



FRA NEWS

No.7/2013

Welcome to this issue of 'TNR FRA News'. Financial Reporting and Auditing (FRA) News ('FRA News') provides partners, staff and clients with a 'heads up' of contemporary financial reporting, auditing and corporate governance developments on a monthly basis. FRA News contains items requiring immediate consideration (**Need to Know**), whereas other items are for general information (**Nice to Know**).

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

Need to know:

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- An interim reminder
- Proprietary company financial reporting ASIC findings
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Liability limited by a scheme approved under Professional Standards Legislation

Minor accounting standards amendments for 30 June



For the 30 June year ends, there are two minor amendments to consider: presentation of items of other comprehensive income and deferred tax regarding recovery of underlying assets.

The "AASB 2011-9 Amendments to Australian Accounting Standards – Presentation of Items of Other Comprehensive Income" changes are:

- Requires grouping together of items within other comprehensive income ('OCI') on the basis of whether they will eventually be 'recycled' to the profit or loss (reclassification adjustments)
- Provides clarity about the nature of items presented as OCI and the related tax presentation, and
- Introduces the term "Statement of profit or loss and other comprehensive income" clarifying that there are two discrete sections, the profit or loss section (or separate statement of profit or loss) and other comprehensive income section. It is permissible to use the term "Statement of comprehensive income".

The amendments do not change the nature of items that are recognised through OCI, nor which items are recycled through profit or loss.

The "AASB 2010-8 Amendments to Australian Accounting Standards – Deferred Tax: Recovery of Underlying Assets" changes are:

- Amends AASB 112 'Income Taxes' and provides a 'practical approach' for the measurement of deferred tax relating to investment properties measured at fair value, property, plant and equipment and intangible assets measured using the revaluation model
- The measurement of deferred tax is based on the rebuttable presumption that the carrying amount of the underlying asset will be recovered entirely through sale, unless the entity has clear evidence that economic benefits of the underlying asset will be consumed during its economic life, and
- Interpretation 121 'Income Taxes – Recovery of Revalued Non-Depreciable Assets' is withdrawn. ^{HLB}

An interim reminder

For those preparing 30 June interim financial statements remember AASB 134 'Interim Financial Statements', in particular, as AASB 10 "Consolidated Financial Statements" and AASB 11 "Joint Arrangements" apply from 1 January 2013:

- **Same accounting policies:** An entity must apply the same accounting policies in the interim financial statements as are applied in its annual financial statements, except for accounting policy changes made after the most annual financial statements that are to be reflected in the next annual financial statements. AASB 134 requires disclosure of changes in accounting policies and methods; a description of the nature of the nature and effect of the change
- **Changes in composition:** In the context of AASB 10 "Consolidated Financial Statements" and AASB 11 "Joint Arrangements", AASB 134 requires changes in the composition of the entity during the interim period. Where there is a business combination, the entity must disclose the information required by AASB 3 "Business Combination"
- **Disclosure:** AASB 134 addresses materiality in the context of interim financial reporting in deciding how to recognise, measure, classify, or disclose an item for interim financial reporting, materiality must be assessed in the relation to interim period date.
- **Comparatives:** Restate the financial statements for the prior interim periods of the current annual reporting period and comparable interim periods of any prior annual reporting periods that will be restated in annual financial statements in accordance with AASB 101 "Presentation of Financial Statements"; there are exception for impracticable and transitional provisions in individual standards. ^{HLB}

Proprietary company financial reporting ASIC findings

ASIC reviewed the financial reports of 200 large proprietary companies required to lodge financial reports for years ended 30 June 2012 and 31 December 2012; the main findings were:

Special purpose financial statements (SPFS): Some 75% of the companies prepared SPFS on the basis that the company was not a reporting entity. ASIC noted that many of these companies had significant numbers of employees, suppliers and customers (implying issues with reporting entity/non reporting entity determinations). ASIC stated that preparers of financial reports should have regard to SAC 1 'Definition of the Reporting Entity' in identifying potential users of financial reports.

SPFS and auditors: ASIC reminded auditors that they are required to form an opinion as to whether a financial report complies with accounting standards. This includes forming their own conclusion as to whether a company has been appropriately classified as a non-reporting entity, including whether it is reasonable to expect that the company has users dependent on general purpose financial reports and who are unable to demand all of the information that they required. Auditors should apply professional scepticism in coming to a view on this issue.

Recognition and measurement: Under ASIC's Regulatory Guide 85 "Reporting requirements for non-reporting entities" financial reports of proprietary companies are required by the Corporations Act and accounting standards to follow the recognition and measurement requirements of accounting standards, whether or not they are reporting entities. ASIC raised questions on the accounting treatments by a number of companies; in most cases, ASIC was satisfied with the information and explanations provided. A small number of companies reviewed had not adequately impaired goodwill and/or other non-current assets.

Going concern: There was a lack of going concern disclosure, particularly where the entity is loss-making, had negative operating cash flows and/or was reliant on another party for continuing support.

Accounting policies: There was a lack of disclosure regarding accounting policies specific to the entity, including revenue recognition, joint venture arrangements, and the valuation basis for non-current assets such as property, plant and equipment.

Class order relief: Some companies purported to rely on ASIC's Class Order 98/1417 for relief from the audit requirements of the Corporations Act, but they did not meet the financial or other conditions for use of that relief.

Lodgement of financial reports: Large proprietary companies and those small proprietary companies that are controlled by foreign companies are generally required to lodge financial reports annually with ASIC; but there have been failures to do so. ASIC has a regular compliance program to identify and contact proprietary companies that appear to have failed to lodge financial reports – ASIC may issue companies with a notice to comply. ASIC also has a program of seeking a civil order from a court or referring a brief of evidence to the Commonwealth Director of Prosecutions for prosecution.

Lodgement of financial reports and s.311 reporting: ASIC stressed that auditors should be mindful of their obligation to report suspected contraventions of the Corporations Act to ASIC in certain circumstances – further guidance for reporting the non-lodgement of financial reports to ASIC refer to ASIC Regulatory Guide 34 "Auditor's obligations: reporting to ASIC". [HLB](#)

Surveillance on analyst briefings by ASIC

ASIC announced that it will be focusing on communications between companies and the investment analysts that cover their stock. This reporting season is the first since ASX issued its revised Guidance Note 8 which assists listed entities understand their continuous disclosure obligations and particularly the requirement to disclose market sensitive information to the ASX.

Over the coming weeks ASIC will raise awareness of the risks of selective disclosure when listed companies brief analysts. ASIC will be reminding key gatekeepers, company officers, individual analysts and their firms, of their obligations. In addition, ASIC will look to conduct spot checks with selected companies so it can hear how companies brief analysts and understand their procedures. ASIC anticipates that companies and securities houses assist it in this exercise to promote market integrity.

ASIC's Regulatory Guide 62 "Better disclosure for investors" suggests a number of practical steps that a listed company should take to ensure the widest audience of investors have access to material information about the company. [HLB](#)

New governance standards for charities

A set of new charity governance standards came into effect on 1 July. They apply to all entities wishing to register with the ACNC – with the exception of “Basic Religious Charities”. At a later stage, there will be consultation on proposed external conduct standards for registered charities that send funds or engage in activities overseas.

Here is a brief summary of the standards:

- *Purposes and not-for-profit nature of a registered entity (Standard One):* Charities must be not-for-profit and work towards their charitable purpose. They must be able to demonstrate this to the ACNC and provide information about their purpose to the public.
- *Accountability to members (Standard Two):* Charities must take reasonable steps to be accountable to their members and provide their members adequate opportunity to raise concerns about how the charity is governed.
- *Compliance with Australian laws (Standard Three):* A charity must not commit a serious offence (such as fraud) under any Australian law or breach a law that may result in a penalty of 60 penalty units (\$10,200) or more.
- *Suitability of responsible entities (Standard Four):* Charities must check that their responsible persons are not disqualified from managing a corporation (under the Corporations Act 2001) or currently disqualified from being a responsible person for a registered charity by the ACNC Commissioner. Charities must take reasonable steps to remove responsible persons that do not meet these requirements.
- *Duties of responsible entities (Standard Five):* Charities must take reasonable steps to make sure that the members of their governing body know and understand their legal duties and that they carry out their duties.

The ACNC’s phased approach to monitoring compliance with the standards, describes that for the first two years it will only act in cases of serious or deliberate breaches – such as money being diverted to non-charitable purposes, non-disclosure of serious conflicts of interest, or gross financial negligence. ^{HLB}

Charities 2014 Annual Information Statement

The Australian Charities and Not-for-profits Commission (ACNC) announced the financial aspects of the 2014 Annual Information Statement (AIS). The 2014 AIS will ask charities to provide details in relation to their activities and operations for the 2013-14 reporting period, including some financial information. The 2014 AIS is not due until 31 December 2014 (or later when an approved substituted accounting period applies), however the ACNC is announcing the financial aspects now to give charities as much time as possible to prepare any relevant information.

The ACNC has significantly reduced the amount of financial data that charities have to enter in the 2014 AIS, and removed questions in relation to business activities, related parties, salary sacrifice expenses and reserves. In terms of

financial information, the 2014 AIS will ask different questions depending on the size of the charity. Small charities, meaning those with annual revenue of less than \$250,000, will have fewer questions to respond to than medium (\$250,000 to \$999,999 annual revenue) and large charities (\$1 million and over annual revenue).

The ACNC reminds charities that they should now consider the impact of the 2014 AIS from 1 July 2013 and, also note that their 2014 AIS will be pre-populated with the information that they provide in their 2013 AIS – making the process simpler and faster.

To assist charities in understanding what is required for the 2014 AIS, the ACNC has published a detailed guide. The guide

includes information on what is different in the 2014 AIS to the 2013 AIS, timelines for gathering information as well as guidance in relation to the financial questions for small, medium and large charities and helpful links. ^{HLB}



Audit reporting significant changes proposed

The AUASB invited comments on the IAASB Exposure Draft "Reporting on Audited Financial Statements: Proposed New and Revised International Standards on Auditing". The IAASB's Exposure Draft, responds to calls from investors, analysts, and other users of audited financial statements in the wake of the global financial crisis for the auditor to provide more relevant information in the auditor's report based on the audit that was performed.

The revised standards are expected to result in substantive changes to how auditors contemplate and approach communication to users of their reports – the beneficiaries of a financial statement audit. The changes are viewed as critical to the perceived value of the financial statement audit and thus to the continued relevance of the auditing profession.

The Exposure Draft includes a new proposed ISA (701) titled "Communicating Key Audit Matters in the Independent Auditor's Report". This proposed ISA directs auditors of financial statements of listed entities to communicate in their report those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements. Among other enhancements, the IAASB is also proposing requirements for auditors to include specific statements about going concern in their reports and, to make an explicit statement about the auditor's independence from the audited entity.

The key proposals in the exposure draft include:

- **Key audit matters:** The audit report for audits of listed entity financial statements would include a new section outlining the key audit matters arising during the audit, being "those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period". Such matters would be selected from the matters communicated by the auditor to those charged with governance over the entity being audited. The proposed

"key audit matters" section of the audit report replaces earlier proposals for an "auditor commentary" which would have required the audit report to highlight matters "likely to be most important to users' understanding of the audited financial statements or the audit". The revised proposals for the "key audit matters" section responds to these concerns by linking it with the dialogue with those charged with governance.

- **Independence:** The audit report would include an explicit statement that the auditor is independent of the entity and has fulfilled any other relevant ethical requirements, and disclose the sources of those requirements
- **Engagement partner:** For audits of financial statements of listed entities, the audit report would be required to explicitly state the name of the engagement partner
- **Prominence of opinion:** The auditor's opinion would be placed at the beginning of the audit report
- **Ordering:** Whilst not mandating specific requirements, the proposals outline a preferred ordering and placement of the elements of the audit report
- **Going concern:** The auditor would be required to report on going concern in the audit report, including a conclusion the appropriateness of management's use of the going concern basis and a statement whether a material uncertainty about going concern has been identified, and
- **Auditor responsibilities:** Improvements are proposed about how the responsibilities of the auditor are described and the key features of the audit. Some elements of the description of responsibilities would be permitted to be moved to an appendix, or referenced from a website of an appropriate authority. [HLB](#)

Investment entity amendments at last

The Australian Accounting Standards Board (AASB) finally issued AASB 2013-5 Amending Standard "Amendments to Australian Accounting Standards – Investment Entities" which implements the International Accounting Standards Board's 'Investment Entities' amendments in the Australian context. The amending Standard adopts the IASB's amendments without modification and represents a change from the AASB's original proposals which proposed additional Australian disclosures requiring consolidated financial information to be included in Australian financial reports.

These amendments apply to investment entities, whose business purpose is to invest funds solely for returns from capital appreciation, investment income or both. Examples of entities which might qualify as investment entities include superannuation entities, listed investment companies, pooled investment trusts and Federal, State and Territory fund management authorities.

Australian investment entities are provided with an exception to consolidation, and they are required to measure unconsolidated subsidiaries at fair value through profit or loss. The amendments also introduce new

disclosure requirements for investment entities that have subsidiaries. The amendments are effective from 1 January 2014 and early adoption is permitted.

The AASB further concluded that the existing disclosure requirements in AASB 12 "Disclosure of Interests in Other Entities" would be sufficient to meet the needs of users of financial statements of investment entities, but that it would undertake a post-implementation review to determine if additional disclosures are warranted. [HLB](#)

Revised ASX corporate governance principles on the way

The ASX Corporate Governance Council (Council) issued a consultation paper seeking comments on a proposed third edition of its “Corporate Governance Principles and Recommendations”. The draft third edition of the “Principles and Recommendations” is built around the existing eight principles in, and maintains the same number of 30 recommendations as, the current edition.

This draft edition has been revised and restructured to improve readability and to assist listed entities to comply with their governance disclosure obligations under the ASX Listing Rules. Substantive changes have also been made to:

- Give greater flexibility to listed entities to make their governance disclosures on their website rather than in their annual report
- Add alternative approaches within a recommendation to recognise that smaller listed entities may legitimately have different governance practices to larger entities, thereby allowing them to report that they comply with a recommendation rather than having to explain why they do not comply
- Introduce new and strengthened recommendations in relation to risk (principle 7)
- Elevate some of the commentary in the current edition into

recommendations in the third edition, reflecting that they now represent contemporary governance standards against which entities should be required to report rather than guidance

- Amend the diversity recommendations to give listed entities the option to report their “Gender Equality Indicators” under the Workplace Gender Equality Act 2012 instead of reporting the respective proportions of men and women on the board, in senior executive positions and across the whole organisation, and
- Strengthen the commentary on the meaning of “measurable objectives” in the diversity recommendations and on the steps a listed entity can take to measure its achievements against the diversity objectives set by its board, in support of greater representation of women in management and on boards.

The third edition of the “Principles and Recommendations” is likely to come into effect for an entity’s first full financial year commencing on or after 1 July 2014. Entities with a 30 June balance date will be expected to benchmark their governance practices with the third edition commencing with the financial year ended 30 June 2015, while entities with a 31 December balance date will be expected to do so commencing with the financial year ended 31 December 2015. [HLB](#)

Governance-related changes to ASX listing rules

The ASX issued a consultation paper seeking comments on a number of proposed governance-related amendments to its Listing Rules and proposed changes to Guidance Note 9 “Disclosure of Corporate Governance Practices”. The ASX’s consultation package includes:

- A consultation paper entitled “Proposed Changes to ASX Listing Rules and Guidance Note 9”
- A document entitled “Proposed Governance-Related Amendments to the ASX Listing Rules”, which sets out in mark-up the proposed amendments to ASX’s Listing Rules and describes in detail the purpose of the amendments; and
- A marked up version of the proposed changes to Guidance Note 9.

Most of the changes proposed to the Listing Rules and to Guidance Note 9 complement and give effect to the reforms proposed by the ASX Corporate Governance Council (Council) in a new edition of its “Corporate Governance Principles and Recommendations”. Those rule changes are proposed to come into effect on 1 July 2014, the same date as the new edition of the “Corporate Governance Principles and Recommendations”.

ASX is also taking the opportunity to make a number of other minor governance-related changes to its Listing Rules and to introduce a new Listing Rule 3.19B. This will require the disclosure of on-market purchases of securities on behalf of employees or directors or their related parties under an employee incentive scheme. These changes are proposed to come into effect on 1 January 2014. [HLB](#)

Emerging market issuers ASIC's findings

Following the high profile collapse of some emerging market issuers overseas, ASIC has undertaken a review of these types of entities here. Not all entities listed on the ASX operate in Australia. Around one-third of ASX entities have operations or assets outside Australia. The jurisdictions ASIC considered to be 'emerging markets' are Eastern Europe, Asia and the Pacific (excluding Singapore, Hong Kong, Japan and New Zealand), Africa, South America and the Middle East.

During the review, ASIC analysed the regulatory regime in Australia and how this applied to emerging market issuers. ASIC also considered the approach of foreign regulators to these entities. The ASIC review did not identify any areas of systemic concern; however it considered that there were specific challenges that retail investors should be aware of before making the decision to invest in an emerging market issuer.

ASIC published Report 368 "Emerging market issuers" about its review of emerging market issuers which included the following key points:

- ASIC identified challenges emerging market issuers may be more likely to encounter than entities operating wholly in Australia
- ASIC is urging emerging market issuers and their advisers to focus on their corporate governance and the disclosure they provide to Australian investors regarding these challenges
- Investors should consider the risks before investing in an emerging market issuer, and

- Investors need to know that they may not have the same protections when investing in an emerging market issuer that is listed in Australia but incorporated abroad.

The Report details ASIC's process undertaken in identifying common challenges faced by emerging market issuers and provides practical recommendations that these entities and their advisers can utilise to promote the confidence of investors in these entities.

ASIC found that there are a number of challenges faced by entities that are operating in, or have significant exposure to, emerging markets. Common challenges include implementing good corporate governance and management systems, operating through complex ownership or contractual arrangements, risks associated with relying on one or two key individuals located outside Australia, and the difficulty in accessing or verifying reliable information about an entity's operation and performance.

Report 368 recommended that emerging market issuers respond to these challenges by implementing effective internal controls and risk management systems. It is important that entities focus on making appropriate disclosure to investors consistent with an exchange's listing rules and ASIC's regulatory guidance.

ASIC will continue to monitor emerging market issuers in the coming year by including a number of these entities in its financial reporting surveillance programs and through reviewing selected disclosure documents lodged with it. [HLB](#)

Superfunds governance guidelines for 2013 AGMs

In time for the 2013 AGM voting season, the Australian Council of Superannuation Investors (ACSI) published updated advice to corporate Australia on how it will be assessing public company directors' behaviours and performance. ACSI's "Governance Guidelines" provides expanded context and commentary on investor expectations of board practices, executive pay structures and conduct during capital raisings.

What's new for 2013?

Director elections: The issues considered when directors seek election, and re-election, to listed company boards include the performance of the company under the incumbent board, length of tenure, performance of the relevant director on other boards, as well as assessing their capacity and workload.

Executive pay: Some of the most contentious issues that are often opposed by ACSI include:

- The payment of bonuses for making acquisitions rather than the value delivered to shareholders, rewarding acquisitive behaviour and 'empire building', instead of improved performance
- Fixed pay increases that simply represent a 'catch up' for executives in cases after a pay freeze has been applied
- The use of normalised, or adjusted, earnings figures which shield executive incentive plans from costs incurred by the company
- The payment of dividends to executives on unvested incentive shares
- Retention payments made without a clear, or robust, rationale
- Termination payments that provide reward for mediocre performance, or failure, and

- Full vesting of options and performance rights in the event of a takeover or change of control in the company, irrespective of how far into the vesting period the options are and whether or not performance hurdles have been satisfied.

Two strikes: ACSI's expectation is that companies which have received a first strike should respond to investor concerns by engaging and addressing material remuneration issues.

Capital raisings: Boards must maintain effective oversight of management and external advisers in the conduct of capital raisings to ensure that shareholder expectations are met. Boards should seek to minimise the costs of raising new equity and to ensure that the fees paid to advisers, including investment banks and underwriters, reflect the actual value delivered and the risks incurred. [HLB](#)

AASB Standard and EDs issued



The AASB approved Australian Accounting Standard AASB 2013-4 "Amendments to Australian Accounting Standards – Novation of Derivatives and Continuation of Hedge Accounting". AASB 2013-4 applies to annual reporting periods beginning on or after 1 January 2014. Early application is permitted.

The AASB issued the following exposure drafts:

- ED 245 "Agriculture: Bearer Plants", which incorporates IASB ED/2013/8
- Tier 2 Supplement to ED 230 "Classification and Measurement: Limited Amendments to AASB 9", which sets out the disclosures proposed in AASB ED 230 from which it is proposed entities applying Tier 2 reporting requirements should be exempt, and
- The AASB also issued Tier 2 Supplement to ED 237 "Financial Instruments: Expected Credit Losses", which sets out the disclosures proposed in AASB ED 237 from which it is proposed entities applying Tier 2 reporting requirements should be exempt.^{HLB}

Financial advice industry practices review

ASIC released Report 362 "Review of financial advice industry practice: Phase 2" which summarised the findings of its recent review of the business and risk practices of the top 21 to 50 Australian financial services (AFS) licensees that provide personal financial advice. The report highlights that:

- Licensees are focused on risk management and compliance, though different licensees identified different key risks
- Licensees employ different methods to manage risks, and some deploy

significantly more resources than others to risk management

- Proactive licensee monitoring should be instrumental in detecting incidents and breaches, and
- Advisers should not rely on risk profiling tools without also considering if the outcomes are appropriate for their clients' circumstances

ASIC is providing individual feedback to the participating licensees on their business and compliance practices. ASIC's findings on the top 20 licensees are discussed in

Report 251 "Review of financial advice industry practice" (Sept. 2011).^{HLB}



AFSL ASIC's new licensee visits

ASIC visited 24 newly licensed financial advice businesses, representing a quarter of the advice licensees that obtained their AFS licence between July 2011 and June 2012. These visits aimed to help the new licensees better comply with AFS licence obligations.

ASIC asked licensees questions about their business model, advice processes and approach to risk and compliance. Key findings from the project include:

- Licensees need to carefully consider whether their advisers are adequately trained for the advice they are authorised to give, e.g. while 83% of the licensees offered SMSF services, only 48% of those licensees required their advisers to complete additional training on SMSFs
- Use of external compliance service providers is very common

among new advice licensees. 86% of the licensees visited used a compliance service provider on an ongoing basis. Licensees need to be mindful that they retain responsibility for achieving compliance and should consider their appointment of external compliance service providers very carefully, and

- 67% of the new licensees, even those with a small number of advisers and clients, had a para-planning function. This suggests licensees recognised the value in allowing para-planners to perform more routine or administrative functions, freeing up advisers' time to focus on services that add value to their clients.

ASIC will be continuing its financial adviser engagement program in the coming year by conducting two further projects: visits to other newly licensed financial advice businesses, and visits to around 60 established AFS licensees to discuss implementation of the Future of Financial Advice (FOFA) reforms.^{HLB}

Derivatives valuation proposals

The International Valuations Standards Council (IVSC) released an exposure draft on the valuation of equity derivatives, the first of a planned series that will include similar guidance on derivatives for foreign exchange, fixed income and commodities. The IVSC believes that the lack of globally accepted and recognised standards for the valuation of derivatives has led to a lack of trust in the valuations that are produced. The problem is particularly acute with over the counter (OTC) products which are not traded on exchanges and for which current price information is not available. All companies that hold any sort of financial instrument need to value these in their accounts.

The ED lists the main types of equity derivatives with a description for each of the listed products. It describes various valuation models and includes the key assumptions and other inputs required. [HLB](#)

AFSL updated record-keeping obligations proposed

ASIC proposes to update the record-keeping obligations for those who provide financial advice. The move comes as the financial advice industry beds down the Future of Financial Advice (FOFA) and Stronger Super reforms, which will result in big changes for most Australian financial services (AFS) licensees including a thorough review of how they go about compliance.

Consultation Paper 214 “Updated record-keeping obligations for AFS licensees” outlines the types of records that must be kept, including: records to prove that the licensee and its representatives have complied with the best interests duty and related obligations; records of ongoing fee arrangements entered into with a client; copies of documents (e.g., fee disclosure statements and renewal notices –

that fee recipients must receive for an ongoing fee arrangement), and records to prove the licensee and its representatives have complied with the ban on conflicted remuneration.

In line with ASIC’s approach to the FOFA and Stronger Super reforms more broadly, ASIC will take a facilitative approach to compliance with the requirements until 30 June 2014. ASIC expects industry participants to make a reasonable effort to comply with the new regime, and will take a measured approach where inadvertent breaches arise, or system changes are underway. Where ASIC finds deliberate and systemic breaches, it will take stronger regulatory action. [HLB](#)

The hybrid risk – ASIC reports

ASIC released Report 365 “Hybrid securities” which reviewed recent offers of hybrids in Australia. There has been more than \$18 billion of hybrids issued by banks and corporates since November 2011. There were approximately 75,000 investors in hybrid securities last year, two thirds of whom were self-managed superannuation funds. ASIC has reviewed the selling methods and sales processes of issuers and brokers.

Hybrid securities often promise ‘high yields’ and are issued by well-known companies with trusted brands, but investors need to very carefully consider the features and risks before investing. The terms and conditions of each hybrid issue vary and in some cases they include features that mean they rank closer to equity than debt.

It may be misleading to:

- Sell or treat hybrids as simple debt products if they have significant equity-like features
- Compare the performance of hybrids to products that are less risky or indexes that contain less risky products (e.g., Government bonds, corporate bonds and fixed income indexes)
- Spruik the returns from hybrids without giving due prominence to their risks.

ASIC will carefully review how issuers, brokers, advisers and asset managers treat or describe hybrids where we have concerns about potential misleading conduct. ASIC encourages investors to very carefully assess the terms of each

hybrid offer. Higher promised returns reflect higher risks.

ASIC will now focus on possible misleading conduct in the sale of hybrids. This includes inappropriate labelling of hybrids and unwarranted comparison of hybrids to different, less risky products e.g. covered bonds or senior debt. Spruiking the potential higher returns of hybrids and the brand name or reputation of the issuer without balancing that with the risks of the product can also cause investors to be misled. Investor education about these products is critical. ASIC will explore whether new strategies can be developed to help investors check their understanding of hybrids before investing in them. [HLB](#)

Religious charitable development funds – APRA proposals

The Australian Prudential Regulation Authority (APRA) released revised proposals on changes to the exemption order under the Banking Act 1959 for religious charitable development funds (RCDFs). Presently, Registered Financial Corporations (RFC) and RCDFs that undertake 'banking business', as defined in the Banking Act, are exempt from the need to be authorised as a deposit-taking institution and regulated by APRA. These exemptions are historic in nature.

APRA's original proposal was to withdraw the current RCDF exemption order for

RCDFs accepting investments from retail investors. An RCDF wishing to offer retail-type products would need to do so under an alternative regulatory regime, either as an authorised deposit-taking institution (ADI), an RFC or a Managed Investment Scheme (MIS). APRA also proposed restrictions on the use of certain terms, including the words 'deposit' and 'at-call', and on offering BPAY facilities. APRA's objective was to minimise the risk that investors in RCDFs form the impression that an RCDF is the same as an ADI and that the products it offers are the same as an ADI product.

APRA is no longer proposing to withdraw the exemption order for such RCDFs and require them to operate under an alternative regulatory regime. Instead, for RCDFs currently exempted, APRA is proposing to extend the existing RCDF exemption order, but subject to additional conditions. In particular, any product offered to a retail investor will have to have a minimum term or notice period of 31 days and the use of terms 'deposit' and 'at-call' will not be allowed in relation to retail products or in marketing to retail investors. These conditions are consistent with those that APRA has recently proposed for RFCs. [HLB](#)

Ethics – proposed amendments

The Accounting Professional and Ethical Standards Board (APESB) released proposed amendments to the Australian Code APES 110 "Code of Ethics for Professional Accountants" (APES 110) following a review of the equivalent standard by the International Ethics Standards Board for Accountants. The proposed revisions address: breach of a requirement of the Code; conflicts of interest; definition of those charged with governance; and the definition of engagement team.

APES 110 includes a robust framework to address any breaches of the auditor independence requirements. Amendments to APES 110 include requiring a firm to:

- Terminate, suspend, or eliminate the interest or relationship that caused the breach
- Evaluate the significance of the breach and determine whether action can be taken and is appropriate in the circumstances to satisfactorily address the consequences of the breach;
- Communicate all breaches with those charged with governance and obtain their concurrence that action can be, or has been, taken to satisfactorily address the consequences of the breach; and
- Document, among other matters, the action taken, and all the matters discussed with those charged with governance.

The requirements and guidance in respect of conflicts of interest has also been revised and affect accountants both in public practice and in business, taking into consideration the different circumstances in which they work. The proposed amendments present a clearer explanation of what a conflict of interest means and provides enhanced guidance on how to identify potential conflicts of interest early for timely action to be taken by the affected parties.

The international ethics Code has revised the definition of "engagement team" to exclude internal auditors who provide direct assistance to the external auditor to ensure consistency with the revised International Standard on Auditing "Using the Work of Internal Auditors" (ISA 610). APESB is of the view that internal auditors who provide direct assistance to the external auditor should not be excluded from the engagement team definition. The APESB has determined that if direct assistance is provided by internal auditors of the entity to the external auditor then they should be included in the definition of the engagement team and be subject to the same independence requirements as an external audit team member. [HLB](#)

Using the work of internal auditors – revised rules proposed

Revisions to ASA 610 ED 02/13 ASA 610 (Revised) “Using the Work of Internal Auditors” are aimed at enhancing the performance of external auditors by strengthening and clarifying the auditor’s responsibilities if using the work of internal auditors. The changes address two key areas: using the work of the internal audit function and using internal auditors to provide direct assistance on an external audit engagement.

The revised standard recognises that the external auditor may be able to leverage the work of a robust internal audit function. It provides a framework for determining whether, in which areas, and to what extent the work of the internal audit function can be used and for determining the adequacy of the work for the purpose of the external audit. The standard emphasises that the external auditor has sole responsibility for the audit opinion. It includes requirements and guidance to ensure the external auditor

is sufficiently involved in the audit and to prevent overuse or undue use of the work of the internal audit function.

The revised standard also includes an explicit prohibition on the use of internal auditors to provide direct assistance in an audit or review conducted in accordance with the Australian Auditing Standards. This prohibition on direct assistance reinforces and clarifies the existing position in Australia, that is, direct assistance is not permitted in accordance with the ethical requirements, including independence requirements, contained in APES 110 “Code of Ethics for Professional Accountants”.

The prohibition supports stakeholders’ expectations that the external auditor should be free from threats to their independence and enhances the quality and value of the audit to stakeholders. The revised standard is in conformity with ISA 610 (Revised 2013), as the IAASB

makes it clear that its requirements and guidance on direct assistance do not apply in jurisdictions where direct assistance is prohibited.

ED 03/13 ASA 2013-2 “Amendments to Australian Auditing Standards” comprises consequential amendments to Australian Auditing Standards arising from the revision of ASA 610, including changes to ASA 315 “Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment”, which includes a new requirement for the auditor’s risk assessment procedures to include enquiries of appropriate individuals within the internal audit function. As a result of the consequential amendments, further changes are necessary to align the paragraph and footnote numbering in the amended Australian Auditing Standards with the equivalent international standards.^{HLB}

Audit transparency reports

ASIC INFO 184 “Audit transparency reports” is an information sheet which summarises the requirements for audit transparency reports as set out in sections 332–332G of the Corporations Act 2001. Transparency reports help to inform the market about audit firms and audit quality.

INFO 184 explains:

- What is a transparency report and why is a transparency report important
- When must the report be published
- What information must be included and what other information may be voluntarily included
- What information from reviews by ASIC and other bodies must be reported
- What happens if a report contains misleading information
- What relief is available

A transparency report must be published on the auditors’ website if they have conducted audits under Division 3 of Pt 2M.3 of any combination of 10 or more of the following bodies in the past

reporting year: listed companies; listed registered schemes; authorised deposit-taking institutions; and any other bodies prescribed by the regulations for this purpose.

The mandatory requirements of a transparency report include the prescribed information such as legal structures, governance arrangements, systems of internal quality control, independence policies, last regulatory inspection, and some financial information. ASIC also identified additional information that may be included, for example, network policy monitoring, actions to improve and maintain audit quality, internal indicators of audit quality, findings from ASIC inspections and other external reviews.

Transparency reports must be published annually for the 12 months commencing on 1 July, within four months after the end of the reporting year. The first transparency report is required for the year ending 30 June 2013. The report must be lodged with ASIC before being published on the auditor’s website.

ASIC intends to review selected transparency reports; it may seek further information and explanations where, for example, aspects of a report appear to be inconsistent with the knowledge and experience obtained from its inspections of audit firms and other activities.^{HLB}

Conceptual Framework discussion paper

The AASB published an Invitation to Comment on the IASB's Discussion Paper (DP) "A Review of the Conceptual Framework for Financial Reporting". The IASB DP seeks comments on important issues the IASB will consider as it develops an exposure draft of possible changes to its Conceptual Framework. The Conceptual Framework sets out the concepts that underlie the preparation and presentation of financial reports. It identifies principles for the IASB to use when it develops and revises International Financial Reporting Standards (IFRSs).

The existing IASB Conceptual Framework does not cover some important areas adequately – for example, principles for derecognition and measurement of assets and liabilities, and principles for presentation and disclosure – and some guidance needs updating. Key issues discussed in the IASB DP include: definitions of assets and liabilities; recognition and derecognition; the distinction between equity and liabilities; measurement; presentation and disclosure; and other comprehensive income. ^{HLB}



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.

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