**Amalgam Case Study**

**Learning objectives**

By completing the *Amalgam case study*, students should enhance their ability to:

1. identify information about economic phenomena that, within the context of the objective of financial reporting as set out in the IASB’s *Conceptual Framework* would be relevant to the economic decision-making needs of users and that is reliable (for example, can be faithfully represented);
2. understand the judgements that must be exercised when accounting for, and reporting, economic phenomena in accordance with IFRS when applying the IAS 8 hierarchy; and
3. develop the ability to make the judgements necessary to apply the IAS 8 hierarchy for a variety of economic phenomena.

**Background**

Amalgam has been listed on the Afriganistan Stock Exchange for more than ten years.1 It was founded by Mrs Conglomerate (Mrs C) and she holds the controlling (80 per cent) equity interest. Amalgam’s functional currency is the US dollar ($).

For many years Mr Judgement (Mr J) has led the financial reporting team at Amalgam. Last year, Amalgam’s financial statements were prepared in accordance with IFRS for the first time. Previously, the financial reporting requirements applied were mostly tax-based. Mr J found that he needed to exercise a greater amount of judgement and needed to make many more estimates in order to apply IFRS.

In the current reporting period (20X2) Amalgam enters into a number of transactions for which Mr J cannot find specific IFRS requirements. Mr J wonders how, in the absence of explicit IFRS requirements, he should account for and report those transactions in Amalgam’s financial statements for the year ended 31 December 20X2. Consequently, he seeks your expert opinion on how to account for the following economic phenomena (for example, a transaction or other event) in accordance with IFRS.

*Mushroom farming*

On 1 February 20X2 Amalgam acquires a mushroom farming business. When visiting the mushroom farming operation, Mr J is surprised to learn that mushrooms are neither plants nor animals—they are fungi. On returning to his office Mr J inspects the definition of a biological asset in IAS 41 *Agriculture* and is surprised to find that definition to be limited to living animals and living plants. Furthermore, he cannot find where in IFRS it is specified how to account for the fungi that Amalgam is farming (ie the living mushrooms).

*Reorganization*

On 31 December 20X2 Amalgam acquires all the equity of Ation from Conglomerate in exchange for $20,000 million in cash. Mrs C owns all the equity of Conglomerate and controls both Conglomerate and Amalgam.

Summary financial information for Amalgam and Ation on 31 December 20X2 (immediately before the transaction above) is as follows:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **Amalgam** | | **Ation** | |
|  | *Carrying amount* | *Fair value* | *Carrying amount* | *Fair value* |
|  | *$’millions* | *$’millions* | *$’millions* | *$’millions* |
| Identifiable assets | 300,000 | 600,000 | 35,000 | 50,000 |
| Liabilities | (200,000) | (190,000) | (32,000) | (29,000) |
| Contingent liabilities | – | (10,000) | – | (3,000) |
|  | **100,000** | **400,000** | **3,000** | **18,000** |

*Gold acquired and held as a ‘store of wealth’*

On 30 June 20X2 Amalgam acquires 1,000,000 ounces of gold at $1,000 per ounce and stores it in a secure vault at the local branch of an international bank. Amalgam neither trades in gold nor does it have any use for the gold, other than as a ‘store of wealth’. Amalgam’s risk management team expect to hold the gold for the foreseeable future and the cash used to pay for the gold is surplus to the entity’s foreseeable cash flow needs.

At 31 December 20X2 (the end of the current annual reporting period) gold is trading at

$1,500 per ounce and Amalgam continues to hold 1,000,000 ounces of gold as a store of wealth.

*Artwork collection*

In September 20X2 Amalgam begins collecting artworks for the first time. It acquires 10 paintings at auctions in London, Hong Kong and New York at a total cost of

$1,000 million.

Amalgam neither trades in artworks nor does it intend to do so in the future. However, in managing the art collection, it is envisaged that some artworks might need to be sold to fund the acquisition of other, more desirable pieces.

The artwork collection is stored in a purpose-built underground vault at Amalgam’s

head office building. On occasion, Amalgam might invite its most important customers and other special guests to view the collection at no charge.

Amalgam’s risk management team expect to hold the art indefinitely and the cash used to pay for the collection is surplus to the entity’s foreseeable cash flow needs.

|  |
| --- |
| *Some IFRS issues for analysis:* |
| In the absence of an IFRS that specifically applies to a transaction or other event, how does an entity develop an accounting policy for that transaction or other event?  Hint: Main issue—in the absence of an IFRS that specifically applies to a transaction, other event or condition, management must *use its judgement* in developing and applying an accounting policy that results in information that is, among other things, relevant to the economic decision-making needs of users—those existing and potential investors, lenders and other creditors who cannot require the reporting entity to provide information directly to them1—and that is reliable (see paragraph 10 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*). |
| How would you advise Mr J when he is developing an accounting policy for Amalgam to account for the growing mushrooms?  Hint: What are the economics of the living mushrooms held by Amalgam?  Some discussion questions:   1. Are Amalgam’s living mushrooms within the scope of IAS 41 *Agriculture*? 2. Does another IFRS specify accounting for a fungi farmer’s living mushrooms? 3. What information about Amalgam’s living mushrooms would be relevant to the economic decision-making needs of primary users—those existing and potential investors, lenders and other creditors who cannot require the reporting entity to provide information directly to them—and that is reliable (can be faithfully represented etc)?   4. Are there IFRS requirements dealing with a similar and related issue? |
| How would you advise Mr J when he is developing an accounting policy for the acquisition of Ation in Amalgam’s consolidated financial statements?  Hint: What are the economics of the acquisition of Ation by Amalgam? (see also IASB meeting December 2007 Agenda Paper 5C)4.  Some discussion questions:   1. Reasons for business combinations under common control 2. Viewed from the perspective of the primary user group 3. Viewed from the perspective of the controlling shareholder (Mrs C) 4. Relevant information for investors, lenders and other creditors that faithfully represents the economics of the transaction |
| How would you advise Mr J when he is developing an accounting policy for Amalgam to account for the gold held as a store of wealth?  Hint: What are the economics of Amalgam holding gold as a store of wealth? Does IFRS specify explicitly how to account for such gold?  Some discussion questions:   * 1. Taking the status quo in the accounting for gold, how must Mr J develop and apply Amalgam’s accounting policy for gold held as a store of wealth?   2. What information about Amalgam’s gold would be relevant to the economic decision-making needs of users—those existing and potential investors, lenders and other creditors who cannot require the reporting entity to provide information directly to them—and that is reliable (can be faithfully represented etc)?   3. Are there requirements in IFRS dealing with similar and related issues? HELP: IFRS 9 for foreign currency held and IAS 21 *The Effects of Changes in Foreign Exchange Rates* OR IAS 40 *Investment Property*   4. How to apply IAS 8 on accounting for gold? |
| How would you advise Mr J when he is developing an accounting policy for Amalgam to account for the artworks held as a store of wealth?  Hint: What are the economics of Amalgam holding artworks as a store of wealth?  Main discussion questions:   1. Are artworks held as a store of wealth similar and related to investment property? 2. Could Mr J use his judgement and when developing and applying an accounting policy for the artworks held it in accordance with the IAS 8 hierarchy, and analogize to IAS 40 *Investment Property*. 3. When/If MrJ decides to develop an accounting policy for the unique artworks by analogy to IAS 40, does the nature of the market for unique artworks—absence of a deep and liquid market—affect the judgement about which measurement basis Mr J should specify in Amalgam’s accounting policy for those artworks? |

While performing the analysis, please discuss:

The aspects of corporate governance, managerial accounting and finance by, for example, performing financial modelling for the entity separately for each of the possible accounting treatments identified for each economic phenomenon presented in the case study to which the IAS 8 hierarchy applies—because IFRS does not explicitly specify accounting and reporting for that transaction. That discussion could also explore what might be a motivation for the choice of one method compared to another and whether that motivation is consistent with the objective of financial reporting.

If the IASB is considering changing an IFRS requirement (for example, by publishing a Discussion Paper or Exposure Draft) relevant to the information in the case study, or the IFRS Interpretations Committee (the ‘Interpretations Committee’) is considering developing an Interpretation (or has stated why it is not developing an Interpretation) on an issue that is relevant to this case study, please briefly discuss the extent to which the principles under development would result in information that better serves the objective of financial reporting.

Discuss which reporting framework (IFRS vs US GAAP) provides more useful information to potential and existing investors, lenders and other creditors for making decisions about providing resources to the entity strengthens the cohesiveness of the students’ understanding of financial reporting.