FINANCIAL REPORTING STANDARDS UPDATE

A summary of changes to financial reporting requirements applicable for financial years ending 30 June 2014

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INTRODUCTION TO BDO

BDO is the fifth largest full service professional services firm in Australia and globally with offices in New South Wales, Northern Territory, Queensland, South Australia, Tasmania, Victoria and Western Australia as well as 1,264 offices around the world, our national practice has 160 partners and over 1,200 staff.

BDO has deep expertise in multiple specialist services specifically audits, taxation and advisory. The depth of our team provides reliability, technical expertise and global reach to match any other service provider. Our foundation of building close relationships with our clients allows us to be highly responsive and nimble to adapt to the ever changing needs of our clients.

We have a unique blend of services, including corporate and international taxation, corporate finance, business consulting, internal audit, risk advisory, specialist IT assurance services, forensic as well as the more traditional audit services.

56,389 PEOPLE

1,264 OFFICES

144 COUNTRIES

CURRENT AS AT NOVEMBER 2013

SECTION A: SUMMARY TABLES

TABLE A: ACCOUNTING STANDARDS AND INTERPRETATIONS APPLICABLE FOR THE FIRST TIME AT 30 JUNE 2014

The accounting standards and interpretations highlighted below will be discussed in more detail in Section B. Others are likely to have little, if any, impact on mainstream accounting practices.

Australian Accounting Standards

AASB NO.	TITLE	ISSUE DATE	OPERATIVE DATE (ANNUAL REPORTING PERIODS BEGINNING ON OR AFTER)	REFERENCE
10	Consolidated Financial Statements	Aug 2011	1 Jan 2013*	1.1
11	Joint Arrangements	Aug 2011	1 Jan 2013*	1.2
12	Disclosure of Interests in Other Entities	Aug 2011	1 Jan 2013*	1.3
13	Fair Value Measurement	Sep 2011	1 Jan 2013	1.4
119	Employee Benefits (September 2011)	Sep 2011	1 Jan 2013	1.5
1053	Application of Tiers of Australian Accounting Standards	June 2010	1 July 2013	1.6
2010 – 2	Amendments to Australian Accounting Standards arising from Reduced Disclosure Requirements	June 2010	1 July 2013	1.7
2010 – 10	Further Amendments to Australian Accounting Standards – Removal of Fixed Dates for First-time Adopters [AASB 2009-11 & AASB 2010-7]	Dec 2010	1 Jan 2013	
2011 – 2	Amendments to Australian Accounting Standards arising from the Trans-Tasman Convergence Project – Reduced Disclosure Requirements [AASB 101 & AASB 1054]	May 2011	1 July 2013	
2011 – 4	Amendments to Australian Accounting Standards to Remove Individual Key Management Personnel Disclosure Requirements [AASB 124]	July 2011	1 July 2013	1.8
2011 – 6	Amendments to Australian Accounting Standards – Extending Relief from Consolidation, the Equity Method and Proportionate Consolidation – Reduced Disclosure Requirements [AASB 127, AASB 128 & AASB 131]	July 2011	1 July 2013	

*1 January 2014 for not-for-profit entities

AASB NO.	TITLE	ISSUE DATE	OPERATIVE DATE (ANNUAL REPORTING PERIODS BEGINNING ON OR AFTER)	REFERENCE
2011 – 7	Amendments to Australian Accounting Standards arising from the Consolidation and Joint Arrangements Standards [AASB 1, 2, 3, 5, 7, 101, 107, 112, 118, 121, 124, 132, 133, 136, 138, 139, 1023 & 1038 and Interpretations 5, 9, 16 & 17]	Aug 2011	1 Jan 2013*	
2011 – 8	Amendments to Australian Accounting Standards arising from AASB 13 [AASB 1, 2, 3, 4, 5, 7, 9, 101, 102, 108, 110, 116, 117, 118, 119, 120, 121, 128, 131, 132, 133, 134, 136, 138, 139, 140, 141, 1004, 1023 & 1038 and Interpretations 2, 4, 12, 13, 14, 17, 19, 131 & 132]	Sep 2011	1 Jan 2013	
2011 – 10	Amendments to Australian Accounting Standards arising from AASB 119 (September 2011) [AASB 1, AASB 8, AASB 101, AASB 124, AASB 134, AASB 1049 & AASB 2011-8 and Interpretation 14]	Sep 2011	1 Jan 2013	
2011 – 11	Amendments to AASB 119 (September 2011) arising from Reduced Disclosure Requirements	Sep 2011	1 July 2013	
2011 – 12	Amendments to Australian Accounting Standards arising from Interpretation 20 [AASB 1]	Nov 2011	1 Jan 2013	
2012 – 1	Amendments to Australian Accounting Standards – Fair Value Measurement – Reduced Disclosure Requirements [AASB 3, AASB 7, AASB 13, AASB 140 & AASB 141]	March 2012	1 July 2013	
2012 – 2	Amendments to Australian Accounting Standards – Disclosures – Offsetting Financial Assets and Financial Liabilities [AASB 7 & AASB 132]	June 2012	1 Jan 2013	
2012 – 4	Amendments to Australian Accounting Standards – Government Loans [AASB 1]	June 2012	1 Jan 2013	
2012 – 5	Amendments to Australian Accounting Standards arising from Annual Improvements 2009–2011 Cycle [AASB 1, AASB 101, AASB 116, AASB 132 & AASB 134 and Interpretation 2]	June 2012	1 Jan 2013	1.9

*1 January 2014 for not-for-profit entities

AASB NO.	TITLE	ISSUE DATE	OPERATIVE DATE (ANNUAL REPORTING PERIODS BEGINNING ON OR AFTER)	REFERENCE
2012 – 6	Amendments to Australian Accounting Standards – Mandatory Effective Date of AASB 9 and Transition Disclosures [AASB 9, AASB 2009-11, AASB 2010-7, AASB 2011-7, AASB 2011-8]	Sep 2012	1 Jan 2013	
2012 – 7	Amendments to Australian Accounting Standards arising from Reduced Disclosure Requirements [AASB 7, AASB 12, AASB 101 & AASB 127]	Sep 2012	1 July 2013	
2012 – 9	Amendment to AASB 1048 arising from the Withdrawal of Australian Interpretation 1039	Dec 2012	1 Jan 2013	1.10
2012 – 10	Amendments to Australian Accounting Standards – Transition Guidance and Other Amendments [AASB 1, 5, 7, 8, 10, 11, 12, 13, 101, 102, 108, 112, 118, 119, 127, 128, 132, 133, 134, 137, 1023, 1038, 1039, 1049 & 2011-7 and Interpretation 12]	Dec 2012	1 Jan 2013	
2012-11	Amendments to Australian Accounting Standards – Reduced Disclosure Requirements and Other Amendments [AASB 1, AASB 2, AASB 8, AASB 10, AASB 107, AASB 128, AASB 133, AASB 134 & AASB 2011-4]	Dec 2012	1 July 2013	

Australian Interpretations

INT NO.	TITLE	ISSUE DATE	OPERATIVE DATE (ANNUAL REPORTING PERIODS BEGINNING ON OR AFTER)	REFERENCE
20	Stripping Costs in the Production Phase of a Surface Mine	Nov 2011	1 Jan 2013	2.1

TABLE B: SUMMARY OF ACCOUNTING STANDARDS AND INTERPRETATIONS ISSUED BUT NOT YET EFFECTIVE FOR 30 JUNE 2014

The accounting standards and interpretations highlighted below will be discussed in more detail in Section B. Others are likely to have little, if any, impact on mainstream accounting practices.

Australian Accounting Standards (including IFRS not yet issued as Australian Accounting Standards)

AASB NO.	TITLE	ISSUE DATE	OPERATIVE DATE (ANNUAL REPORTING PERIODS BEGINNING ON OR AFTER)	REFERENCE
9	Financial Instruments **Originally 1 January 2013 – Amended to 1 Jan 2017 by AASB 2013-9 (refer below)	Dec 2010	1 Jan 2017**	3.1
14	Regulatory Deferral Accounts	Jan 2014	1 Jan 2016	
IFRS 15	Revenue from Contracts with Customers	May 2014	1 Jan 2017	3.2
2012 – 3	Amendments to Australian Accounting Standards – Offsetting Financial Assets and Financial Liabilities [AASB 132]	June 2012	1 Jan 2014	
2013 – 1	Amendments to AASB 1049 – Relocation of Budgetary Reporting Requirements	March 2013	1 July 2014	
2013 – 3	Amendments to AASB 136 – Recoverable Amount Disclosures for Non-Financial Assets	June 2013	1 Jan 2014	3.3
2013 – 4	Amendments to Australian Accounting Standards – Novation of Derivatives and Continuation of Hedge Accounting [AASB 139]	July 2013	1 Jan 2014	
2013 – 5	Amendments to Australian Accounting Standards – Investment Entities [AASB 1, AASB 3, AASB 7, AASB 10, AASB 12, AASB 107, AASB 112, AASB 124, AASB 127, AAB 132, AASB 134 & AASB 139]	Aug 2013	1 Jan 2014	3.4
2013 – 6	Amendments to AASB 136 arising from Reduced Disclosure Requirements	Sep 2013	1 Jan 2014	
2013 – 7	Amendments to AASB 1038 arising from AASB 10 in relation to Consolidation and interests of policy holders [AASB 1038]	Oct 2013	1 Jan 2014	

AASB NO.	TITLE	ISSUE DATE	OPERATIVE DATE (ANNUAL REPORTING PERIODS BEGINNING ON OR AFTER)	REFERENCE
2013 – 8	Amendments to Australian Accounting Standards – Australian Implementation guidance for Not-for-Profit Entities – Control and Structured Entities [AASB 10, AASB 12 & AASB 1049]	Oct 2013	1 Jan 2014	
2013 – 9	Amendments to Australian Accounting Standards – Conceptual Framework, Materiality and Financial Instruments	Dec 2013	Various	3.5
IFRS	Annual Improvements to IFRSs 2010-2012 Cycle	Dec 2013	1 July 2014	
IFRS	Annual Improvements to IFRSs 2011-2013 Cycle	Dec 2013	1 July 2014	
IFRS	Clarification of Acceptable Methods of Depreciation and Amortisation – Amendments to IAS 16 and IAS 38	May 2014	1 Jan 2016	3.6
IFRS	Accounting for Acquisitions of Interests in Joint Operations – Amendments to IFRS 11	May 2014	1 Jan 2016	3.7

Australian Interpretations

INT NO.	TITLE	ISSUE DATE	OPERATIVE DATE (ANNUAL REPORTING PERIODS BEGINNING ON OR AFTER)	REFERENCE
21	Levies	June 2013	1 Jan 2014	4.1

TABLE C: ON THE HORIZON – EXPOSURE DRAFTS

The interpretations highlighted below will be discussed in more detail on page 23. Others are likely to have less impact on mainstream accounting practices..

Exposure drafts

ED	TITLE	ISSUE DATE	REFERENCE
223	Superannuation entities	Dec 2011	
230	Classification and Measurement: Limited Amendments to AASB 9	Nov 2012	5.1
237	Financial instruments: Expected credit losses	March 2013	5.2
242	Leases	May 2013	5.3
244	Insurance Contracts	June 2013	5.4
245	Agriculture: Bearer plants	July 2013	
246	Equity Method in Separate Financial Statements	Dec 2013	
247	Annual Improvements to IFRSs 2012-2014 Cycle	Dec 2013	
248	Amendments to AASB 1053 – Transition to and between Tiers, and related Tier 2 Disclosure Requirements	March 2014	
249	Disclosure Initiative (Proposed amendments to AASB 101)	March 2014	5.5
ITC 30	Request for Comment on IASB Request for Information on Post-implementation Review: IFRS 3 Business Combinations	Feb 2014	

SECTION B: DISCUSSION

Information on Accounting Standards and Interpretations applicable for the first time at 30 June 2014

1. Australian Accounting Standards

1.1 AASB 10 *Consolidated Financial Statements*

AASB 10 replaces AASB 127 *Consolidated and Separate Financial Statements* for annual periods beginning on or after 1 January 2013. AASB 10 has three key elements to determine whether an entity has control over an investee. According to AASB 10, an investor controls an investee only if the investor has **all** of the following:

a. Power over the investee

b. Exposure, or rights, to variable returns from its involvement with the investee

c. The ability to use its power over the investee to affect the amount of the investor's returns.

Additional guidance is provided about how to evaluate each of the three limbs above. While this is not a wholesale change from the previous definition of control within AASB 127 (and for many entities no change will result in practice) some entities may be impacted by the change. The above limbs are more principles-based rather than hard and fast rules.

On adoption of AASB 10, you are advised to reconsider whether you have control of related entities or have lost control of your former subsidiaries. You should pay particular attention to de facto control, whether potential voting rights are substantive, and for fund managers, whether you are acting as principal or agent.

De facto control

De facto control usually occurs where one shareholder has a large holding (albeit less than 50%) and the remaining shareholders are widely dispersed. Application Example 4 in AASB 10 illustrates de facto control:

- An investor acquires 48 per cent of the voting rights of an investee
- Remaining voting rights are held by thousands of shareholders, none individually holding more than one per cent of the voting rights
- None of the shareholders have any arrangements to consult any of the others or make collective decisions
- When assessing the proportion of voting on the basis of the relative size of the other shareholdings, the investor determined that a 48 per cent interest would be sufficient to give it control.

In this case, on the basis of the absolute size of its holding and the relative size of the other shareholdings, the investor concludes that it has a sufficiently dominant voting interest to meet the power criterion without the need to consider any other evidence of power.

Potential voting rights

Potential voting rights are also discussed within AASB 10 and the following Application Example 9 in AASB 10 is provided:

- Investor A holds 70 per cent of the voting rights of an investee
- Investor B has 30 per cent of the voting rights of the investee as well as an option to acquire half of Investor A's voting rights
- The option is exercisable for the next two years at a fixed price that is deeply out of the money (and is expected to remain so for that two-year period)
- Investor A has been exercising its votes and is actively directing the relevant activities of the investee.

In such a case, Investor A is likely to meet the power criterion because it appears to have the current ability to direct the relevant activities. Although investor B has currently exercisable options to purchase additional voting rights (that, if exercised, would give it a majority of the voting rights in the investee), the terms and conditions associated with those options are such that the options are not considered substantive (i.e. remote possibility of being exercised).

Principal vs. agent

Investors with decision-making rights (power) that do not own more than 50 per cent of the voting rights also need to determine whether they are acting as principal or agent to determine whether they have the ability to use their power to affect their returns. This scenario is common amongst fund managers and some of the factors that need to be considered to determine if they are acting as principal or agent include:

- Rights held by other parties (i.e. kick-out rights) and whether it is feasible that these could be exercised
- Remuneration and whether it is commensurate with services provided
- Their exposure to variable returns from other interests held (i.e. returns beyond remuneration).

Application Example 14A to AASB 10 illustrates these principles as follows:

- Fund manager of an investment fund must make decisions that are in the best interests of all investors (kick-out rights likely to be considered protective rights only)
- Fund manager has wide discretion for making investment decisions
- Fund manager receives a fee calculated as one per cent of the net asset value of the fund as well as 20 per cent of the fund's profits if a specified level of profits is achieved
- All fees are considered commensurate with performance
- Fund manager has a two per cent interest in the fund and is not obliged to fund losses beyond its two per cent investment.

Although the fund manager has extensive decision-making authority and is exposed to variable returns from its remuneration and two per cent interest, it is likely that the fund manager's exposure indicates that they are acting as agent and not principal.

The principles-based nature of AASB 10 means that judgement is required and no 'bright line' guidance is provided. For example, Application Example 14B in AASB 10 says the fund manager is more likely to be acting in their own best economic interests (and therefore as principal) where there is greater magnitude of, and variability associated with, the fund manager's economic interests (i.e. remuneration and other interests in aggregate).

So for example, while a two per cent interest in the fund could indicate that the fund manager is acting as agent, a 20 per cent investment in the fund together with the remuneration arrangements in Application Example 14A could indicate that the fund manager is acting as principal.

No other examples are included if, for example, the fund manager had a 10 per cent interest.

For more information

Please refer to BDO international publication *Need to Know IFRS 10 Consolidated Financial Statements.*

1.2 AASB 11 *Joint Arrangements*

AASB 11 *Joint Arrangements* replaces AASB 131 *Interests in Joint Ventures* for annual periods beginning on or after 1 January 2013. To be within the scope of AASB 11, two or more parties must have unanimous control of the operation's relevant activity.

AASB 131 had three types of joint ventures whereas AASB 11 only has two. These are:

- Joint operations
- Joint ventures.

A **joint operation** is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the assets, and obligations for the liabilities, relating to the arrangement. Those parties are called joint operators.

A **joint venture** is a joint arrangement, structured through a separate legal vehicle, whereby the parties that have joint control of the arrangement have rights to the **net assets** of the arrangement. Those parties are called joint venturers.

A separate vehicle is a separately identifiable financial structure, including legal entities or entities recognised by statute, regardless of whether those entities have a legal personality. The standard does not provide examples of what might be considered to be a separate vehicle, although it is likely that, subject to local laws, partnerships, companies, trusts and syndicates will be considered to be separate vehicles.

The definition of a joint venture is much stricter than previously applied under AASB 131.

Joint ventures must now be accounted for using the equity method of accounting. **The option to proportionately consolidate a joint venture entity has been removed.** This will have significant implications if you have previously used proportionate consolidation. Adopting AASB 11 will result in you having to apply equity accounting, which will result in a different presentation in the statement of profit or loss and other comprehensive income, statement of financial position and statement of cash flows.

Accounting for interests in **joint operations** will be different to that of **joint ventures**. If you are a joint operator, you will recognise, in relation to your interest in a joint operation, your:

- Assets, including your share of any assets held jointly
- Liabilities, including your share of any liabilities incurred jointly
- Revenue from the sale of your share of the output arising from the joint operation
- Expenses, including your share of any expenses incurred jointly.

In considering the above, it is important to understand how AASB 11 distinguishes between the two types of joint arrangements. The classification of a joint arrangement as a joint operation or a joint venture depends upon the **rights and obligations** of the parties to the arrangement. Joint arrangements not structured through a separate vehicle will always be a **joint operation** but arrangements structured through a separate vehicle will not always be a **joint venture**. The following can change what appears to be a joint venture (because it is a separate vehicle) into a joint operation:

- Terms of contractual arrangement (e.g. contract modifies features of a company so that each party has interests in assets and each is liable for liabilities of the company), or
- Other facts and circumstances (e.g. joint arrangement company manufactures parts used by parties to the arrangement in their own manufacturing processes, operates at a break-even level and no output is sold to third parties. Parties to the arrangement are likely to have rights to all the assets and obligations for all the liabilities of the arrangement, rather than rights to the net assets of the company).

Partnerships were accounted for as jointly controlled entities under AASB 131, and therefore equity accounted or proportionately consolidated, irrespective of rights and obligations of the partners. Partnerships meet the definition of a structured vehicle under AASB 11 but contractual terms and other facts and circumstances need to be analysed to determine whether rights and obligations are akin to a joint venture (net) or a joint operation (gross).

You are advised to reconsider all your joint arrangements in light of the new AASB 11 requirements.

For more information
Please refer to BDO international publication *Need to Know IFRS 11 Joint Arrangements*.

1.3 AASB 12 *Disclosure of Interests in Other Entities*

In line with the application dates for AASB 10 (refer 1.1 above) and AASB 11 (refer 1.2 above), AASB 12 *Disclosure of Interests in Other Entities* also applies to annual periods beginning on or after 1 January 2013 and provides the disclosure requirements for entities that have an interest in a subsidiary, a joint arrangement, an associate or an unconsolidated structured entity. As such, it pulls together and replaces disclosure requirements from many existing standards.

The International Accounting Standards Board (IASB) noted:

> "The global financial crisis that started in 2007 also highlighted a lack of transparency about the risks to which a reporting entity was exposed from its involvement with structured entities, including those that it had sponsored."

AASB 12 is an attempt to improve the level of disclosure around these types of arrangements and to enhance existing disclosures with regard to interests in a subsidiary, a joint arrangement and an associate.

AASB 12 requires you disclose information that enables users of financial statements to evaluate the:

- Nature of, and risks associated with, your interests in other entities
- Effects of those interests on your financial position, financial performance and cash flows.

You are advised to review AASB 12 in more detail because disclosures are generally more detailed compared to previous disclosure requirements.

1.4 AASB 13 *Fair Value Measurement*

AASB 13:

- Defines fair value
- Sets out in a single accounting standard a framework for measuring fair value
- Requires disclosures about fair value measurements.

Fair value is defined as:

> "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 (i.e. an exit price)."

The standard does not require fair value measurements in addition to those already required or permitted by other accounting standards.

Key issues in applying this standard are:

- The valuation must apply the 'exit' value
- The 'unit of account' must be determined correctly. For listed shares, the unit of account is the individual share, so the valuation cannot be adjusted for volume discounts or control premiums
- The valuation for a non-financial asset must be the 'highest and best use'
- Valuation adjustments on derivatives for your own credit risk if the derivative is a liability or the counterparty's credit risk if the derivative is an asset.

The key to applying AASB 13 is to ensure that those preparing the valuation comply with the requirements of AASB 13. The standard also introduces extensive disclosures, particularly where a valuation is derived from non-observable market inputs.

The IASB note:

> "That definition of fair value emphasises that fair value is a market-based measurement, not an entity-specific measurement. When measuring fair value, an entity uses the assumptions that market participants would use when pricing the asset or liability under current market conditions, including assumptions about risk. As a result, an entity's intention to hold an asset or to settle or otherwise fulfil a liability is not relevant when measuring fair value."

We recommend that you review your previous policies with regards to measuring fair value in light of the guidance in AASB 13 and the principles highlighted above. We also recommend that you review the disclosures required by AASB 13, particularly if you have Level 3 non-financial assets such as land and buildings and investment properties, where a significant amount of additional disclosures are required.

For more information
Please refer to BDO international publication *Need to Know IFRS 13 Fair Value Measurement*.

1.5 AASB 119 *Employee Benefits* (September 2011)

In September 2011, the Australian Accounting Standards Board (AASB) issued an amended version of AASB 119 *Employee Benefits* which applies to annual periods beginning on or after 1 January 2013. Main changes include:

- Elimination of the 'corridor' approach for deferring gains/losses on defined benefit plans
- Actuarial gains/losses on remeasuring defined benefit plan obligations/assets to be recognised in other comprehensive income rather than in profit or loss, and such gains/losses will never be able to reclassified in profit or loss in a subsequent period
- Subtle amendments to the timing for recognition of liabilities for termination benefits, in many cases deferring recognition
- Liabilities for employee benefits being calculated based on date of expected settlement, rather than the date when settlement is due. This may result in liabilities for annual leave being discounted where the entity does not expect that all employees will take their annual leave wholly within twelve months after the end of the reporting period, i.e. annual leave being treated as a long-term benefit, resulting in potentially lower annual leave liabilities where pay rises and promotions were factored into the previously undiscounted annual leave liability.

In light of the retrospective adjustments required on first-time adoption, you are advised to reconsider your accounting for defined benefit plans, termination liabilities and annual leave.

1.6 AASB 1053 *Application of Tiers of Australian Accounting Standards*

This standard establishes a differential financial reporting framework consisting of two tiers of reporting requirements for preparing general purpose financial statements:

- Tier 1: Australian Accounting Standards
- Tier 2: Australian Accounting Standards – Reduced Disclosure Requirements (RDR).

Tier 2 comprises the recognition, measurement and presentation requirements of Tier 1 and substantially reduced disclosures corresponding to those requirements.

The following entities apply Tier 1 requirements in preparing general purpose financial statements:

- For-profit entities in the private sector that have public accountability (as defined below)
- The Australian Government and State, Territory and Local Governments.

The following entities apply either Tier 1 or Tier 2 requirements in preparing general purpose financial statements:

- For-profit private sector entities that do not have public accountability
- All not-for-profit private sector entities
- Public sector entities other than the Australian Government and State, Territory and Local Governments.

Public accountability means accountability to those existing and potential resource providers and others external to the entity that make economic decisions, who are not in a position to demand reports tailored to meet their particular information needs. A for-profit private sector entity has public accountability if:

- Its debt or equity instruments are traded in a public market or it is in the process of issuing such instruments for trading in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets), or
- It holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses. This is typically the case for banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks.

1.7 AASB 2010-2 *Amendments to Australian Accounting Standards arising from Reduced Disclosure Requirements*

This standard provides the detail behind the reduced disclosure requirements (RDR) framework permitted by AASB 1053 *Application of Tiers of Australian Accounting Standards* and applies to annual reporting periods beginning on or after 1 July 2013, but was available for early adoption. It outlines the disclosures in each individual accounting standard that are no longer required when an entity adopts the RDR.

Not-for-profit private sector entities (such as charities and schools) and unlisted private companies not intending to IPO in the near future are advised to consider whether they are eligible for RDR and whether to adopt RDR as it may result in significantly less disclosure and shorter financial statements.

Prior to adopting the RDR, you need to consider any external covenants or requirements that you may be subject to because the RDR is not compliant with IFRSs. You also need to modify note 1 and the directors' declaration. The auditor will amend their audit report to remove any reference that the financial statements are compliant with IFRSs. The financial statements are however, still categorised as general purpose financial statements.

1.8 AASB 2011-4 *Amendments to Australian Accounting Standards to Remove Individual Key Management Personnel Disclosure Requirements*

In 2011, the Australian Accounting Standards Board (AASB) issued this standard to remove the additional Australian requirements for disclosures about individual key management personnel from AASB 124 *Related Party Disclosures*. The information is not required by IFRSs, and the AASB considered them more in the nature of corporate governance disclosures and therefore better dealt with by the *Corporations Act 2001*.

However, in July 2013, Regulation 2M.3.03(1) of the *Corporations Act 2001* was issued to include within the audited remuneration report, disclosures about reconciliations of individual key management personnel option and share holdings, loan transactions, and other transactions and balances. This means that for companies that are disclosing entities (including listed companies), in their 30 June 2014 annual report, these disclosures will be included as part of the audited remuneration report, rather than in the notes to the financial statements.

As no changes have been made to the *Corporations Act 2001* with respect to trusts having to include individual key management personnel disclosures, the annual financial statements for trusts that are disclosing entities for their year ended 30 June 2014 will not include any individual key management personnel disclosures. However, they will still be required to discuss key management personnel transactions and balances under the general related party disclosures included in AASB 124 *Related Party Disclosures*.

1.9 AASB 2012–5 *Amendments to Australian Accounting Standards arising from Annual Improvements 2009–2011 Cycle*

This standard results from the International Accounting Standards Board's annual improvements project 2009-2011. The annual improvements project provides a vehicle for making non-urgent but necessary amendments to IFRSs.

The amendments clarify:

- The minimum requirements for comparatives under AASB 101 *Presentation of Financial Statements*
- That a third statement of financial position under AASB 101 *Presentation of Financial Statements* is only required where the impact of a retrospective statement from a change in accounting policy, reclassification or error, is material, and that notes are only required for the third statement of financial position to explain the impact of these adjustments
- That spare parts, stand-by or servicing equipment are required to be classified as property, plant and equipment (PPE) if they meet the definition of PPE, otherwise they must be classified as inventory.

1.10 AASB 2012-9 *Amendment to AASB 1048 arising from the Withdrawal of Australian Interpretation 1039*

This standard formally withdraws Australian Interpretation 1039 *Substantive Enactment of Major Tax Bills in Australia* because the Australian Accounting Standards Board's (AASB's) policy of IFRS adoption is that Australian Interpretations only be issued in rare and exceptional circumstances, and then only after having explored all options with the IFRS Interpretations Committee.

The AASB's view is that in Australia:

- A non-linked tax Bill would only be considered substantially enacted when it has passed through both Houses of Parliament
- Where the commencement of a Bill is linked to the enactment or commencement of another Bill, the first Bill would not be considered substantively enacted until the second Bill has passed through both Houses of Parliament. This is because there is significant uncertainty about the outcome of the second Bill until it has been passed.

Royal Assent is not considered necessary for substantive enactment as it is considered to be a mere formality once the Bill(s) have passed through both Houses of Parliament.

2. Australian Interpretations

2.1 Interpretation 20 *Stripping Costs in the Production Phase of a Surface Mine*

This interpretation clarifies when production stripping costs should lead to the recognition of an asset and how that asset should be initially and subsequently measured.

Stripping costs incurred during the development phase of a mine are usually capitalised and depreciated or amortised on a systematic basis (typically units of production method) once production begins.

Interpretation 20 deals with the situation where an entity continues to remove overburden and to incur stripping costs during the production phase of the mine. Stripping in this phase may produce inventory and/or provide access to deeper levels of material that have a higher ratio of ore to waste.

If you undertake stripping activity that provides benefit in the form of inventory produced, you will need to account for this in accordance with the principles of AASB 102 *Inventories*. To the extent the benefit is improved access to ore, you will need to recognise these costs as a non-current asset, if certain criteria are met. This interpretation refers to the non-current asset as the 'stripping activity asset' and you will need to account for it as an addition to, or as an enhancement of an existing asset.

This interpretation does not apply to pre-production stripping activities.

Information on Accounting Standards and Interpretations issued but not yet effective for 30 June 2014

3. Australian Accounting Standards

3.1 AASB 9 *Financial Instruments*

AASB 9 *Financial Instruments*, as originally issued by the Australian Accounting Standards Board (AASB) in December 2009 and December 2010, applied to annual reporting periods beginning on or after 1 January 2013. However, due to the delay in issuing final requirements for hedging and impairment of financial assets, AASB 2012-6 *Amendments to Australian Accounting Standards – Mandatory Effective Date of AASB 9 and Transition Disclosures* extended the application date to annual reporting periods beginning on or after 1 January 2015. In December 2013, the AASB issued *AASB 2013-9 Amendments to Australia Accounting Standards Conceptual Framework, Materiality and Financial Instruments* which further extends the application date of AASB9 to 1 January 2017 and the IASB are expected to delay this even further to 1 January 2018.

AASB 9 is available for early adoption and currently contains requirements for:

- Classification and measurement of financial assets, financial liabilities and embedded derivatives
- Derecognition requirements for financial assets and financial liabilities
- Hedging (added in by AASB 2013-9).

It is important for you to consider what you need to do in the lead up to adopting AASB 9 and whether it is to your advantage to adopt AASB 9 early. This publication aims to give a high level overview of AASB 9 and the key issues for you to consider.

Transition

AASB 9 requires that you classify financial instruments on the date of initial application of the standard based on facts and circumstances at that date. This means that your classifications under AASB 139 *Financial Instruments: Recognition and Measurement* (outgoing financial instrument standard) are not relevant when you initially classify financial instruments under AASB 9. The date of initial application is the date when you first apply the requirements of AASB 9.

First-time adoption of AASB 9 therefore provides you with a once-off opportunity to reclassify your financial instruments compared to their current classifications under AASB 139. This is an important opportunity because you would otherwise not be able to change classifications under AASB 139. After assigning initial classification under AASB 9, you can only reclassify financial instruments when you change your business model for managing your financial instruments (likely to be extremely rare in practice).

If you initially apply AASB 9 in periods beginning on or after 1 January 2013, you must provide the disclosures set out in AASB 7. You do not need to restate prior periods (if you choose to restate prior periods, you are still required to include disclosures set out in AASB 7).

If you do not restate prior periods, you must recognise any difference between the previous carrying amount under the old requirements, and the carrying amount under the new requirements, at the date of initial application in opening retained earnings (or other component of equity, as appropriate). This adjustment occurs in your annual reporting period that includes the date of initial application.

A brief overview of the AASB 7 disclosures is set out below.

For each class of financial assets and financial liabilities at the date of initial application, you will need to disclose:

- The original measurement category and carrying amount determined
- The new measurement category and carrying amount determined, and
- The amount of any financial assets and financial liabilities in the statement of financial position that were previously designated as measured at fair value through profit or loss but are no longer so designated.

In the reporting period in which AASB 9 is initially applied, you must disclose the following for financial assets and financial liabilities that have been reclassified so that they are measured at amortised cost as a result of the transition to AASB 9:

- Fair value of the financial assets or financial liabilities at the end of the reporting period
- Fair value gain or loss that would have been recognised in profit or loss or other comprehensive income during the reporting period if the financial assets or financial liabilities had not been reclassified
- Effective interest rate determined on the date of reclassification, and
- Interest income or expense recognised.

Disclosures in the financial report must permit reconciliation between the:

- Measurement categories in accordance with AASB 139 and AASB 9
- Line items presented in the statements of financial position, and
- Class of financial instrument at the date of initial application.

Financial assets

AASB 9 has replaced the four key categories in AASB 139. Financial assets will now be classified based on the following:

- Objective of the entity's business model for managing the financial assets, and
- Characteristics of the contractual cash flows.

There are two main measurement categories within AASB 9:

- Amortised cost
- Fair value.

Amortised cost will be used if both of the following criteria are met:

- The asset is held within a business model whose objective is to hold assets in order to collect contractual cash flows, and
- The contractual terms of the financial asset give rise to cash flows on specified dates that are solely payments of principal and interest on the principal amount outstanding.

Fair value is used where:

- Amortised cost is not applicable, or
- If doing so eliminates or significantly reduces a measurement or recognition inconsistency (accounting mismatch).

Under this new system, fair value gains or losses are recognised in profit or loss unless:

- It is part of hedging relationship, or
- It is an investment in an equity instrument (that is not held for trading) and you have made an irrevocable election to present gains and losses on that investment in other comprehensive income.

AASB 9 introduces significant changes for available-for-sale (AFS) financial assets. If you make no election regarding equity instruments, you will need to recognise gains and losses in profit or loss. It is therefore important that you consider your accounting policies and choices with regard to equity instruments. You need to make your election to present gains and losses on equity instruments in other comprehensive income on acquisition date. You can make this election on an item by item basis, but you cannot revoke this choice once made. Some entities may choose to make a blanket policy choice that gains and losses on all investments in equity instruments will be presented in other comprehensive income. Others will need to document their choice on a case by case basis on acquisition.

Note also that at the time of writing, the IASB had issued proposals to further amend these classification and measurement requirements. Refer to discussion at **5.1 ED 230 *Classification and Measurement: Limited Amendments to AASB 9*** below.

Example 1

Scott Ltd has acquired $100,000 worth of shares in Outback Ltd on 1 January 2015. At 30 June 2015 these shares were valued at $110,000 and had paid a dividend during the period of $5,000. Scott Ltd sold these shares on 1 October 2015 for $140,000. The year end is 30 June.

The accounting implications under AASB 9 if Scott Ltd has made the irrevocable election to present gains and losses on that investment in other comprehensive income are as follows.

	2016	2015
	$	$
Revenue		5,000
Net Profit		5,000
Other comprehensive income	30,000	10,000
Total Comprehensive income	30,000	15,000

Important factors to note:

- Dividends are still part of the profit or loss in revenue.
- Even when the investment is sold, fair value movements remain in other comprehensive income and are not recycled through profit or loss.

Example 2

Scott Ltd has acquired $100,000 worth of shares in City Ltd on 1 January 2015. At 30 June 2015 these shares were valued at $60,000. Scott Ltd assessed these shares were likely to be significantly below cost for an extended period of time. Scott Ltd sold these shares on 1 October 2015 for $55,000. The year end is 30 June.

The accounting implications under AASB 9 if Scott Ltd has made the irrevocable election to present gains and losses on that investment in other comprehensive income are as follows.

	2016	2015
	$	$
Other comprehensive income	(5,000)	(40,000)
Total Comprehensive income	**(5,000)**	**(40,000)**

Important factor to note:

- Where an entity has made an irrevocable election to present gains and losses on an investment in an equity instrument in other comprehensive income, all movements in fair value of that instrument go through other comprehensive income regardless of whether the investment was impaired or not.

Financial liabilities

There are only a few changes in AASB 9 regarding financial liabilities, and the only significant change relates to financial liabilities designated at fair value through profit or loss. If you have financial liabilities in this category, you must assess the change in the liability's fair value attributable to changes in the liability's credit risk and recognise this amount directly in other comprehensive income (unless it creates or increases an accounting mismatch). You will continue to recognise changes in the liability's fair value caused by other factors in profit or loss.

For more information, please refer to BDO international publication *Need to Know IFRS 9 (2010) Financial Instruments – Classification and Measurement*.

Embedded derivatives

AASB 9 makes one key change with regard to embedded derivatives. For a hybrid contract that is a financial asset, you need to apply the requirements of the standard to the entire hybrid contract i.e. you do not separate the host and embedded derivative.

For instance, Entity A invests in a note where coupon payments are indexed to the gold price. Under AASB 139, the gold price index coupon payment meets the definition of an embedded derivative that is not closely related and would require separation (unless the fair value option is elected). Under AASB 9, the embedded derivative is not separated. Instead, the entire instrument is assessed as a whole, and if the instrument does not meet the contractual cash flow characteristics requirements for amortised cost, the whole instrument is measured at fair value through profit and loss.

An embedded derivative shall continue to be separated as per the current AASB 139 requirements:

- If a hybrid contract is a financial liability under the scope of AASB 9, or
- If it contains a host that is not within the scope of AASB 9.

Hedging accounting (AASB 2013-9)

The AASB released the hedge accounting requirements for AASB 9 in December 2014. Under the new hedge accounting requirements more economic hedge relationships are likely to be able to qualify for hedge accounting and the hedge effectiveness testing requirements have been made easier to apply.

The key changes are summarised as follows:

- Hedge effectiveness testing would be prospective only with no retrospective testing required and no bright line 80/125 threshold for evaluating whether a hedge is effective
- Risk components of non-financial items can qualify as hedged items. For example, entities can designate the crude oil component of jet fuel or a specified benchmark price component in supply/purchase agreements as the hedged item
- Allows entities to be able to apply hedge accounting more effectively when two risks arising from a single exposure (e.g. interest rate risk and foreign exchange rate risk arising from a foreign currency debt) can be managed separately using two derivatives over different time periods
- Can designate forecast offsetting foreign currency cash inflows and outflows as one net position cash flow hedge, and
- Less profit or loss volatility for entities using options as hedging instruments.

For more information, please refer to BDO international publication *Need to Know Hedge Accounting (IFRS 9 Financial Instruments)*.

Note that the IASB is finalising its work on the impairment requirements for financial assets, as well as some limited amendments to the classification and measurement requirements. Refer further discussion at 5.1 and 5.2 below.

3.2 IFRS 15 *Revenue from Contracts with Customers*

On 28 May 2014, the IASB and the US Financial Accounting Standards Board (FASB) jointly issued their final standard for revenue recognition, IFRS 15 *Revenue from Contracts with Customers*. IFRS 15 establishes a single revenue recognition framework, and supersedes the following:

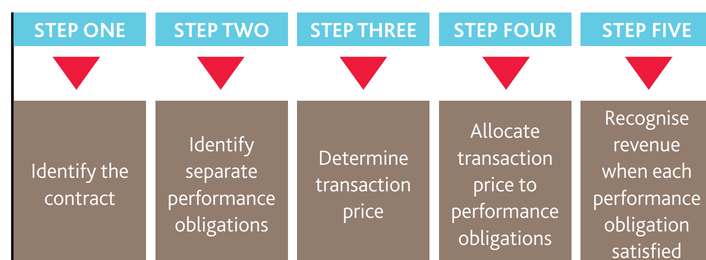
- IAS 11 *Construction Contracts*
- IAS 18 *Revenue*
- Interpretation 13 *Customer Loyalty Programmes*
- Interpretation 15 *Agreements for the Construction of Real Estate*
- Interpretation 18 *Transfers of Assets from Customers*
- Interpretation 131 *Revenue – Barter Transactions Involving Advertising Services*.

IFRS 15 applies to all contracts with **customers**, except for lease contracts (IAS 17 *Leases*), insurance contracts (IFRS 4 *Insurance Contracts*), and financial instruments and other contractual rights or obligations (IAS 39 *Financial Instruments: Recognition and Measurement*, IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements*, IAS 27 *Separate Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures*).

Core principle

The core principle of IFRS 15 is that an entity should recognise revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This means that revenue will be recognised when control of goods or services is transferred, rather than on transfer of risks and rewards as is currently the case under IAS 18 *Revenue*.

Five step process
IFRS 15 includes a five step process for recognising revenue as follows:



Step one: Identify the contract(s)
IFRS 15 identifies various criteria that must be met for contracts with customers to fall within its scope. It usually applies to each individual contract with a customer, but in some cases, separate contracts entered into with the same customer can be combined and accounted for as a single contract. It also includes detailed requirements for accounting for contract modifications i.e. whether a modification is treated as a separate, new contract, or whether it is treated as a variation of the existing contract.

Step two: Identify separate performance obligations
A performance obligation is a contractual promise to transfer a good or service to the customer. Each good or service is treated as a separate performance obligations if it is 'distinct'. A good or service is 'distinct' if both of the following criteria are met:
- The customer can benefit from the good or service, either on its own, or together with other resources that are readily available to the customer (e.g. if entity regularly sells goods or services separately), and
- The good or service is separately identifiable from other promises in the contract.

Non-exhaustive indicators that goods or services are separately identifiable include:
- No significant service is provided to integrate the goods or services with other goods or services promised in the contract into a bundle of goods or services
- The good or service does not significantly modify or customise other goods or services
- The good or service is not **highly dependent/interrelated** with other goods or services promised in the contract.

If promised goods or services provided are not 'distinct', the entity must combine them with other goods or services until it identifies a 'bundle' that is distinct.

Judgement is required to determine whether performance obligations are **highly dependent/interrelated** as these terms are not defined in IFRS 15.

Revenue is recognised when the entity satisfies the performance condition, i.e. when the entity transfers the promised good or service to a customer (when the customer obtains control). The standard includes detailed guidance to determine whether the performance obligation is satisfied over time, or at a point in time, as this will impact the timing of revenue recognition.

Step three: Determine transaction price
The transaction price can be a fixed or variable amount. Where the amount of consideration is variable, entities may use the most likely amount or the expected value amount (i.e. probability-weighted amount). IFRS 15 constrains the amount of variable consideration that can be recognised by an entity to an amount where it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur.

The time value of money only needs to be included when determining the transaction price if the contract includes a financing component that is significant to the contract. Time value of money can also be ignored if, at contract inception, the period between transfer of goods or services and payment is expected to be one year or less.

Warranties will only be accounted for as separate performance obligations (and hence revenue deferred) if the customer could purchase the warranty separately from the company, or if the warranty provides a service in addition to the assurance that the company's past performance was as specified in the contract (e.g. warranty could not be purchased separately but covers for future claims, rather than for past performance).

Goods sold with a right of return must recognise a 'refund liability' based on the amount of consideration that the entity expects not be entitled. The 'refund liability' is assessed at each reporting date for changes in expectations about the amount of refunds.

Step four: Allocate transaction price to performance obligations
For contracts with more than one performance obligation, an entity must allocate the transaction price on the basis of the **relative stand-alone selling prices** of the goods and services. If an observable price is not available, IFRS 15 requires that the stand-alone price is **estimated**.

IFRS 15 provides several methods of estimating the stand-alone selling price, including the market-based approach, expected cost plus margin approach, and the residual approach. If a discount is allocated to a performance obligation, it must be allocated before using the residual approach to estimate the stand-alone selling price of a good or service.

Any changes to the transaction price subsequent to contract inception are generally allocated to all performance obligations on the same basis as at inception. However, in limited circumstances, the change is allocated to one or more specific performance obligations, where there is observable evidence that the change is specific to one (or more) performance obligations.

Step five: Recognise revenue when each performance obligation is satisfied

Obligations are satisfied when (or as) the entity transfers control of a promised good or service to a customer. This occurs when (or as) the customer can direct the use of, and can obtain substantially all the remaining benefits from the promised good or service. IFRS 15 provides detailed guidance for assessing when control of the good or service has transferred from the entity to the customer. Entities will need to exercise judgment to determine if the performance obligations are transferred over a period of time, or at a single point.

In addition to the general principle of recognising revenue when control is transferred, variable consideration associated with a performance obligation that has been satisfied is only recognised to the extent that it is highly probable that a significant reversal in the amount of revenue recognised will not occur when the uncertainty is subsequently resolved (i.e. it is constrained). Entities will be required to exercise judgment to make that determination based on their experience with similar contracts, where that experience is still considered predictive.

Disclosures

IFRS 15 contains significantly more detailed disclosure requirements than currently required under the various standards and interpretations that deal with revenue recognition.

Effective date and transition

IFRS 15 is effective for annual periods beginning on or after 1 January 2017, with early adoption permitted (although it can only be early adopted in Australia once approved by the AASB). It is required to be applied retrospectively using one of the following methods:

- Retrospective application to each reporting period presented in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, or
- Retrospective application with the cumulative effect of initially applying IFRS 15 recognised directly in equity (retained earnings).

If an entity chooses the latter method, additional disclosures must be provided stating the amount by which each financial statement line item is affected as compared to IAS 11 and IAS 18 and their related Interpretations. Additionally, the entity is required to explain the reasons for significant changes identified.

More information

Refer to BDO international publication International Financial Reporting Bulletin – *Revenue from Contracts with Customers* for more information about IFRS 15.

3.3 AASB 2013-3 *Amendments to AASB 136 – Recoverable Amount Disclosures for Non-Financial Assets*

The amendments included in AASB 2013-3 clarify that you are only required to disclose the recoverable amount of a cash-generating unit (CGU) that has significant amounts of goodwill and intangibles with indefinite useful lives when there has been an impairment loss.

The amendments also require additional disclosures about the level in the fair value hierarchy when the recoverable amount for a CGU is determined based upon fair value less costs to sell.

3.4 AASB 2013-5 *Amendments to Australian Accounting Standards – Investment Entities*

In October 2012, the IASB issued an amendment to IFRS 10 *Consolidated Financial Statements* which introduced an exception to the consolidation principles in IFRS 10 *Consolidated Financial Statements* for investment entities. These amendments were approved by the Australian Accounting Standards Board (AASB) in August 2013 as AASB 2013-5.

Investment entities will not present consolidated financial statements but must instead measure investments in subsidiaries at fair value through profit or loss in accordance with AASB 9 *Financial Instruments* or AASB 139 *Financial Instruments: Recognition and Measurement*. However, the parent entity of an investment entity will consolidate all subsidiaries, including the investment entity and its controlled entities, unless that parent entity itself is an investment entity.

Investment entities are entities that meet **all** of the following criteria:

- They obtain funds from one or more investors for the purpose of providing those investors with investment management services
- They commit to investors that their business purpose is to invest funds solely for returns from capital appreciation, investment income or both, and
- They measure and evaluate the performance of substantially all of their investments on a fair value basis.

In practical terms, investment entities usually have more than one investment, more than one investor, investors are not related parties and ownership interests are in the form of equity or other similar interests (e.g. units). Entities that do not have all these characteristics can still be an investment entity but they will need to disclose the reason.

In accordance with AASB 12 *Disclosure of Interests in Other* Entities, all investment entities will need to disclose information about the significant judgements and assumptions it made to conclude that it is an investment entity.

3.5 AASB 2013-9 *Amendments to Australian Accounting Standards – Conceptual Framework, Materiality and Financial Instruments*

This amending standard is divided into three parts as follows:

- Part A – Conceptual Framework
- Part B – Materiality
- Part C – Financial Instruments.

Part A updates references to the *Framework for the Preparation and Presentation of Financial Statements* (July 2004) (*Framework*) in particular Australian Accounting Standards (including Interpretations) as a consequence of the issue of AASB CF 2013-1 in December 2013. It applies to annual periods ending on or after 20 December 2013 and when the *Framework for the Presentation of Financial Statements* is applied.

Part B deletes references to AASB 1031 *Materiality* in various Australian Accounting Standards (including Interpretations). Once all references to AASB 1031 have been deleted from all Australian Accounting Standards, AASB 1031 will be withdrawn. Part B applies to annual reporting periods beginning on or after 1 January 2014.

Part C includes the new hedging requirements (Chapter 6) to be included in AASB 9 *Financial Instruments* and amends the effective date of AASB 9 from to annual reporting periods beginning on or after 1 January 2015 to 1 January 2017.

3.6 Clarification of Acceptable Methods of Depreciation and Amortisation – Amendments to IAS 16 and IAS 38

This amending standard was issued by the International Accounting Standards Board (IASB) in May 2014 and applies to annual periods beginning on or after 1 January 2016.

It clarifies that the use of revenue-based methods for calculating depreciation and amortisation is not appropriate because revenue generated by an activity that includes the use of an asset generally reflects factors other than the consumption of economic benefits embodied in the asset.

This assumption is rebuttable for intangible assets and can be overcome in limited circumstances, for example, where revenue is established as the predominant limiting factor in the contract, such as a concession to explore and extract from a gold mine that expires when total cumulative revenue from extraction of gold reaches a certain dollar threshold.

This amending standard has not yet been approved by the Australian Accounting Standards Board and therefore technically cannot be adopted early. However, because it merely clarifies appropriate current practice, we recommend that you change depreciation/amortisation methods (for new and existing assets) to non-revenue based methods. For existing assets, changes will be treated as changes in accounted estimates and depreciation/amortisation expenses adjusted prospectively.

3.7 Accounting for Acquisitions of Interests in Joint Operations – Amendments to IFRS 11

This amending standard was issued by the International Accounting Standards Board (IASB) in May 2014 and applies to an acquisition of an interest in a joint operation that constitutes a business that occurs on or after the beginning of the first annual period that begins on or after 1 January 2016.

When an entity acquires an interest in a joint operation and the activities of the joint operation meet the definition of a 'business' in IFRS 3 *Business Combinations*, to the extent of its share of assets, liabilities, revenues and expenses as specified in the contractual arrangement, the entity must apply all of the principles for business combination accounting in IFRS 3, and other IFRSs, as long as these principles do not conflict with the guidance in IFRS 11 *Joint Arrangements*.

This means that it will expense all acquisition-related costs, and recognise its share, according to the contractual arrangements, of:

- Fair value of identifiable assets and liabilities, unless fair value exceptions included in IFRS 3 or other IFRSs, and
- Deferred tax assets and liabilities that arise from the initial recognition of an asset or liability as required by IFRS 3 and IAS 12 *Income Taxes*.

Goodwill will then be recognised as the excess consideration over the fair value of net identifiable assets acquired.

This amending standard has not yet been approved by the Australian Accounting Standards Board and therefore technically cannot be adopted early. However, because it merely clarifies current practice, we recommend that you adopt this method of accounting for all acquisitions that occur on or before 1 July 2016.

4. Australian Interpretations

4.1 Interpretation 21 *Levies*

This interpretation clarifies the circumstances under which a liability to pay a government imposed levy should be recognised, and whether that liability should be recognised in full at a specific date or progressively over a period of time. The issue arises where the 'levy' only triggers a liability after a particular hurdle is met. This will be particularly relevant where the entity's reporting date is not the same as the date at which the triggering date of the levy is met. It may therefore be particularly significant to overseas subsidiaries.

Unfortunately it is not clear what level of government this interpretation refers to and what constitutes a 'levy'. The scope of the interpretation may be significantly wider than it would first appear, including 'levies' raised by federal, state, local and municipal levels of government. The term levy may apply to taxes (other than income taxes) i.e. property taxes, payroll taxes, royalties, rates, state rates and quotas.

If you are liable to pay any government levies, we recommend that you consider the examples included in the interpretation to determine how your current treatment may change when the interpretation is first adopted.

Information on Exposure drafts

5. Exposure Drafts

The following exposure drafts relate to live projects of the IASB.

5.1 ED 230 *Classification and Measurement: Limited Amendments to AASB 9*

An exposure draft was released in November 2012 which proposes to change certain aspects of the already finalised sections in IFRS 9 (AASB 9). These sections relate to classification and measurement of financial assets. The document proposes to:

- Include additional application guidance to clarify the 'contractual cash flow characteristics test', which is one of the two tests that a financial asset is required to meet to qualify for amortised cost. There have been requests for additional application guidance on how certain types of financial instruments would meet the solely payments of principal and interest contractual cash flow characteristics test. An example is a financial instrument with a maturity of 5 years and an interest rate that reset every 6 months, but always with reference to a 5 year interest rate irrespective of the remaining time to maturity. Another example is a financial instrument where the interest rate is set by the regulator or the government.
- Introduce a new measurement category for debt instruments where the debt instrument would be:
  - Measured at fair value in the balance sheet
  - Changes in fair value would be recognised in other comprehensive income, and
  - Interest income is recognised at the effective interest rate in profit or loss.

This new measurement category would apply to debt instruments where the entity is holding the debt instrument to both collect the contractual cash flows, and to sell the financial assets (i.e. where the entity has a dual business objective for that debt instrument).

Under the current version of IFRS 9, debt instruments are either carried at amortised cost (if the business objective is to hold to collect the cash flows and meets the 'contractual cash flow characteristics test') or at fair value through profit or loss (if business objective is held to sell). This new measurement category would be an 'in between' category of the current two measurement categories.

A final standard based on the ED is expected to be issued by 30 June 2014.

For more information please refer to BDO international publication *Need to Know Classification and Measurement: Limited amendments to IFRS 9.*

5.2 ED 237 *Financial Instruments: Expected Credit Losses*

Proposals for an updated impairment model were issued by the IASB in March 2013. The proposed model replaces the current 'incurred loss' model (where impairment is only recognised when a certain loss event has occurred) with a forward looking expected loss model. The general model works as follows:

- Stage 1: Recognise the next 12-months expected credit losses on financial assets
- Stage 2: Recognise lifetime expected credit losses if there has been a significant credit deterioration
- Stage 3: Recognise lifetime expected credit losses and recognise interest revenue on the net carrying amount (gross amount less the provision amount) if the incurred loss triggers in AASB 139 have been met.

STAGE	1	2	3
Recognition of impairment	12 month expected credit loss	Lifetime expected credit loss	
Recognition of interest	Effective interest on the gross amount		Effective interest on the net (carrying) amount

Financial assets that have low credit risk (e.g. at investment grade – AAA to BBB) would only be required to recognise 12-months of expected credit losses.

The model proposes that when payments are 30 days or more past due it is generally presumed that significant deterioration in credit risk has occurred, so lifetime expected credit losses are to be recognised (however this presumption can be rebutted).

Short term trade receivables would apply a simplified approach (i.e. only recognise lifetime expected losses). Other long term trade receivables and lease receivables have the option to apply the simplified approach or the general approach.

As a practical expedient, the proposed model allows entities to calculate expected credit losses on trade receivables using a provision matrix where trade receivables are grouped based on different customer bases and different historical loss patterns (e.g. geographical region, product type, customer rating, collateral or trade credit insurance, or type of customer). Under the simplified model, entities could adjust the historical provision rates (which are an average of historical outcomes) on their trade receivables to reflect relevant information about current conditions compiled with reasonable and supportable forecasts.

A final standard based on the ED is expected to be issued by 30 June 2014.

For more information please refer to an article in our April 2013 *Accounting Newsletter* and BDO international publication *Need to Know – Financial Instruments: Expected Credit Losses.*

Once the limited amendments to classification and measurement (Section 5.1 above) and the impairment phase of IFRS 9 is finalised, IFRS 9 is deemed to be complete. The International Accounting Standards Board intends to set a final effective date for IFRS 9 as 1 January 2018. In addition, once IFRS 9 is completed, there is only a six month window where entities can still choose to early adopt previously finalised versions of IFRS 9. Once the six month window is over, only the completed IFRS 9 can be early adopted in its entirety.

For more information please refer to an article in our March 2014 *Accounting Newsletter*.

5.3 ED 242 *Leases*

In May 2013, the IASB issued revised proposals for leases. This ED is their second attempt in developing a set of new accounting requirement for leases where all assets and liabilities arising under lease contracts are being recognised on an entity's balance sheet.

The IASB made significant changes to the proposals set out the previous ED (ED 202), the key change being that ED 242 proposes two types of lease model for lessees and lessors, depending on the proportion of economic benefits consumed during the lease, and the type of the underlying asset.

'A dual lease' model

The two types of leases are:

- Type A leases – consumes some of the economic benefit of the asset – usually equipment and vehicle leases
- Type B leases – consumes an insignificant part of the total economic life of the underlying asset – usually property leases.

If the underlying asset is NOT PROPERTY, a lease is classified as a Type A lease unless:

- The lease term is for an insignificant part of the total economic life of the underlying asset, or
- The present value of the lease payments is insignificant relative to the fair value of the underlying asset at the commencement date.

If the underlying asset IS PROPERTY, a lease is classified as a Type B lease unless:

- The lease term is for the major part of the remaining economic life of the underlying asset, or
- The present value of the lease payments accounts for substantially all of the fair value of the underlying asset at the commencement date.

The ED provides no 'bright line' guidance as to what is meant by 'insignificant', 'major part' and 'substantially all'.

Example Type A lease – Equipment lease classification

(Extracted from Example 12 of the Illustrative Examples to ED 242)

Facts are as follows:

- Two-year lease of an item of equipment
- Total economic life of 12 years
- Lease payments are $9,000 per year
- Present value of lease payments is S16,700 calculated using the rate the lessor charges the lessee
- Fair value of the equipment at the commencement date is $60,000.

The lessee determines that the lease is a Type A lease because:

- Underlying asset is not property
- Lease term is for more than an insignificant part of the total economic life of the equipment (i.e. 2/12 years is considered more than insignificant in this example)
- Present value of the lease payments is more than insignificant relative to the fair value of the equipment at the commencement date (i.e. $9,000/$16,700).

Example Type B lease – Commercial property lease classification

(Extracted from Example 13 of the Illustrative Examples to ED 242)

The following facts are relevant:

- 15-year lease of an office building
- Remaining economic life of 40 years at the commencement date
- Lease payments are $30,000 per year
- Present value of lease payments is $300,000, calculated using the lessee's incremental borrowing rate (i.e. the rate the lessor charges the lessee is not readily determinable to the lessee)
- Fair value of the property at the commencement date is $400,000.

The lessee determines that the lease is a Type B lease because:

- Underlying asset is property
- Lease term is not for the major part of the remaining economic life of the property (i.e. 15/40)
- Present value of the lease payments does not account for substantially all of the fair value of the property (i.e. $300,000/$400,000).

Lessee Accounting

For both Type A and Type B leases, the ED proposes that the lessee will recognise in the balance sheet a:

- Right-of-use asset
- Lease liability.

The lease liability is equal to the present value of the lease payments discounted using the rate the lessor charges the lessee (or if unknown, the lessee's incremental borrowing rate).

The right-of-use asset in a Type A lease is amortised on a straight-line basis (unless another systematic basis is more representative).

The amortisation expense for a right-of-use asset in a Type B lease is calculated as the difference between:

- The periodic lease cost
- The periodic unwinding of the discount on the lease liability.

Essentially, the amortisation charge is the balancing figure that ensures that the overall charge to profit or loss is consistent each period.

The effect of the proposed requirement would be such that for:

- Type A leases it would result in a front-end loaded interest expense and a straight line or similar amortisation expense in profit or loss
- Type B leases it will result in one combined expense in profit or loss, being the interest cost and the 'balancing number' for amortisation as described above.

Lessor accounting

For Type A leases, the lessor derecognises the full value of the underlying asset but also records a residual asset which is the right to the underlying asset that the lessor retains. Interest is also unwound on this residual asset as income so that its value grosses up over time.

For Type B leases, the proposed accounting is asymmetrical between lessees and lessors, specifically:

- The lessor continues to recognise the underlying asset whereas the lessee would also recognise the right-of-use asset (i.e. increasing the global balance sheet)
- Lessors do not recognise a lease receivable whereas the lessee would recognise a lease liability
- Income is recognised on a straight line basis or a more representative basis by lessors whereas lessees must recognise a straight-line cost.

Short-term leases

For short term leases, whose maximum possible term, including any options to extend, is for a period of twelve months or less, the ED proposes an accounting policy choice to either:

- Apply the accounting policies described above for Type A and Type B leases, or
- Recognise lease payments in profit or loss (on a straight line basis for lessees and a straight line or more representative basis for lessors).

Redeliberations

The IASB continue to deliberate the leasing proposals. At their March 2014 meeting, the IASB decided to revert back to a single on-balance sheet leases model as originally proposed in its first leases exposure draft (ED 202 in Australia). This means that for all leased assets, a lease liability and a right-of-use asset would be recorded on initial recognition. Over the life of the lease, the lessee would record a finance charge and amortisation of the right of use of asset. This would result in a front loading of lease expense in profit or loss for property leases, because interest costs would unwind using a constant periodic rate of return, which would be greater in the earlier periods.

Summary

These proposals are likely to impact most entities as leasing/rental arrangements are both a common form of financing and give lessees efficiency in managing assets and associated services which they themselves are not experts in sourcing or managing. Unless you have very short-term rental agreements (less than 12 months), these proposals are likely to mean more debt on your balance sheet which could have a spill over effect to bank covenants etc. It may also cause a significant administrative burden having to create 'right-of-use' asset registers and calculate the finance charge in respect of each leased asset. The proposals could significantly change the business model of both lessees and the major leasing companies.

Next steps

Deliberations continue.

5.4 ED 244 *Insurance Contracts*

In June 2013, the IASB published a revised exposure draft on insurance contracts. Like the previous ED, the revised ED proposes that an entity should measure insurance contracts using a current value approach and covers all types of insurance contracts issued by insurers.

Under the proposals an insurance contract, other than a short-duration contract, would be measured on the basis of the obligations and rights under the contract using the following 'building blocks':

- A current estimate of the future cash flows
- A discount rate that adjusts those cash flows for the time value of money
- An explicit risk adjustment, and
- A residual margin.

For short-duration insurance contracts, a modified version of the comprehensive measurement approach would involve an entity applying:

- A premium deferral model for pre-claims liabilities ('stand ready' obligations to meet valid claims for insured events that have not yet occurred), and
- The 'building block' approach for claims liabilities (obligations to meet valid claims for insured events that have occurred).

The key changes from the original ED are:

- The insurance liability would include a contractual service margin (i.e. expected profit on the contract) that is 'unlocked' i.e. you would adjust the margin for changes in assumptions relating to future coverage and services
- Insurance contracts for which cash flows are contractually linked to, and vary directly with an underlying item, would use the carrying amount of the underlying item to account for such cash flows
- Gross presentation of insurance contract revenue and claims/ expenses incurred (the original ED proposed a net margin presentation format in the statement of comprehensive income)
- Interest expense recognised based on amortised cost, and all other current value changes recognised in other comprehensive income
- Full retrospective approach to transition if practicable and with a modified retrospective approach otherwise.

Next steps

Comments closed 25 October 2013. The IASB is planning to discuss comments received during the second quarter of 2014. No date has yet been set for a final standard.

5.5 ED 249 Disclosure Initiative (Proposed amendments to AASB 101)

In April 2014, the AASB issued this exposure draft which results from the IASB's Disclosure Initiative that was started in response to concerns raised by respondents to the IASB's Agenda Consultation in 2011. ED 249 proposes amendments relating to the Disclosure Initiative as follows:

- Materiality – Clarifies that materiality applies to all primary financial statements and notes, and applies even in the case of a specific list of minimum disclosures
- Line items in financial statements – Clarifies that line items can be disaggregated if doing so could impact users' decision. Subtotals must be made up of items recognised in accordance with IFRSs and additional subtotals in the statement of profit or loss and other comprehensive income must be reconciled back to subtotals required by AASB 101.82
- Notes to the financial statements – Notes no longer need to follow the order of presentation in the primary financial statements. Notes can be positioned in order of importance and various related items can be grouped together, e.g. all financial instruments. This means that accounting policies could be placed at the end of the financial statements.

ED 249 also proposes amendments to clarify that the share of other comprehensive income of associates and joint ventures be presented as two line items, i.e.:

- Those items that will be reclassified subsequently to profit or loss, and
- Those items that will not be reclassified subsequently to profit or loss.

The IASB noted that this form of 'one line' presentation is consistent with the presentation requirement that an entity's share of net profit or loss of associates and joint ventures is to be shown as a separate line item in the profit or loss section of the statement of profit or loss and other comprehensive income.

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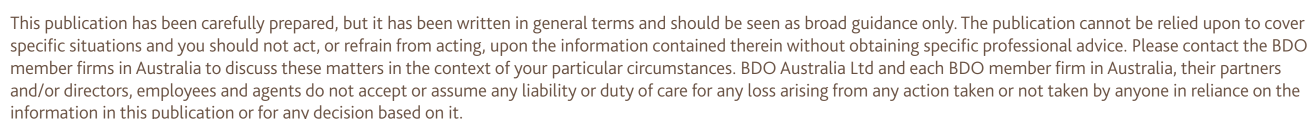
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