TNR®

FRA NEWS

No.4/2014

Welcome to this issue of 'TNR FRA News'.

Financial Reporting and Auditing News ('FRA News') provides you with our insight into current and emerging financial reporting, auditing and corporate governance matters on a monthly basis. FRA News contains items requiring immediate consideration (**Need to Know**), whereas other items are for general information (**Nice to Know**).

FRA News is prepared by Colin Parker, Principal, GAAP Consulting, and former member of the Australian Accounting Standards Board (2006-2009) with the input of staff of GAAP.com.au Pty Ltd.

In this FRA News, your attention is drawn to the following developments:

Need to know:

- 30 June – financial reports ASIC's focus
- 30 June – new and revised Standards operative
- IFRS 15 Revenue released
- Reporting for charities registered with TEQSA
- Joint arrangements amendments
- AASB May meeting highlights
- ACNC Repeal Bill
- Changes to "Income Tax Exempt Fund" status
- Late 2013 Annual Information Statements

Nice to know:

- Accounting for dynamic risk management
- Auditing disclosures – proposals
- APESB May meeting highlight

30 June – financial reports ASIC's focus

ASIC's focus areas for 30 June 2014 financial reports of listed entities and other entities of public interest with a large number of stakeholders are: impairment, accounting policy choices and role of directors.

ASIC's encourages preparers of financial reports to carefully consider the need to impair goodwill and other assets. ASIC has continued to find impairment calculations that use unrealistic cash flows and assumptions, including cases where entities have made unrealistic forecasts that have not been met over several reporting periods. ASIC also continued to find material mismatches between the cash flows used and the assets being tested for impairment.

Preparers should also focus on the appropriateness of key accounting policy choices that can significantly affect reported results. These include revenue recognition, expensing of costs that should not be included in asset values, and the impact of new requirements for consolidations and joint arrangements.

Even though directors do not need to be accounting experts, ASIC stated they should challenge the accounting estimates and treatments applied in the financial report, seek explanations and seek appropriate professional advice supporting the accounting treatments chosen, particularly where a treatment does not reflect their understanding of the substance of an arrangement.

Although calculations supporting impairment or valuation of significant assets can be complex, directors should review the cash flows and assumptions used in the calculations prepared by management or experts, bearing in mind their knowledge of the business, its assets, and the future prospects of the business.

To ensure that financial reports are of high quality, and that useful and meaningful information is provided to users of financial reports, ASIC stated entities should:

- have a culture focused on quality financial reporting;
- have adequate governance arrangements, and processes and controls;
- ensure the financial literacy of directors is appropriate;
- apply the accounting standards;
- apply appropriate experience and expertise to financial reporting, and the underlying processes supporting the information in the financial report, including engaging external experts where appropriate; and
- consider accountability and internal incentives for company management that are focused on financial reporting quality.

ASIC also noted the importance of its Information Sheet 183 "Directors and financial reporting".

ASIC's surveillance continues to focus on material disclosures of information useful to investors and other users of financial reports, such as key assumptions supporting accounting estimates. ASIC does not pursue immaterial disclosures that may add unnecessary clutter to financial reports; so unclutter your financial statements.

Now lets us look at ASIC concerns in more detail:

Impairment testing and asset values: The recoverability of the carrying amounts of assets such as goodwill, other intangibles and property, plant and equipment continues to be an important area of focus. For each reporting period, it is important for directors to ensure:

- cash flows and assumptions are reasonable having regard to matters such as historical cash flows, how an entity is funded, and economic and market conditions. Significant variances between prior period cash flow projections and actual results are likely to raise doubt as to whether assumptions are reasonable and supportable;
- discounted cash flows are not used to determine fair value less costs to sell where forecasts and assumptions are not reliable. Fair value less costs to sell should not be viewed as a means to use unreliable estimates that could not be used under a value in use model. In the absence of a reliable fair value, value in use must be applied which also requires reliable best estimates and, for example, does not allow increasing cash flows after five years, or cash flows from restructurings and improving or enhancing asset performance;
- cash flows used are matched to carrying values of all assets that generate those cash flows, including inventories, receivables and tax balances; and
- cash generating units (CGUs) are not identified at too high a level, including where cash inflows for individual assets are not largely independent. CGUs must not be at a higher level than the operating segments.

Directors should focus on the valuation of financial instruments, particularly where values are not based on quoted prices or observable market data.

Amortisation of intangible assets: Directors should review the amortisation periods and methods applied for intangible assets, including:

- amortising time based intangible assets that are available for use even if they have not yet generated revenue;
- having regard to the significant constraints on taking into account renewal periods for intangible assets, which includes only including periods covered by contractual rights and where renewal is not subject to significant cost; and

- challenging the basis for any assertion that assets have an indefinite life.

Off-balance sheet arrangements and new standards: Accounting standards AASB 10 "Consolidated Financial Statements", AASB 11 "Joint Arrangements", AASB 12 "Disclosure of Interests in Other Entities" and AASB 13 "Fair Value Measurement" apply for reporting periods beginning on or after 1 January 2013. As AASB 10 can significantly change the identification of controlled entities, directors should carefully review the treatment of off-balance sheet arrangements under the new standard. AASB 11 can change the accounting for joint arrangements, AASB 12 includes disclosures on unconsolidated structured entities, and AASB 13 affects aspects of the determination of fair values of financial instruments and other assets.

Revenue recognition: Directors should review an entity's revenue recognition policies to ensure that revenue is recognised in accordance with the substance of the underlying transactions. This includes ensuring that:

- services to which the revenue relates have been performed;
- control of relevant goods has passed to the buyer;
- where revenue relates to both the sale of goods and the provision of related services, revenue is appropriately allocated to the components and recognised accordingly;
- assets are properly classified as financial or non-financial assets; and
- revenue is recognised on financial instruments on the basis appropriate for the class of instrument.

To assist users of financial reports to understand the results of an entity, items of income and expense should only be included in other comprehensive income rather than profit/loss where specifically permitted by the accounting standards.

Expense deferral: Directors should ensure that expenses are only deferred where:

- there is an asset as defined in the accounting standards;
- it is probable that future economic benefits will arise; and
- the requirements of the intangibles accounting standard are met, including: expensing start-up, training, relocation and research costs; ensuring that any amounts deferred meet the requirements concerning reliable measurement; and development costs meet the six strict tests for deferral.

Tax accounting: Tax effect accounting can be complex and preparers of financial reports should ensure that:

- **there is a proper understanding of both the tax and accounting treatments, and how differences between the two affect tax assets, liabilities and expenses;**
- the impact of any recent changes in legislation are considered; and
- the recoverability of any deferred tax asset is appropriately reviewed.

Estimates and accounting policy judgements: Disclosures regarding sources of estimation uncertainty and significant judgements in applying accounting policies are important to allow users of the financial report to assess the reported financial position and performance of an entity. Directors should ensure disclosures are made and are specific to the assets, liabilities, income and expenses of the entity. Disclosure of key assumptions and a sensitivity analysis are important. These enable users of the financial report to make their own assessments about the carrying values of the entity's assets and risk of impairment given the estimation uncertainty associated with many asset valuations.

Financial reporting quality is supported by the quality of the independent audit, which is also important to confident and informed markets and investors. In this regard, directors should have regard to ASIC Information Sheet 196 "Audit quality: the role of directors and audit committees".

ASIC's findings from reviews of 31 December 2013 financial reports of public interest entities will be released in June 2014. ASIC will also release its next public audit firm inspection report in June-July period.

30 June – many new and revised Standards operative

The June 2014 financial reporting season sees the biggest change to financial statements preparation since Australia moved to IFRS equivalents back in 2005and 2006. The new and revised Standards and Interpretation are:

- AASB 10 "Consolidated Financial Statements"
- AASB 11 "Joint Arrangements"
- AASB 12 "Disclosure of Interests in Other Entities"
- AASB 13 "Fair Value Measurements"
- AASB 119 (2011) "Employee Benefits"
- AASB 127 (2011) "Separate Financial Statements"
- AASB 128 (2011) "Investments in Associates and Joint Ventures"
- INT 20 "Stripping Costs in the Production Phase of a Surface Mine"
- AASB 2011-4 "Amendments to Australian Accounting Standards" to remove individual key management personnel disclosure requirements
- AASB 7 "Financial Instruments: Disclosures" amendments regarding rights of offset and related arrangements (such as collateral) for financial instruments under an enforceable master netting agreement or similar arrangement
- "Annual Improvements 2009–2011 Cycle Amendments" to Australian Accounting Standards including: clarification of the requirements for comparative information, classification of servicing equipment, and tax effect of the distribution to holders of equity instruments, and
- Amendments to the Australian "Conceptual Framework", AASB 1 "First-time Adoption of Australian Accounting Standards", and AASB 1048 "Interpretation of Standards" that removed Interpretation 1039 "Substantive Enactment of Major Tax Bills" in Australia from the list of 'other Australian interpretations' contained in AASB 1048.

Some of these require:

- transitional adjustments and the preparation of a third Statement of Financial Position;
- comparatives revision;
- changes in accounting policies;
- identification of new sources of information regarding the extensive disclosures;
- judgements at the level of aggregation and disaggregation of disclosure; and
- significant revisions to the financial reporting template.

IFRS 15 Revenue released

The International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) jointly issued a converged Standard on the recognition of revenue from contracts with customers. The Standard will improve the financial reporting of revenue and improve comparability of the top line in financial statements globally.

Revenue is a vital metric for users of financial statements and is used to assess a company's financial performance and prospects. However, the previous requirements of both IFRS and US GAAP were different and often resulted in different accounting for transactions that were economically similar. Furthermore, while revenue recognition requirements of IFRS lacked sufficient detail, the accounting requirements of US GAAP were considered to be overly prescriptive and conflicting in certain areas.

Responding to these challenges, the IASB and FASB developed new, fully converged requirements for the recognition of revenue in both IFRS and US GAAP – providing substantial enhancements to the quality and consistency of how revenue is reported while also improving comparability in the financial statements of companies reporting using IFRS and US GAAP.

The core principle of the new Standard is for companies to recognise revenue to depict the transfer of goods or services to customers in amounts that reflect the consideration (that is, payment) to which the company expects to be entitled in exchange for those goods or services.

To recognise revenue, a company would apply the following five steps:

1. identify the contract(s) with the customer;
2. identify the performance obligations in the contract;
3. determine the transaction price;
4. allocate the transaction price; and
5. recognise revenue when a performance obligation is satisfied.

Although IFRS 15 specifies the accounting required for an individual contract, in some cases, a company may be able to apply the requirements to a portfolio of contracts instead of applying the requirements separately to each contract with a customer.

IFRS 15 also includes requirements for accounting for some costs that are related to a contract with a customer. A company would recognise an asset for the incremental costs of obtaining a contract if those costs are expected to be recovered.

To help investors better understand the nature, amount, timing and uncertainty of revenue and cash flows from contracts with customers, IFRS 15 requires a company to disclose quantitative and/or qualitative information.

The standard supersedes IAS 18 "Revenue", IAS 11 "Construction Contracts" and a number of revenue-related interpretations. It applies to nearly all contracts with customers: the main exceptions are leases, financial instruments and insurance contracts.

The new Standard will also result in enhanced disclosures about revenue, provide guidance for transactions that were not previously addressed comprehensively (for example, service revenue and contract modifications) and improve guidance for multiple-element arrangements.

The standard will take effect for U.S. public companies for annual reporting periods beginning after 15 December 2016, including interim reporting periods. Companies using IFRS will be required to apply the standard for reporting periods beginning on or after 1 January 2017. That means preparers who are performing full retrospective transition rather than the alternate method may want to have systems in place to capture data for dual reporting by 1 January 2015.

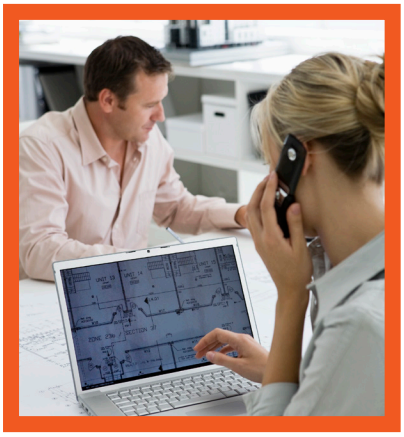
The AASB is to consider IFRS 15 in the Australian context at its July meeting.

Reporting for charities registered with TEQSA

The ACNC signed a Memorandum of Understanding (MoU) with the Tertiary Education Quality and Standards Agency (TEQSA) confirming that the ACNC will accept financial reports lodged with TEQSA as satisfying ACNC requirements for annual financial reports, until at least 2014-15.

For higher education providers that lodge the Provider Information Request (PIR) with TEQSA, the ACNC will also accept the relevant worksheets (namely the Income Statement and Balance Sheet) of the PIR in place of completing the financial components of the ACNC 2014 and 2015 Annual Information Statements (provided the entity gives the ACNC consent to publish this on the ACNC Register).

The non-financial components of the Annual Information Statements will be pre-populated with the information provided in 2013. This means that charities that are registered with TEQSA will not be required to provide any duplicative information to the ACNC



Joint arrangements amendments

The IASB issued "Accounting for Acquisitions of Interests in Joint Operations (Amendments to IFRS 11)". The amendments clarify the accounting for acquisitions of an interest in a joint operation when the operation constitutes a business. The amendments are effective for annual periods beginning on or after 1 January 2016, with earlier application being permitted.

"Accounting for Acquisitions of Interests in Joint Operations (Amendments to IFRS 11)' amends IFRS 11 such that the acquirer of an interest in a joint operation in which the activity constitutes a business, as defined in IFRS 3 "Business Combinations", is required to apply all of the principles on business combinations accounting in IFRS 3 and other IFRSs with the exception of those principles that conflict with the guidance in IFRS 11.

Accordingly, a joint operator that is an acquirer of such an interest has to:

- measure most identifiable assets and liabilities at fair value;
- expense acquisition-related costs (other than debt or equity issuance costs);
- recognise deferred taxes;
- recognise any goodwill or bargain purchase gain;
- perform impairment tests for the CGUs to which goodwill has been allocated; and
- disclose information required relevant for business combinations.

The amendments apply to the acquisition of an interest in an existing joint operation and also to the acquisition of an interest in a joint operation on its formation, unless the formation of the joint operation coincides with the formation of the business.

IFRS 1 "First-time Adoption of International Financial Reporting Standards" was also amended to extend the business combination exemptions, so that they include past acquisitions of interests in joint operations in which the activity of the joint operation constitutes a business.

The AASB is likely to consider these amendments in the Australian context at its July meeting.

AASB May meeting highlights

The highlights of the AASB May meeting included:

Reporting Entity Concept (amending the application focus of Standards): Decided that the application paragraphs of Standards that currently apply to corporate non-reporting entities should be amended to apply to reporting entities/GPFSs only. Consultation with stakeholders will be undertaken before commencing a formal due process of proposing the amendment. The AASB will also undertake steps to help ensure that the reporting entity concept is as clear as possible.

The AASB also noted that its tentative decision is not conditional on, and is independent of, progressing the other remaining proposals in ED 192 "Revised Differential Reporting Framework" (February 2010) regarding the clarification of GPFSs in an Australian context, including the enhancement of other regulators' roles in identifying reporting entities in respective jurisdictions.

The AASB noted the Standards that would be affected by its tentative decision were:

- **AASB 101 "Presentation of Financial Statements"**
- **AASB 107 "Statement of Cash Flows"**
- **AASB 108 "Accounting Policies, Changes in Accounting Estimates and Errors"**
- **AASB 1031 "Materiality"**
- **AASB 1048 "Interpretation of Standards"**
- **AASB 1053 "Application of Tiers of Australian Accounting Standards", and**
- **AASB 1054 "Australian Additional Disclosures.**

AASB 14 Regulatory Deferral Accounts (ballot draft): Decided to vote on issuing AASB 14 (incorporating IFRS 14 of the same name, without substantive amendments) shortly after the meeting. AASB 14 may have an impact on a newly listed entity from a foreign jurisdiction and a foreign entity that 'back door' lists in Australia.

Related Party Disclosures: Reconfirmed, its previous tentative decisions in respect of extending the scope of AASB 124" Related Party Disclosures" to not-for-profit public sector entities. The AASB agreed that the requirements should apply to annual reporting periods beginning on or after 1 July 2016.

Amendments to AASB 1053 – Transition to and between Tiers, and related Tier 2 Disclosure Requirements: After considering the submissions received on ED 248, the AASB decided to proceed with the proposals without any substantive amendments. The AASB decided to retain the proposed effective date of 1 July 2014, and requested staff to prepare a ballot draft for voting.

Income from Transactions of NFP Entities: Received a staff presentation on AASB tentative decisions to date in developing an Exposure Draft on "Income from Transactions of Not-For-Profit Entities (NFPs)", and a draft project plan. The ED will be based on IFRS 15 "Revenue from Contracts with Customers", modified where necessary to address NFP-specific issues, including accounting for income from transactions of NFPs arising from non-customer sources (e.g. taxes). It will include a proposed replacement of the income recognition requirements in AASB 1004 "Contributions". The ED is targeted for issue during the second half of 2014.

AASB 105X Superannuation Entities: Finalisation of the ballot draft AASB 105X "Superannuation Entities" and accompanying Regulation Impact Statement, which has been sent to AASB members for voting.

July meeting: Tentative agenda items include: revenue, service concession arrangements, stapled entities, insurance, and leases.

ACNC Repeal Bill

On 27 March, the Senate referred the Australian Charities and Not-for-profits Commission (Repeal) (No. 1) Bill 2014 to the Senate Economics Legislation Committee for inquiry and report. Submissions closing date was 2 May. The reporting date is 16 June. In the Federal Budget, the ACNC's full allocation of funding in the Forward Estimates has been retained for 2014-15.

Changes to "Income Tax Exempt Fund" status

More than 600 income tax exempt funds (ITEFs) will soon receive a letter reminding them that their organisation will be listed on the ACNC Register after 30 June, unless the ACNC is advised otherwise.

The organisations were all endorsed as ITEFs by the ATO as at 31 December 2013. The Charities Act 2013 provided that these funds be registered with the ACNC as charities from 1 January 2014. This change means that these entities are registered with the ACNC, and will now be endorsed by the ATO to access tax concessions as a registered charity, rather than as an income tax exempt fund.

The ACNC is delaying publishing information about ITEFs on the Register until after 30 June to enable these funds time to request information about their organisation or responsible persons to be withheld.

ITEFs that do not want to remain registered with the ACNC can opt out of registration up until 31 December 2014 by completing Form AF Income Tax Exempt Funds Opt Out. If the fund chooses to opt out, it will not be eligible for income tax exemption as a registered charity. It will also not be able to access income tax exemption as an income tax exempt fund, since this category no longer exists.

Late 2013 Annual Information Statements

If your charity has not completed its 2013 Annual Information Statement, remember that it is a legal requirement to do so. Charities who have missed their reporting deadlines will receive final reminders prior to any penalties (under the ACNC Act) being applied.

Accounting for dynamic risk management

The AASB issued ITC 31 "Accounting for Dynamic Risk Management: a Portfolio Revaluation Approach to Macro Hedging". The IASB Discussion Paper seeks comments on the IASB's preliminary views regarding an approach to accounting for an entity's dynamic risk management activities, the 'portfolio revaluation approach' (PRA).

The IASB is particularly interested in whether the information provided by the PRA would be useful to users of financial statements, whether the PRA faithfully represents the dynamic risk management perspective in the view of preparers and to understand the operational effects of the PRA. The feedback from the Discussion Paper will help the IASB determine the next steps in the accounting for dynamic risk management. Comments to the AASB are requested by 19 September.

Auditing disclosures – proposals

The International Auditing and Assurance Standards Board (IAASB) released for public comment proposed changes to the International Standards on Auditing (ISAs) to clarify expectations of auditors when auditing financial statement disclosures. The proposals include new guidance on considerations relevant to disclosures – from when the auditor plans the audit and assesses the risks of material misstatement, to when the auditor evaluates misstatements and forms an opinion on the financial statements.

One of the key areas addressed in the proposals is additional guidance to help establish an appropriate focus by the auditor on disclosures and encourage earlier auditor attention on them during the audit process, including disclosures where the information is not derived from the accounting system. Comments are requested by 11 September.

The AASB is expected to seek comment on these proposals.

APESB May meeting highlight

The highlight of the APESB meeting was:

- **Proposed ED APES 315 Compilation of Financial Information: Directed staff to revise the proposed Exposure Draft and to re-present to the Board out of session for approval.**

Internet

Copies of 'FRA NEWS' are available on the internet at www.tnr.com.au

Queries

For further information or assistance, please contact your TNR Audit & Assurance Partner or Manager.

The information provided in this publication was provided by Colin Parker FCA, former member of the AASB.

TNR® Thomas Noble & Russell

Accountants | Auditors | Business Advisers

www.tnr.com.au

BRW. CLIENT CHOICE AWARDS 2013 WINNER

BRW. CLIENT CHOICE AWARDS 2014 WINNER