapter 3.