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ACCOUNTING NEWS

IN THIS EDITION

The IASB announced last week that they will re-expose certain aspects of the revenue recognition standard and last month they issued a suite of four new and two amended Accounting Standards. In this edition we look at the expected timing of re-exposure of revenue recognition, the new standards on fair value measurement and joint arrangements and some of the major impacts they may have on your financial statements in future, as well as AASB 1054, which results in the additional 'Aus' disclosures for for-profit entities being moved into a separate Accounting Standard.

REVENUE RECOGNITION TO BE RE-EXPOSED

THE INTERNATIONAL ACCOUNTING STANDARDS BOARD (IASB) AND THE US-BASED FINANCIAL ACCOUNTING STANDARDS BOARD (FASB) AGREED LAST WEEK TO RE-EXPOSE THEIR REVISED PROPOSALS FOR A COMMON REVENUE RECOGNITION STANDARD.

This will provide interested parties with an opportunity to comment on revisions the boards have undertaken since the publication of an exposure draft on revenue recognition in June 2010. While the boards agreed unanimously that there was no formal due process requirement to re-expose the proposals, they felt that it was appropriate to go beyond established due process because of:

- The importance of the revenue number to all companies
- The large number of changes made to date and the need to take all possible steps to avoid unintended consequences.

The boards therefore intend to re-expose their work in Q3 of 2011 for a comment period of 120 days. This will be a limited re-exposure of amended proposals only.

MORE FAIR VALUE DISCLOSURES

AT PRESENT, REQUIREMENTS FOR HOW TO MEASURE FAIR VALUE, AS WELL AS FOR FAIR VALUE DISCLOSURES, ARE DISPERSED ACROSS A VARIETY OF ACCOUNTING STANDARDS SUCH AS AASB 116 *PROPERTY, PLANT AND EQUIPMENT*, AASB 138 *INTANGIBLE ASSETS*, AASB 139 *FINANCIAL INSTRUMENTS: RECOGNITION AND MEASUREMENT* AND AASB 140 *INVESTMENT PROPERTY*.

IFRS 13 *Fair Value Measurement* was released last month by the IASB to resolve any of these measurement inconsistencies by having one set of fair value measurement requirements, and one set of disclosure requirements, for all components of financial statements.

IFRS 13 will result in more disclosure about fair value for non-financial items such as property, plant and equipment, intangible assets and investment properties, and more disclosures for items not measured at fair value in the financial statements where fair value is quantified in the notes to the financial statements.

IFRS 13 will apply prospectively to annual periods beginning on or after 1 January 2013 and early adoption is permitted (although given the onerous disclosure requirements for items such as PPE and investment properties, we do not expect many entities to early adopt). Comparative information does not need to be included for new fair value disclosures introduced by IFRS 13 that are not required under current Accounting Standards.

The Australian Accounting Standards Board (AASB) considered IFRS 13 at their meeting of 8-9 June 2011 and will vote out of session on whether to make IFRS 13 an Australian Accounting Standard. No Board members indicated their intention to oppose adoption.

Fair value is the price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date.

Basic requirements

There are five basic steps to applying this Standard which are illustrated on the diagram below:

Identify asset/liability

When measuring fair value, we need to take into account the condition and location of the asset and any restrictions on the sale or use of the asset that a market participant would take into account. We also need to identify whether we are measuring fair value of an asset/liability on a stand-alone basis, a group of assets, a group of liabilities, or a group of assets and liabilities (i.e. a cash-generating unit or a business).

'Highest and best use' for non-financial assets

When measuring the fair value of non-financial assets, the standard requires that we take into account the 'highest and best use' that is physically possible (e.g. based on size of a property), legally permissible (e.g. zoning regulations) and financially feasible. 'Highest and best use' is determined from the perspective of all market participants, even if the entity uses the non-financial asset for another purpose.

Identify market for orderly transaction

When measuring fair value, we assume that the transaction to sell the asset or transfer the liability takes place either in the principal market for the asset/liability, or in the absence of a principal market, in the most advantageous market. The market that the entity would normally sell the asset/transfer the liability is usually the principal market, or if there is no principal market, then the most advantageous market. The entity must have access to the principal (or most advantageous market) on measurement date, but does not need to be able to sell the asset or transfer the liability on measurement date to be able to measure fair value on the basis of the price in that market.

Identify and apply valuation techniques

Valuation techniques should maximise the use of relevant observable inputs and minimise the use of unobservable inputs. The standard achieves this by introducing a three level fair value hierarchy (similar to that currently used in AASB 7 *Financial Instruments: Disclosures*). The highest priority is given to quoted prices in active markets (Level 1 inputs) and the lowest priority is given to unobservable inputs (Level 3 inputs). This means that when determining fair value, we first try and use Level 1 inputs, if those are not available, then we try use Level 2 inputs, and so on.

HIERARCHY	TYPES OF INPUTS TO VALUATION CALCULATIONS	EXAMPLES
Level 1	Quoted prices (unadjusted) in active markets	Listed shares/equity instruments Certain tradeable intangible assets, e.g. taxi licences
Level 2	Inputs, other than quoted prices, that are observable, either directly, or indirectly	Interest rate swaps Foreign currency contracts
Level 3	Unobservable inputs	Unlisted shares/equity instruments Unlisted debt instruments Investment properties Land and buildings

Fair value must reflect current market conditions, i.e. it is an **exit price**. No adjustment is made for transaction costs (e.g. selling costs) because they are specific to a transaction, rather than forming part of the asset/liability. However, transport costs to get an asset from its current location to the principal market (e.g. for a commodity) must be deducted to arrive at fair value.

Fair values for liabilities and an entity's own equity instruments are established on the basis of a 'transfer value', rather than an extinguishment or settlement value. When measuring fair value for an entity's liabilities or own equity instruments and a quoted price is not available:

- If the liability or own equity instrument is held by another party as an asset, we must measure fair value from the perspective of the holder
- If the liability or own equity instrument is not held by another party as an asset, we must measure fair value using a valuation technique
- We must take into account non-performance risk, i.e. the entity's own credit risk, and any other factors that may influence whether the liability will, or will not, be repaid
- We do not take into account restrictions on transfer of the liability as a separate input to the valuation as these are included in other inputs to the fair value measurement
- If there is a demand feature, fair value is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid.

Providing certain criteria are met, an entity that holds and manages a group of financial assets and financial liabilities on the basis of its net exposure to either market risk or credit risk, can measure fair value based on the net position consistently with how market participants would price the net risk exposure.

In addition to the brief discussion above, Appendix B to the standard includes extensive application guidance on valuation techniques:

VALUATION TECHNIQUE	DESCRIPTION
Market approach	Uses prices and other relevant information generated by market transactions involving identical or similar assets, liabilities, or groups of assets and liabilities (e.g. multiples of revenues, earnings etc.)
Cost approach	The amount that would be required currently to replace the service capacity of an asset (current replacement cost)
Income approach	Present value of future cash flows or income and expenses and option pricing models

Disclosure

IFRS 13 will result in more disclosure about components of financial statements being measured at fair value, irrespective of whether such fair values are recognised in the statement of financial position, or whether such fair values are merely disclosed in notes to the financial statements.

The main standards that permit/require items to be measured and/or disclosed at fair value are:

- IFRS 7 (AASB 7) *Financial Instruments: Disclosures*
- IAS 16 (AASB 116) *Property, Plant and Equipment*
- IAS 38 (AASB 138) *Intangible Assets*
- IAS 40 (AASB 140) *Investment Property*
- IAS 41 (AASB 141) *Agriculture.*

Whilst all the fair value disclosures required by IFRS 7 *Financial Instruments: Disclosures* have been deleted and moved into IFRS 13, the only fair value disclosures deleted from the remaining standards above are those about methods and significant assumptions applied in determining fair value. All remaining fair value disclosures in these standards are still required, e.g. details of dates of valuations, whether performed by an independent valuer, etc.

IFRS 13 disclosures are essentially a 'copy and paste' exercise from IFRS 7, which means **that for all items measured at fair value**, for example, land and buildings and investment properties, agriculture, etc., information is now required about which level in the fair value hierarchy the fair value measurement relates to. For level 3 valuations, required disclosures are extensive. Less disclosure is required for non-recurring fair value measurements than for recurring fair value measurements.

RECURRING	NON-RECURRING
Other IFRSs require or permit fair value measurements in the statement of financial position at the end of each reporting period	Other IFRSs require or permit fair value measurements in the statement of financial position in particular circumstances, e.g. if measured under AASB 5 *Non-current Assets Held for Sale and Discontinued Operations* at fair value less costs of disposal

However, entities that merely disclose fair value in the notes to the financial statements will be required to disclose new information such as:

- Which level in the fair value hierarchy the fair value measurement relates to
- For level 2 and 3 – a description of the valuation technique
- For level 2 and 3 – if there has been a change in the valuation technique, description of change and reasons for change
- If highest and best use of non-financial asset differs from current use – that fact and reasons why it is being used in a manner that differs from highest and best use.

When performing impairment testing for cash-generating units to which goodwill or intangible assets with indefinite useful lives have been allocated under IAS 36 *Impairment of Assets*, if recoverable amount is based on fair value less costs of disposal, additional disclosures are required in IAS 36 about the level in the fair value hierarchy that the fair value measurement is categorised, and if there has been a change in valuation technique, details also need to be disclosed about the change and the reason for making the change.

It will now also be mandatory to provide almost all the detailed fair value disclosures required by IFRS 13 in the interim financial statements under IAS 34 *Interim Financial Reporting*.

Scope

The measurement and disclosure requirements in IFRS 13 will not apply to:

- Share-based payment transactions under IFRS 2 *Share-based Payment*
- Leasing transactions under IAS 17 *Leases*
- Measurements that are similar to fair value but are not fair value, e.g. net realisable value for inventories under IAS 2 *Inventories*.

Also, fair value disclosure requirements of IFRS 13 will not apply to:

- Plan assets measured at fair value under IAS 19 *Employee Benefits*
- Assets for which recoverable amount is fair value less costs of disposal under IAS 36 *Impairment of Assets*.

NEW STANDARD ON JOINT ARRANGEMENTS

ED 9 *JOINT ARRANGEMENTS* (ED 157 IN AUSTRALIA) WAS INITIALLY RELEASED FOR COMMENT BY THE IASB IN 2007. AFTER MORE THAN THREE YEARS OF DELIBERATION, IFRS 11 *JOINT ARRANGEMENTS* WAS ISSUED BY THE IASB LAST MONTH AS PART OF A SUITE OF FIVE NEW STANDARDS DEALING WITH CONSOLIDATIONS AND JOINT ARRANGEMENTS AND THEIR RELATED DISCLOSURES.

IFRS 11 will supersede IAS 31 (AASB 131) *Interests in Joint Ventures* and SIC 13 *Jointly Controlled Entities – Non-Monetary Contributions by Venturers* and is effective for annual periods beginning on or after 1 January 2013. Early adoption is permitted, provided that the following other standards are adopted at the same date:

- IFRS 10 (AASB 10) *Consolidated Financial Statements*
- IFRS 12 (AASB 12) *Disclosure of Interests in Other Entities*
- IAS 27 (AASB 127) *Separate Financial Statements*
- IAS 28 (AASB 128) *Investments in Associates and Joint Ventures.*

The AASB considered the above standards at their meeting of 8-9 June 2011 and will vote out of session on whether to make each of these standards into Australian Accounting Standards. No Board members indicated their intention to oppose adoption.

Why a new standard?

Under AASB 131 *Interests in Joint Ventures*, the structure of the joint venture is the only driver for the accounting and when joint ventures are structured as separate vehicles, there is then an accounting option, i.e. proportionate consolidation or equity accounting. This results in cases where the joint venture parties have similar rights and obligations which are accounted for differently because of the structure, and vice versa.

The guiding principle in IFRS 11 is that a party to a joint arrangement recognises its rights and obligations arising from the arrangement, thus eliminating accounting options.

What is a joint arrangement?

A joint arrangement is one where two or more parties have **joint control. Joint control** is the contractual sharing of control of an arrangement where decisions about the activities require **unanimous consent** of all joint venture parties.

What are the different types of joint arrangements?

There are two types of joint arrangements: **joint operations and joint ventures**.

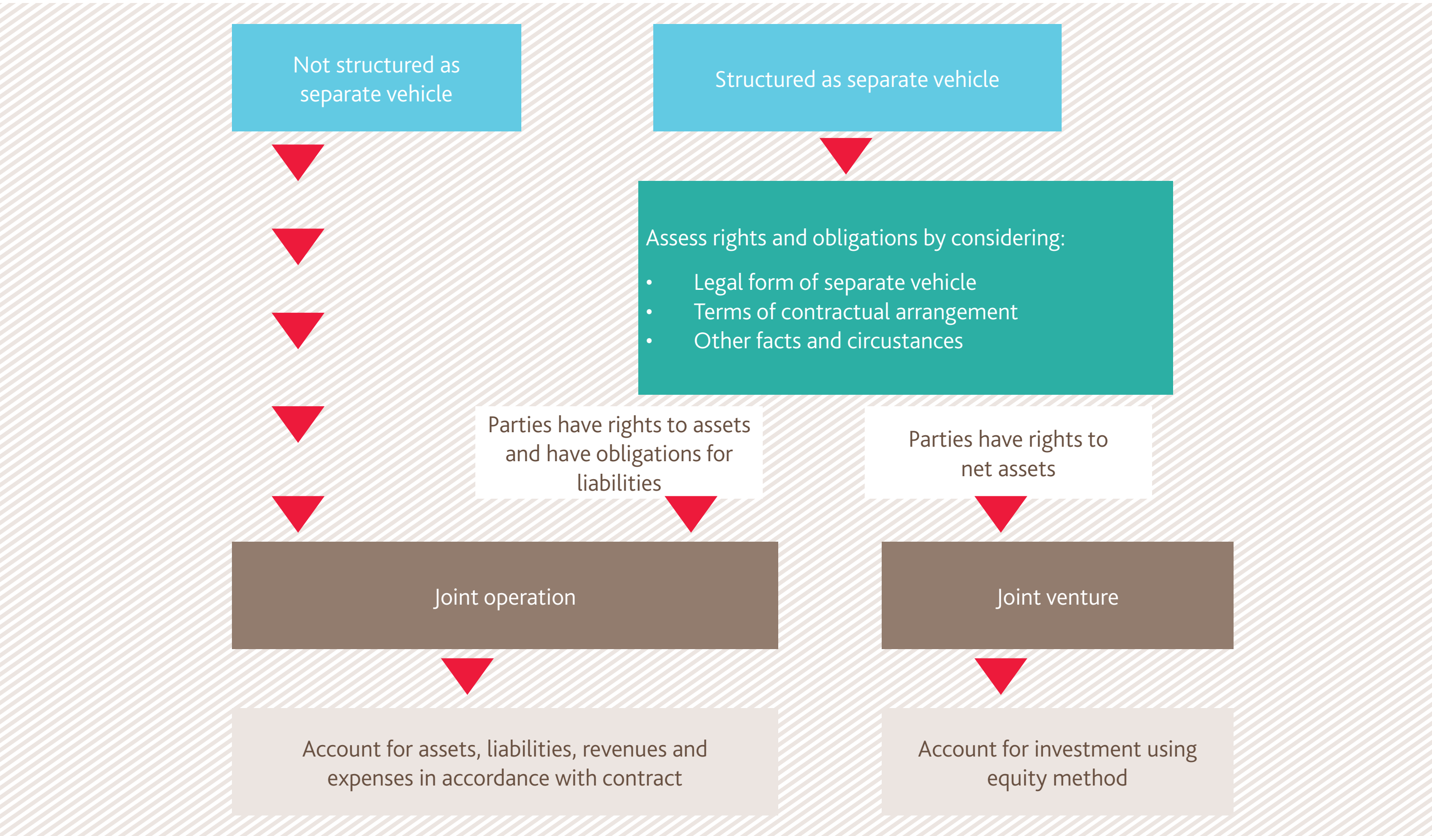
Joint operation – the parties (joint operators) have joint control of the arrangement and have rights to the assets and obligations for liabilities of the arrangement.

Joint venture – the parties (joint venturers) have joint control of the arrangement and have rights to the net assets of the arrangement.

Are there different accounting treatments for these two types of joint arrangements?

Under AASB 131, joint ventures structured as a separate vehicle (jointly controlled entities) could be accounted for using equity accounting or proportionate consolidation. Unincorporated joint venture arrangements generally either used proportionate consolidation or merely recognised their own assets, liabilities, expenses and income relating to jointly controlled operations.

IFRS 11 uses a principles-based approach whereby the structure of the joint arrangement may not necessarily determine the appropriate accounting. The diagram below illustrates the various options.



Joint arrangements that are not structured as a separate vehicle are considered to be **joint operations** and the parties would account for the arrangement in a similar manner to that applied to unincorporated joint ventures under AASB 131. That is, assets, liabilities, revenues and expenses are accounted for in accordance with applicable Accounting Standards, which in some cases may be proportionate consolidation.

For joint arrangements structured as a separate vehicle, where the joint venturers have rights to the net assets, **only equity accounting is permitted**. There is no longer a choice to apply proportionate consolidation accounting. However, such arrangements are not automatically treated as joint ventures. We need to also consider the legal form of the separate vehicle and the terms of the arrangement and any other facts and circumstances to ensure that the parties do not, in fact, have rights to the gross assets and obligations for the gross liabilities of the arrangement.

Example: Terms of arrangement:
Each joint venture party has a 50:50 interest in a company incorporated to carry out joint venture activities. The company enables separation between the entity and the joint venturers, which at first glance indicates that the joint venturers have rights to the net assets of the arrangement.

If the parties amend the features of the company through a contractual arrangement such that each has an interest in the gross assets of the company and each is liable for the gross liabilities of the company on a 50:50 basis, the terms of the contractual arrangement could cause this arrangement to be a joint operation.

Example: Other facts and circumstances:
Each joint venture party has a 50:50 interest in a company incorporated to carry out joint venture activities (JV Co Pty Ltd). The purpose of the arrangement is to manufacture materials required by both parties for their own individual manufacturing processes. The manufacturing process produces the quantity and quality of materials specified by both parties (similar to an outsourcing arrangement).

Even though the legal form is that of a company, and the contractual arrangement does not indicate that each party has rights and obligations with respect to the gross assets/liabilities of the joint venture, the following additional facts and circumstances need to be taken into account:
- Both joint venture parties agreed to purchase the entire output of the joint arrangement according to their 50:50 share
- JV Co Pty Ltd cannot sell any output to outside customers unless approved by both joint venture parties
- The price of the materials manufactured is set by both parties at a level to cover costs of production and administrative expenses incurred by JV Co Pty Ltd (break-even).

These facts and circumstances indicate that JV Co Pty Ltd is dependent upon the two joint venture parties to generate cash flows and that the parties therefore have an obligation to fund the settlement of the liabilities of JV Co Pty Ltd. The joint venture parties are also consuming all the output and therefore have rights to the economic benefits of the assets of JV Co Pty Ltd.

This arrangement is therefore a joint operation, and not a joint venture.

If the terms of the arrangement were amended such that JV Co Pty Ltd was able to sell its output to third parties, this would result in JV Co Pty Ltd assuming demand, inventory and credit risk, and the arrangement may then be considered to be a joint venture.

How are joint arrangements accounted for in separate financial statements?
In your separate financial statements, joint arrangements will be accounted for as follows:

Joint operations – recognise direct share of assets, liabilities, revenues and expenses (same as in consolidated financial statements)

Joint ventures – Either at cost, or in accordance with IFRS 9 (fair value).

Most entities would account for joint ventures in their separate financial statements at cost.

Disclosures
With IAS 31 to be withdrawn, all disclosures relating to joint arrangements have now been included in IFRS 12 *Disclosures of Interests in Other Entities*. Most disclosures are similar to those contained in IAS 31, except that the following new disclosures are also required for each joint arrangement that is material to the entity:

- Nature of the entity's relationship with the joint arrangement (e.g. describing nature of activities of the joint arrangement and whether they are strategic to the entity's activities)
- Principal place of business (and country of incorporation if different to principal place of business) of the joint arrangement
- Summarised financial information about the joint arrangement (IAS 31 was not clear whether this disclosure was in aggregate or for each separate joint arrangement)
- Total amounts of the following included in the summarised financial information:
  - Cash and cash equivalents included in current assets
  - Financial liabilities included as current liabilities
  - Financial liabilities included as non-current liabilities
  - Depreciation and amortisation
  - Interest income
  - Interest expense
  - Income tax expense/income.

When the interest in a joint venture is classified as held for sale under IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, summarised financial information is not required.

AASB 1054 *AUSTRALIAN ADDITIONAL DISCLOSURES*

AASB 1054 HAS RECENTLY BEEN ISSUED BY THE AASB. IT INCLUDES ALL AUSTRALIAN-SPECIFIC DISCLOSURES FOR FOR-PROFIT ENTITIES THAT ARE CURRENTLY INCLUDED ACROSS VARIOUS AUSTRALIAN ACCOUNTING STANDARDS VIA ADDITIONAL 'AUS' PARAGRAPHS.

It has been issued as part of the Trans-Tasman convergence project with the Financial Reporting Standards Board (FRSB) of the New Zealand Institute of Chartered Accountants to harmonise Australian Accounting Standards with New Zealand equivalents to IFRSs.

A possible Phase 2 of the convergence project would address differences affecting private not-for-profit entities and a possible Phase 3 would address differential reporting and qualifying entity differences (Reduced Disclosure Requirements in Australia).

Most 'Aus' disclosure requirements have been moved into AASB 1054, except for the requirement to disclose capital and other expenditure commitments contracted for at the end of the reporting period. There has been some change in terminology, with franking credits now being referred to as imputation credits.

AASB 1054 applies to annual periods beginning on or after 1 July 2011.

COMMENTS SOUGHT ON EXPOSURE DRAFTS

At BDO, we provide comments locally to the AASB and internationally to the IASB. We welcome any client comments. If you like to provide any comments please contact Wayne Basford.

DOCUMENT	PROPOSALS	COMMENTS DUE TO AASB BY	COMMENTS DUE TO IASB BY
ED *Tier 2 Supplement to ED 210 Financial Instruments: Impairment (proposed amendments to AASB 7)*	Proposes various disclosure exemptions for the Reduced Disclosure Requirements	27 June 2011	NA

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