Djerriwarrh faces transitional issues

Listed investment company Djerriwarrh Investments involves itself in investing in the equities of a range of listed companies. According to a prospectus issued recently by the company it generally focuses on the top 50 listed entities on the Australian Stock Exchange.

The prospectus relates to the company's seeking of finance via the offer of unsecured convertible notes. It says that funds obtained from the unsecured convertible notes would allow it to buy back and repay $84 million of existing notes that mature in September this year.

The entity is also seeking funding to repay a bank debt totalling $52 million, which was the bank debt as at May 12, 2004, and to help the company invest in other listed entities.

Djerriwarrh is, therefore, a company that is going have a range of transitional issues relating to the adoption of the literature on financial instruments and — as you would expect — the prospectus disclosures related to financial reporting reflect this.

There are equities that the company trades. They live in something called a trading portfolio. Anything living in the trading portfolio will need to be revalued to fair market value, the company tells potential investors, and movements up or down will find their way into the assessment of net profit, which under IFRS will be reflected in the income statement.

The company currently accounts for the trading portfolio by valuing that portfolio "at the lower of carrying value and market value in aggregate", the prospectus explains. The change will cause the company to have some increase in volatility in its financial statements over time.

When equities are bought or sold there is going to be an impact on the figures in the accounts that relate to tax. Any movement in the values of those trading portfolio components means that there will need to be a corresponding change in tax effect accounting. Additional tax assets or tax liabilities will appear on balance sheet as a result.

The company also has an investment portfolio and in this case any gains realised on the investment portfolio will be included in net profit rather than sitting in the equity part of the balance sheet. There is an asset realisation reserve that will no longer have relevance and vanish. This also has some tax consequences.

"The Company must recognise an additional deferred tax liability amount for the capital gains tax payable on unrealised gains in the investment portfolio," the IFRS transition disclosures in the prospectus state. "This additional deferred tax liability is offset against the unrealised gains on the investment portfolio recognised in the asset revaluation reserve of the Company." There is a trust deed the company has relating to the new notes it is trying to issue via this prospectus that states that the deferred tax liability arising from the increase in the value of the investment portfolio is excluded for the purposes of the company's financial covenant.

There is a portfolio of written options that the company has decided will not be accounted for as a hedge under the new reporting regime. This means the company has taken an accounting policy choice that will eliminate the use of the asset revaluation reserve in this instance because the gains and losses will need to form a part of the net profit figure arrived at the end of a reporting period. An amount reflecting deferred tax consequences of gains or losses relating to the portfolio of written options will pop up on balance sheet and any amounts recognised will, according to the company's disclosure, make an appearance in the total tax expense reported.

This article was supplied by Tom Ravlic. Tom Ravlic is a financial journalist who has spent the past seven years covering the accounting profession, accounting and audit standard setting and corporate governance. His work has appeared in various publications including *Business Review Weekly*, *Personal Investment* (now *Personal Investor*), *The Age*, *CFO Magazine*, the *Australian CPA*, the *Company Director Journal* and the newsletters of the internationally renowned Lafferty Group. In addition to his freelance commitment to a wide range of publications, Tom has recently accepted an appointment to be editor of *Chartac Accountancy News*, published by Melbourne-based publisher Crown Content.