case study 3.1 solution

Telecom Corporation of New Zealand Limited Balance Sheet



SOURCE: *Telecom Corporation of New Zealand Limited Annual Report 2013*, p. 77.

Questions

1 Figures are provided for both ‘Telecom Corporation of New Zealand Group’ and ‘Telecom Corporation of New Zealand Parent’.

(a) What is the difference between these two entities?

Telecom Corporation of New Zealand Parent represents the parent, holding or controlling company’s report. It is the report of a single legal entity that has controlling interests in a number of other companies within the group.

Telecom Corporation of New Zealand Group represents the financial position of the economic entity comprising the holding or parent company and all other subsidiary entities within the group (those where the holding or parent company has direct or indirect control).

(b) Why are the two sets of figures provided?

Two sets of figures are provided to show the balance sheet of the holding company Telecom Corporation of New Zealand Parent as a separate entity and subsequently the balance sheet for the overall Telecom Corporation of New Zealand Group to include all interests of subsidiaries.

2 The assets are classified as ‘current’ and ‘non-current’.

(a) What is the difference between these two categories?

Current assets represent those assets that are in the form of cash, or will be converted to cash or fully used up or realised within either the next accounting cycle period or 12 months. Non-current assets are those that will not be converted to cash or fully used up or realised within the next 12 months or operating cycle period.

(b) How else could the assets be classified?

An acceptable alternative, providing it provides more relevant information, is to classify the assets in order of liquidity (the speed with which non-cash assets can be converted to cash).

3 What sort of items would be included in the inventory of ‘Telecom Corporation of New Zealand Group’?

Inventory refers to raw material used in the production process, work or goods in process (partly produced), finished goods for sale (merchandise) or use, and consumable stores.

In the case of Telecom you could identify possible items within each class:

• maintenance materials and consumables

• goods held for resale

• work in progress.

4 Both the current and non-current liability categories include an account labelled ‘Provisions’.

(a) What does the term ‘provision’ mean?

According to *NZ IAS 37: Provisions, Contingent Liabilities and Contingent Assets*, a provision is a liability of uncertain timing or amount.

A provision shall be recognised when:

• an entity has a present obligation (legal or constructive) as a result of a past event

• it is probable that outflow of resources embodying economic benefits will be required to settle obligation, and

• a reliable estimate can be made of the amount of the obligation.

(b) Provide possible examples of liability provision accounts.

The liability provisions relate to expected future outlays of economic benefits related to existing contractual claims against the entity, but normally where the amount of the claim has not been previously determined (for example, insurance, warranty, long service leave, holiday pay, taxation).

Specific examples include:

• Commercial – these provisions principally relate to the cost of rectifying several billing application configuration issues, and covers the cost of investigating and resolving these issues.

• Property – property provisions relate primarily to make good requirements under property leases.

• Other – other provisions include legal provisions.

(c) Discuss how a provision can be both a ‘current liability’ and a ‘non-current liability’.

The expected future outflow of goods or services may be within one year or within the normal operating cycle (classified as ‘current’), or beyond that time frame (classified as ‘non-current’).

5 Intangible assets make up 40.3% of Telecom Corporation of New Zealand Group’s 2013 total non-current assets.

(a) What is meant by the term ‘intangible assets’?

*NZ IAS 38: Intangible Assets* defines an intangible asset as ‘[a]n identifiable non-monetary asset without physical substance’.

‘... Physical form is not essential to the existence of an asset ... [intangible assets exist] if future economic benefits are expected to flow from them to the entity and if they are controlled by the entity.’ (NZ Framework, para 56)

Three conditions need to be established before an item can be recognised as an intangible asset. The item must be non-monetary, identifiable, and lack physical substance.

An asset meets the identifiability criterion in the definition when it:

• is separable, that is, is capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, asset or liability, or

• arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

(b) What are some likely examples of intangible assets that Telecom Corporation of New Zealand may hold?

Examples include patents, goodwill, research and development, mastheads, brand names, copyrights, and trademarks.

Examples specific to Telecom include software, capacity, spectrum licences, other intangibles, and goodwill.

6 Does this report represent an ‘entity’ or ‘proprietary’ approach to the accounting equation?

The report uses the proprietary approach (OE = A – L).

7 Outline what is meant by ‘long-term derivative assets’. You should also illustrate your answer with examples.

A long-term derivative asset is a type of financial instrument governed by *NZ IAS 39: Financial instruments: Recognition and Measurement*. NZ IAS 39 defines a derivative in para 9 as:

Definition of a derivative

A *derivative* is a financial instrument or other contract within the scope of this Standard (see paragraphs 2–7) with all three of the following characteristics:

(a) its value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract (sometimes called the ‘underlying’)

(b) it requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors

(c) it is settled at a future date.

Examples include:

• currency options

• electricity price hedges

• foreign exchange contracts

• interest rate swaps

• cross-currency interest rate swaps.

8 Provide possible examples of ‘Reserve’ accounts for Telecom Corporation of New Zealand.

Examples of reserve accounts are:

• asset revaluation reserve

• capital reduction reserve

• capital profits reserve

• asset replacement reserve

• forfeited shares reserve

• foreign currency translation reserve

• dividend equalisation reserve.

9 Why would accounts payable and accruals of the Telecom Corporation of New Zealand Group be greater than accounts payable and accruals of Telecom Corporation of New Zealand Parent?

The accounts payable and accruals of Telecom Corporation of New Zealand Parent will only include the accounts payable and accruals of that company. The accounts payable and accruals of the Telecom Corporation of New Zealand Group will represent an aggregation of all of the accounts payable and accruals of the parent company and all subsidiary companies.