GAAP Consulting

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SPECIAL GAAP REPORT

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Financial reporting and audit considerations for 30 June 2017

What you need to know

As the 30 June reporting season has arrived, the *GAAP Consulting* team wants to share with you several financial-reporting, ethical and auditing considerations.

We've listed them as:
- Write useful reports, says ASIC
- What ASIC's latest review has taught us
- Corporate tax cuts and AASB 112 *Income Taxes*
- New draft guidance promotes tax clarity
- ASIC's advice on communicating to boards
- How to pay dividends
- Size does matter for proprietary companies
- Guidance on narrative reporting
- APESB issues guidance on management representations
- ASIC guides on risk management for responsible entities
- *Audit Committees* good-practice guide released
- Enhanced audit-reporting standards in force
- ATO releases revised SMSF independent auditor's report, and
- ASIC releases audit inspection results.

We trust that you find this Special GAAP Report helpful and look forward to working with you to meet the challenges of 2017.

Write useful reports, says ASIC

The Australian Investments and Securities Commission has continued its call for companies to write useful and meaningful financial reports.

ASIC commissioner John Price said: 'As with previous reporting periods, directors and auditors should focus on values of assets and accounting-policy choices. ASIC continues to see companies use unrealistic assumptions in testing the value of assets and applying inappropriate approaches in areas such as revenue recognition.'

Specifically, the commission will focus on:

- Accounting estimates: impairment testing and asset values; extractive industries or entities providing supporting services; inventories; financial instruments
- Accounting-policy choices: revenue; expense deferral; off-balance sheet arrangements; and tax accounting, and
- Key disclosures: estimates and accounting-policy judgements; effects of new revenue, financial instrument, lease and insurance standards.

See *Appendix 1 – ASIC focuses for 30 June 2017 financial reports*.

ASIC reminds directors of their responsibilities

ASIC reminds directors that they are primarily responsible for the quality of financial reports.

They must ensure that management produces quality financial information. Companies must have appropriate processes and records to support information in reports rather than simply relying on an independent auditor.

Companies should apply appropriate experience and expertise, particularly in more difficult and complex areas such as accounting estimates (including impairment of non-financial assets), accounting policies (such as revenue recognition) and taxation.

While ASIC does not expect directors to be accounting experts, they should seek explanations and advice that support accounting treatments chosen and, where appropriate, challenge estimates and treatments applied in reports. They should particularly seek advice when a treatment does not reflect their understanding of the substance of an arrangement.

Information should be produced on a timely basis and be supported by appropriate analysis and documentation for the independent auditor.

The aim is to enable auditors to focus on their role in providing independent assurance.

Further information can be found in ASIC's information sheets 183 *Directors and financial reporting* and 203 *Impairment of non-financial assets: materials for directors*.

Plan for new accounting standards

It is important that directors and management plan for new accounting standards and inform investors and other report-users how they will affect results.

This includes making required disclosures on the standards' effects in notes to the financial report.

It may well mean quantifying effects for the reporting date that coincides with the start of the first comparative period that will be affected in a future financial report, subject to transitional arrangements, that is 30 June 2017 for new standards on revenue and financial-instruments.

Further information can be found in ASIC media release *Companies need to respond to major new accounting standards* (refer: 16-442MR).

See *Appendix 2 – Accounting standards operative for the first time for 30 June 2017,* and *Appendix 3 – Issued but not yet operative accounting standards*.

Listed entities must enhance their audit reports

Auditors of listed entities are required to issue enhanced audit reports that outline key audit matters – aspects of reports that require significant attention.

Preparers and directors should be mindful that these types of matters may relate to accounting estimates and significant accounting-policy choices that also require specific disclosures, as well as matters relating to areas usually covered in operating and financial reviews.

Auditors should describe key audit matters and how they have interpreted them in a clear and understandable manner, bearing in mind the broad audience of investors and other report-users. The description of key audit matters and their interpretations should be specific, of course, to the circumstances of the company and the audit.

ASIC's focus on material disclosures

ASIC's surveillance continues to focus on material disclosures of information useful to investors and other report-users such as assumptions supporting accounting estimates and significant accounting-policy choices.

ASIC will not pursue immaterial disclosures that may add unnecessary clutter to reports; efforts should be made to communicate information more clearly.

Take care with clients' cash

Australian financial-services licensees should ensure that client monies are appropriately held in separate, designated trust bank accounts and that they are applied according to client instructions and the requirements of the Corporations Act.

Auditors are reminded of the importance of testing to obtain assurance that assets and liabilities are not materially misstated, that monies are dealt with appropriately and that breaches are reported to ASIC in accordance with Act and Regulatory Guide 34 *Auditors' obligations: reporting to ASIC*.

Operating and financial reviews

Listed companies should continue to disclose information on matters that can have material effects on future financial positions. ASIC says that this could include, for example, matters relating to climate change or cyber-security.

Proprietary companies

ASIC continues to review the financial reports of proprietary companies and unlisted public companies following complaints and other intelligence.

The commission identifies and follows up where companies have not met their obligations to lodge reports. It is their responsibility to do so, and ASIC will take all necessary steps to see that they do.

What ASIC's latest review has taught us

ASIC has queried 23 entities about 28 accounting treatments in its review of the 31 December 2016 financial reports of 90 listed and other public-interest entities.

The commission continues to be concerned about assessments of the recoverability of the carrying values of assets, including goodwill, exploration and evaluation expenditure, and property, plant and equipment. Most of its recent enquiries relate to assets in the energy and extractive industries.

ASIC's risk-based surveillance of financial reports of public-interest entities for periods ended 30 June 2010 to 30 June 2015 has led to material changes to 4 per cent of reports reviewed. The main changes were about impairment of assets, revenue recognition and expense deferral.

Following is a breakdown of the enquiries.

Issue	Number of enquiries
Impairment and other asset values	10
Consolidation accounting	5
Amortisation of intangibles	3
Revenue recognition	2
Tax accounting	2
Business combinations	1
Other matters	5

Enquiries of individual entities will not necessarily lead to material restatements. Matters involving seven of the entities have been concluded without any changes to their financial reporting.

ASIC commissioner John Price said: 'The largest number of our findings continue to relate to impairment of non-financial assets and inappropriate accounting treatments. Directors and auditors should continue to focus on values of assets and accounting-policy choices in preparing their 30 June 2017 financial reports.'

See *Appendix 4 – Lessons from ASIC review of 31 December 2016 financial reports*.

Corporate tax cuts and AASB 112 Income Taxes

Changes to the corporate tax rate for small business entities and base-rate entities are as follows:

<table>
<tr><th>Income year</th><th>Aggregated turnover</th><th>Company tax rate</th></tr>
<tr><td>2016</td><td>< $2 million</td><td>28.5%</td></tr>
<tr><td>2017</td><td>< $10 million</td><td rowspan="8">27.5%</td></tr>
<tr><td>2018</td><td>< $25 million</td></tr>
<tr><td>2019</td><td rowspan="9">< $50 million</td></tr>
<tr><td>2020</td></tr>
<tr><td>2021</td></tr>
<tr><td>2022</td></tr>
<tr><td>2023</td></tr>
<tr><td>2024</td></tr>
<tr><td>2025</td><td>27%</td></tr>
<tr><td>2026</td><td>26%</td></tr>
<tr><td>2027 and later</td><td>25%</td></tr>
</table>

A base-rate entity carries on a business and meets the aggregated turnover threshold for a specific year. For the 2017-2018 financial year, the threshold is less than $25 million. From 2018-2019, it will increase to less than $50 million.

The corporate tax rate for base-rate entities will decrease further from 27.5 per cent to 25 per cent. For all other companies above these thresholds and non-business company structures (such as an investment company or bucket company), the corporate tax rate will remain at 30 per cent.

Under AASB 112 *Income Taxes* deferred tax assets and liabilities are measured at the tax rates that are expected to apply when the asset is realised or the liability is settled based on the tax rates (and laws) that have been enacted by the end of the reporting period.

Tax liabilities (or assets) for current and prior periods are measured at the amount of tax expected to be paid (or recovered from) taxation authorities using the tax rates (and laws) that have been enacted or 'substantively' enacted by the end of the reporting period.

New draft guidance promotes tax clarity

Australian stakeholders (and international investors) wanting to see clearer, more consistent and 'comparable' tax reporting this financial year will benefit from new guidance from the Australian Accounting Standards Board.

The AASB's draft appendix to the Board of Taxation's tax-transparency code promotes consistency and comparability of key information about entities' tax positions and, in particular, their effective tax rate (ETR) relative to corporate tax rates.

Effective tax rates are the amount of tax incurred as a proportion of profit before tax. The guidance aims to help entities to communicate tax information in a way that is consistent with evolving international disclosure practices and the Australian Securities and Investments Commission's requirements regarding non-GAAP information.

The taxation board's code aims to improve comparisons among companies on tax reports.

Its chair Michael Andrew said: 'The aim of the code is to increase transparency around tax and to help educate the public about compliance with tax laws. But tax is a complex subject that can be difficult for companies to explain in a way that is accessible to the readers of their reports, and there is potential for inconsistency in some key areas.'

AASB chair Kris Peach said: 'This guidance helps to establish some common approaches, makes it easier for preparers to pull reports together, and easier for readers to understand and compare information.'

Explaining tax and the financial statements, the code requires disclosures of effective tax rates based only on corporate tax to enable comparisons with company tax rates.

The guidance sets out the necessary disclosures to ensure interested parties can better understand the differences, if any, between an ETR under the code and an ETR prepared according to accounting standards. The guidance also sets out how companies can improve their disclosures by reconciling their profit-to-income tax expense and their income-tax expense to income-tax paid or payable, including any material temporary and non-temporary differences.

Ms Peach said: 'While there are good reasons the numbers in financial statements and tax transparency reports are not the same, this often causes confusion for the reader and can be a difficult area to explain. The AASB has set out some principles and examples to help companies better communicate their tax positions and practices to stakeholders.'

The guide has been published as a draft to allow companies to trial its advice in the upcoming reporting season and can be found on the Board of Taxation and AASB websites.

ASIC's advice on communicating audit findings to boards

ASIC has released regulatory guide 260 *Communicating findings from audit files to directors, audit committees or senior managers*.

The guide provides transparency on the commission's criteria and processes for communicating financial reporting and audit findings to directors and audit committees.

Based on reviews of audit files, the guide may help directors in meeting financial-reporting obligations and supporting audit quality.

The guide covers:

- When the commission will communicate reporting and audit-quality findings to directors, audit committees and senior managers
- The process it will follow before communicating findings, and
- When the commission will inform directors of its routine audit-file reviews.

How to pay dividends

The 30 June reporting season entails dividend considerations for many profit-seeking entities, so a reminder of what the Corporations Act (Sect 254t) says is timely.

A company must not pay a dividend unless:

- Its assets exceed its liabilities *immediately* before the dividend is declared and the excess is sufficient for the dividend payment
- The payment of the dividend is fair and reasonable for the company's shareholders as a whole, and
- The dividend payment does not materially prejudice the company's ability to pay its creditors.

Assets and liabilities are to be calculated according to accounting standards in force.

The payment of a dividend would materially prejudice the company's ability to pay its creditors if the company becomes insolvent as a result of the payment. For directors' duties to prevent insolvent trading on payment of dividends see section 588G.

Size does matter for proprietary companies

ASIC has written to more than 1000 proprietary companies about their size at the end of June last year.

If a company is deemed to be 'large', lodgement of outstanding financial statements is required.

A proprietary company must be limited by shares or be an unlimited company with a share capital, have no more than 50 non-employee shareholders and refrain from anything that would require disclosure to investors under Chapter 6D of the Corporations Act.

A proprietary company is 'small' if it satisfies at least two of the following tests:

- The consolidated revenue for a financial year of it and the entities (if any) it controls is less than $25 million
- The value of its consolidated gross assets and those of its entities is less than $12.5 million, and
- The company and entities have fewer than 50 employees.

Any other proprietary company is deemed 'large'.

In determining revenue and asset value thresholds to lodgement, AASBs need to be applied. Then consideration is given as to whether the financial statements to be lodged are special purpose financial statements or general purpose financial statements.

Whether a proprietary company controls an entity is to be decided in accordance with accounting standards (for example, AASB 10 *Consolidated Financial Statements*). Consolidated revenue and the value of consolidated gross assets are to be calculated according to standards in force at the relevant time.

In counting employees, part-timers are accounted for as appropriate fractions of a full-time equivalent.

Guidance on narrative reporting

If management commentary is part of your external reporting considerations, the IASB and AASB give helpful guidance.

The *IFRS Practice Statement Management Commentary* is not an international standard as such, and entities that apply IFRSs are not required to comply with it. Unless, of course, a regulator requires it.

Nonetheless, the statement is valuable enough to be included on the Australian Accounting Standards Board's website. Entities preparing general-purpose financial statements may elect to apply the principles it outlines in narratives that accompany statements prepared in accordance with Australian standards.

The AASB acknowledges that there are other guides to management commentary and that they might take precedence over the IFRS statement.

APESB issues guidance on management representations

The Accounting Professional and Ethical Standards Board has issued a guidance note to assist professional accountants who prepare, review and approve management-representation statements. Preparers should consider incorporating it into their year-end close-out procedures.

APES guidance note 41 *Management Representations* is directed primarily at chief financial officers or those in senior finance roles. However, it also provides specific guidance on the responsibilities of accountants at differing levels of an organisation.

It highlights the importance of factors such as considering the context and purpose of management representations, using the work of others and acting with sufficient expertise in preparing management representations.

Members in business should also be familiar with their ethical responsibilities under APES 110 *Code of Ethics for Professional Accountants* for preparation and reporting of information (section 320), acting with sufficient expertise (section 330) and financial interests, compensation and incentives linked to financial reporting and decision-making (section 340). All members of professional accounting bodies (CA ANZ, CPA Australia and IPA) must comply with APES 110.

ASIC guides on risk management for responsible entities

ASIC has released regulatory guide 259 *Risk Management systems of responsible entities* to provide extra help about its expectations for compliance with maintaining adequate risk-management systems.

Responsible entities such as Australian financial-services licence-holders have an obligation under s912A(1)(h) of the Corporations Act to have adequate risk-management systems. Until now, there has been no detailed guidance on what is required of responsible entities in complying with this obligation.

The guide is aimed at ensuring that the risk-management of responsible entities – including minimum procedures and practices – are adaptable to changing market conditions.

It promotes early identification and management to avoid adverse consequences that might affect investors. Several responsible entities have collapsed, resulting in significant investors' losses. The commission considered inadequate risk-management systems played a role in the demises.

ASIC expects responsible entities to have:

- Overarching risk-management systems in place
- Processes for identifying and assessing risks, and
- Processes for managing risks.

The commission has included good-practice guidance, which is voluntary for responsible entities. It outlines measures that entities can adopt to enhance their risk-management to operate at a level above their statutory obligations.

As responsible entities are subject to an obligation to maintain adequate risk-management, the commission has not provided any formal transition period for compliance with guidance.

ASIC's stated intention is to take a constructive and facilitative approach to any breaches of the guidance for a period of 12 months from 29 March provided entities can show that they are taking steps to bring their risk-management into compliance.

Audit Committees good-practice guide released

The Institute of Internal Auditors – Australia, the Australian Institute of Company Directors, and the Auditing and Assurance Standards Board have released the latest edition of their joint publication *Audit Committees: A Guide to Good Practice.*

Enhanced audit-reporting standards in force

A new suite of enhanced audit-reporting standards applies to periods ending 30 June 2017. The new and revised standards affect general-purpose and special-purpose financial statements.

The enhanced reporting standards are:

- ASA 700 *Forming an Opinion and Reporting on a Report*
- ASA 701 *Communicating Key Audit Matters in the Independent Auditor's Report*
- ASA 705 *Modifications to the Opinion in the Independent Auditor's Report*
- ASA 706 *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*
- ASA 720 *The Auditor's Responsibilities Relating to Other information*
- ASA 805 *Special Considerations – Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statements*
- ASA 810 *Engagements to Report on Summary Financial Statements*
- ASA 570 *Going Concern*, and
- ASA 260 *Communicating with Those Charged with Governance.*

Conforming amendments resulting from the changes affect the following standards: ASA 210 (engagement terms), ASA 220 (quality control), ASA 230 (audit documentation), ASA 510 (initial engagements), ASA 540 (accounting estimates), ASA 580 (representations), ASA 600 (audit of groups) and ASA 710 (comparatives).

As well as the significant changes to the format and content of auditors' reports (including key audit matters for listed entities) there are significant changes to:

- An auditor's responsibility over other information
- Going-concern basis, and
- Audits of accounting disclosure.

The new auditing standards are likely to drive the following changes:

- Better alignment of financial-reporting disclosures with KAMs and 'other information' in annual reports
- Improved going-concern disclosures, and
- General removal of immaterial and improved disclosures.

KAMs' requirements should also improve governance reporting, auditors' identifying likely KAMs during their planning and for the half-yearly review.

The Auditing and Assurance Standards Board has published a set of frequently-asked questions to help with the adoption of enhanced auditor reporting.

ATO releases revised SMSF independent auditor's report

The Australian Taxation Office has released an updated SMSF independent auditor's report, effective for reporting periods starting on or after 1 July last year.

The report complies with AUASB auditing and assurance standards including ASA 800 *Special Considerations-Audits of Financial Reports Prepared in Accordance with Special Purpose Frameworks* and ASAE 3100 *Compliance engagements*. It can also be used for audits completed for earlier periods provided it is updated to include the SISA and SISR provisions that were relevant to the earlier period.

While the form may appear very different from forerunners, the most significant changes are to the order of paragraphs, some additions to the wording required. An SMSF auditor's opinion now appears at the beginning of reports and the opinion headings align with those in the Australian Prudential Regulation Authority auditor-report form. No changes were made this year to the list of SISA and SISR provisions specified in Part B: Compliance Report.

ASIC releases audit inspection results

ASIC commissioner John Price has called the results of audit-firm inspections 'disappointing'.

The commission reviewed 390 key audit areas across 93 audit files at firms of different sizes. It found that in a quarter of key audit areas auditors did not obtain reasonable assurance of the financial report as a whole, even if it was free of material misstatement. This compares with 19 per cent for the previous 18 months to 30 June 2015.

The results were for audit-firm inspections for the 18 months to 31 December 2016. ASIC has also released three information sheets on improving audit quality and its inspection process.

ASIC's findings are similar to those of previous years and audit regulators in other countries.

The commission's findings suggest that audit firms should continue to pay particular attention to:

- *The audit of asset values* – particularly impairment of non-financial assets, including challenging the reasonableness of any forecasts and key assumptions and the basis of valuation
- *The audit of revenue* – including accounting policy choices, meaningful analytical procedures, and tests of detail, and
- *Maintaining a strong culture of audit quality* – including strong messages from firm leadership, setting expectations, leading by example, coaching, robust review processes, and effective accountability mechanisms.

Commissioner John Price said: 'Auditors play a critical role in ensuring investors can be confident and well-informed. Given the efforts by firms to improve audit quality and the consistency of execution of audits, this is a disappointing result. The findings suggest that further work and, in some cases, new or revised strategies are needed to improve quality.

'We think that good auditors deliver professional, high-quality audits through matters such as applying appropriate experience and expertise, effective internal supervision and review, and having robust accountability mechanisms. We encourage all auditors to work to this standard.'

ASIC's report outlines areas that auditors should continue to focus on to improve quality and consistency of execution. It has also named future focus areas for its inspections.

ASIC states that while firms continue to make good efforts to improve quality and consistency, they should consider enhancing existing initiatives and focus on new and sustainable ones.

Firms should undertake, or continue to undertake, comprehensive analyses to identify underlying root causes of findings from their own reviews of audit files and ASIC's inspections. They should identify effective solutions to address root causes, and consider past initiatives that have been effective in improving audit quality.

ASIC also released three information sheets related to audit quality:

- *Improving and maintaining audit quality* – outlines considerations for auditors to improve and maintain audit quality (INFO 222)
- *Audit quality: The role of others* – outlines how parties other than audit firms can contribute to audit quality (INFO 223), and
- *ASIC audit inspections* – outlines ASIC's approach to inspecting audit firms and measuring inspection findings (INFO 224).

We're here to help

During the 30 June reporting season the *GAAP Consulting* team (Colin Parker, Carmen Ridley, Sonya Sinclair, Stephen Downes, and Stephen Newman) are available to assist you with your financial reporting, ethical and auditing issues as well as with pre-issuance reviews of financial statements, streamlining financial reports, and audit-quality control issues.

Carmen Ridley *GAAP Consulting team leader, corporate financial reporting services*
Carmen Ridley is an expert in financial reporting who was previously Associate Director in the technical team at Grant Thornton, National Technical Director of William Buck, and author of *'Understanding and Implementing the Reduced Disclosure Regime'*, and leads Corporate Financial Reporting Services team. Carmen is a member of the Australian Accounting Standards Board.

Sonya Sinclair *GAAP Consulting team member, corporate financial reporting services*
Sonya Sinclair is a registered company auditor, registered superannuation auditor and quality-control reviewer, CAANZ. Sonya specialises in risk management, implementation of audit quality through development of audit systems and processes, and interpretation and advice on generally accepted accounting and auditing principles.

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Appendix 1 – *ASIC focuses for 30 June 2017 financial reports*

Focus	Principle issue	Considerations
Accounting estimates – impairment testing and asset values	Recoverability of the carrying amounts of assets such as goodwill, other intangibles and property, plant and equipment	Directors and auditors should ensure that: (a) Cash flows and assumptions are reasonable having regard to matters such as historical cash flows, economic and market conditions, and funding costs. Where prior-period cashflow projections have not been met, careful consideration should be given to whether current assumptions are reasonable and supportable (b) Discounted cash flows are not used to determine fair value less costs of disposal where forecasts and assumptions are not reliable. Fair value less costs to sell should not be viewed as a means of using unreliable estimates that could not be used under a value-in-use model (c) For value-in-use calculations use sufficiently reliable cash flow estimates; do not use increasing cash flows after five years that exceed long-term average growth rates, and without taking into account offsetting impacts on discount rates, and do not include cash flows from restructurings and improving or enhancing asset performance (d) Cash flows used are matched to carrying values of assets that generate those cash flows, including inventories, receivables and tax balances (e) Different discount rates are used for cash-generating units (CGUs) where the risks are different and the CGUs are located in different countries, and that similar discount rates are used where the risks are similar (f) CGUs are not identified at too high a level, including where cash inflows for individual assets are not largely independent (g) CGUs for testing goodwill are not grouped at a higher level than the operating segments or the level at which goodwill is monitored for internal management purposes (h) Corporate costs and assets are allocated to CGUs on an appropriate basis where it is reasonable to allocate them, and (i) Appropriate use of fair values for testing exploration and evaluation assets during the exploration and evaluation phase. Asset values may also be affected by the risk of digital disruption.
Accounting estimates – extractive industries and entities providing supporting services	Valuation	Values of assets including assets during the exploration and evaluation phase. Also focus on the adequacy and treatment of any liabilities required for mine restoration and closure costs.
Accounting estimates – inventories	Methodology	Pricing, valuation and accounting for inventories, including the net realisable value of inventories, possible technical or commercial obsolescence, and the substance of pricing and rebate arrangements.
Accounting estimates – financial instruments	Valuation	Valuation of financial instruments, particularly where values are not based on quoted prices or observable market data. Fair values should be based on appropriate models, assumptions and inputs.
Accounting policy choices – revenue	Recognition	Review revenue-recognition policies to ensure that revenue is recognised in accordance with the substance of the underlying transaction. This includes ensuring that: (a) services to which the revenue relates have been performed (b) control of relevant goods has passed to the buyer (c) where revenue relates to both the sale of goods and the provision of related services, revenue is appropriately allocated to the components and recognised accordingly (d) assets are properly classified as financial or non-financial assets, and (e) revenue is recognised on financial instruments on the basis appropriate for the class of instrument. The appropriate timing of revenue recognition may also need careful consideration in industries with complex sale and licensing arrangements that may include continuing obligations, such as software providers.

Focus	Principle issue	Considerations
Accounting policy choices – expense deferral	Recognition as an asset	Expenses are only deferred where: (a) There is an asset as defined in the accounting standards (b) It is probable that future economic benefits will arise, and (c) The requirements of the intangibles accounting standard are met, including expensing start-up, training, relocation and research costs, ensuring that any amounts deferred meet the requirements concerning reliable measurement, and development costs meet the six tests for deferral.
Accounting policy choices – off-balance sheet arrangements	Recognition and disclosure	Carefully review the treatment of off-balance sheet arrangements, the accounting for joint arrangements and disclosures relating to structured entities.
Accounting policy choices –tax accounting	Methodology	Ensure that: (a) There is a proper understanding of both the tax and accounting treatments, and how differences between the two affect tax assets, liabilities and expenses (b) The effect of any recent changes in legislation are considered, and (c) The recoverability of any deferred tax asset is appropriately reviewed.
Key disclosures – estimates and accounting-policy judgements	Disclosures regarding sources of estimation uncertainty and significant judgements in applying accounting policies are important to allow users of financial reports to assess the reported financial position and performance of an entity	Ensure disclosures are made and are specific to the assets, liabilities, income and expenses of the entity. Disclosure of key assumptions and a sensitivity analysis are important. These enable users of the financial report to make their own assessments about the carrying values of an entity's assets and risk of impairment given the estimation uncertainty associated with many asset valuations. Preparers should be particularly mindful to make these disclosures as this information may be revealed under key audit matter disclosures in the new enhanced audit reports for listed entities. Preparers should note that the key audit matter disclosures may also refer to matters that should have been discussed in the operating and financial review.
Effect of new revenue, financial instrument, lease and insurance standards	Disclosure of issued but not-yet-operative accounting standards	Disclose the impact on future financial positions and results of new requirements for recognising revenue, for valuing financial instruments, and accounting for leases. New accounting standards in these areas will apply to future financial reports and may significantly affect how and when revenue can be recognised, the values of financial instruments (including loan provisioning and hedge accounting), and assets and liabilities relating to leases. The IASB has also issued a new accounting standard for insurance contracts.

Appendix 2 – *Accounting Standards operative for the first time from 30 June this year*

The following accounting standards are operative for the first time for 30 June 2017.

AASB 14 *Regulatory deferral accounts*

AASB 14 specifies the financial-reporting requirements for regulatory deferral account balances that arise when an entity provides goods or services to customers at a price or rate that is subject to rate regulation.

A deferral account balance is the balance of any expense (or income) account that would not be recognised as an asset or a liability in accordance with other standards but that qualifies for deferral because it is included, or is expected to be included, by the rate regulator in establishing the rate(s) that can be charged to customers.

Rate regulation is a framework for establishing the prices that can be charged for goods or services and it is subject to oversight and/or approval by a regulator

AASB 14 requires:

- Limited changes to the accounting policies that were applied in accordance with previous GAAP for regulatory deferral account balances, which are primarily related to the presentation of these accounts, and
- Disclosures that identify and explain the amounts recognised in the entity's financial statements that arise from rate regulation. They help users of financial statements to understand the amount, timing and uncertainty of future cashflows from any regulatory deferral account balances that are recognised.

AASB 14 permits an entity to continue to account for regulatory deferral account balances in its financial statements in accordance with its previous GAAP when it adopts Australian accounting standards.

AASB 1056 *Superannuation Entities*

AASB 1056 *Superannuation Entities* specifies requirements for the general purpose financial statements of superannuation entities with a view to providing users with information useful for decision-making.

AASB 1056 replaces AAS 25 *Financial Reporting by Superannuation Plans*.

AASB 1056 requires a superannuation plan to:

- Present a complete set of financial statements in accordance with AASB 101 *Presentation of Financial Statements*
- Measure all assets and liabilities at fair value through profit or loss (with limited exceptions)
- Recognise and measure both defined contribution and defined-benefit member obligations as liabilities at the amount of the members' accrued benefits
- Recognise a receivable from an employer-sponsor in respect of a difference between a defined-benefit member liability and the fair value of the assets available to meet that liability as an asset at its 'intrinsic value', subject to the receivable meeting the definition and recognition criteria for an asset, and
- Require superannuation-specific disclosures.

AASB 1053 *Application of Tiers of Australian Accounting Standards* specifically deems superannuation plans regulated by the Australian Prudential Regulation Authority, other than Small APRA Funds, to be entities that have public accountability. Accordingly, those APRA-regulated superannuation plans that are classified as 'large' prepare Tier 1 general-purpose financial statements.

AASB 1056 does not permit Tier 2 general purpose financial statements for superannuation entities.

AASB 2014-3 *Amendments to Australian Accounting Standards – Accounting for Acquisitions of Interests in Joint Operations*

AASB 2014-3 amends AASB 1 *First-time Adoption of Australian Accounting Standards* and AASB 11 *Joint Arrangements* to provide guidance on the accounting for acquisitions of interests in joint operations in which the activity constitutes a business.

These amendments arise from *Accounting for Acquisitions of Interests in Joint Operations (Amendments to IFRS 11;* May 2014).

The amendments require:

- The acquirer of an interest in a joint operation in which the activity constitutes a business, as defined in AASB 3 Business Combinations, to apply all of the principles on business combinations accounting in AASB 3 and other Australian accounting standards except for those principles that conflict with the guidance in AASB 11, and
- The acquirer to disclose the information required by AASB 3 and other Australian standards for business combinations.

AASB 2014-4 *Amendments to Australian Accounting Standards – Clarification of Acceptable Methods of Depreciation and Amortisation*

AASB 2014-4 amends AASB 116 *Property, Plant and Equipment* and AASB 138 *Intangible Assets*.

The amendments:

- Establish the principle for the basis of depreciation and amortisation as being the expected pattern of consumption of the future economic benefits of an asset
- Clarify that the use of revenue-based methods to calculate the depreciation of an asset is not appropriate because revenue generated by an activity that includes the use of an asset generally reflects factors other than the consumption of the economic benefits embodied in the asset, and
- Clarify that revenue is generally presumed to be an inappropriate basis for measuring the consumption of the economic benefits embodied in an intangible asset. This presumption, however, can be rebutted in certain circumstances.

AASB 2014-6 *Amendments to Australian Accounting Standards – Agriculture: Bearer Plants*

AASB 2014-6 defines a bearer plant and changes its accounting. Bearer plants are required to be accounted under AASB 116 *Property, Plant and Equipment* (cost or fair-value measurement) rather than under AASB 141 *Agriculture* (fair-value measurement).

A bearer plant is a living plant that is used in the production or supply of agricultural produce, is expected to bear produce for more than one period and has a remote likelihood of being sold as agricultural produce, except for incidental scrap sales. Plants such as tea bushes, grape vines, oil palms and rubber trees would usually meet the definition of a bearer plant and would be within the scope of AASB 116.

The produce growing on bearer plants – for example, tea leaves, grapes, oil palm fruit and latex – remain within the scope of AASB 141 and continue to be measured at fair value.

AASB 2014-9 *Amendments to Australian Accounting Standards – Equity Method in Separate Financial Statements*

AASB 2014-9 amends AASB 1 *First-time Adoption of Australian Accounting Standards,* AASB 127 *Separate Financial Statements* and AASB 128 *Investments in Associates and Joint Ventures* to allow investors to use the equity method of accounting for investments in subsidiaries, joint ventures and associates in their separate financial statements.

2015-1 *Amendments to Australian Accounting Standards – Annual Improvements to Australian Accounting Standards 2012–2014 Cycle*

AASB 2015-1 amends the following AASBs through Annual Improvements to IFRSs 2012-2014 Cycle.

The amendments include:

- AASB 5 *Non-current Assets Held for Sale and Discontinued Operations* – clarifies the accounting treatment of an asset held-for-sale that is reclassified as held for distribution to owners, and the reclassification of assets no longer held for distribution to owners
- AASB 7 *Financial Instruments: Disclosures* – clarifies what 'continuing involvement' means in the context of a transferred financial asset and that the offsetting disclosures in AASB 2012-2 *Amendments to Australian Accounting Standards – Disclosures – Offsetting Financial Assets and Financial Liabilities* do not apply to interim statements unless such disclosures provide a significant update to the information provided in the most recent annual report
- AASB 119 *Employee Benefits* – clarifies that the discount rates used to measure defined-benefit obligations should be determined based on the currency in which the obligations are denominated rather than the country where the obligation is located, and
- AASB 134 *Interim Financial Reporting* – clarifies that certain disclosures may be incorporated in an interim financial statement by cross-reference to another part of an interim financial report.

AASB 2015-2 *Amendments to Australian Accounting Standards – Disclosure Initiative: Amendments to AASB 101*

AASB 2015-2 amends some of the presentation and disclosure requirements in AASB 101 *Presentation of Financial Statements*.

The amendments include:

- An entity discloses its significant accounting policies (not a summary of those policies)
- Specific line items in the statement of profit or loss and other comprehensive income and statement of financial position can be disaggregated
- Materiality applies in respect of items specifically required to be presented or disclosed, even when AASB 101 contains a list of specific requirements or describes them as minimum requirements
- Flexibility in relation to the order in which they present their notes, and
- Describing the requirements that apply when additional subtotals are presented in the statement of profit or loss and other comprehensive income and statement of financial position.

AASB 2015-5 *Amendments to Australian Accounting Standards – Investment Entities: Applying the Consolidation Exception*

AASB 2015-5 amends AASB 10 *Consolidated Financial Statements,* AASB 12 *Disclosure of Interests in Other Entities* and AASB 128 *Investments in Associates and Joint Ventures*.

The amendments:

- Clarify that the exemption from preparing consolidated financial statements applies to a parent entity that is a subsidiary of an investment entity that produces financial statements for public use, subject to the investment entity measuring all of its subsidiaries at fair value
- Clarify that only a subsidiary of an investment entity that is not an investment entity itself and that provides investment services is consolidated, and all other subsidiaries are measured at fair value
- Clarify the applicability of AASB 12 *Disclosure of Interests in Other Entities* applies to the financial statements of an investment entity, and
- Introduce relief in AASB 128 *Investments in Associates and Joint Venturers* to permit a non-investment entity investor in an associate or joint venture that is an investment entity to retain the fair value through profit or loss measurement applied by the associate or joint venture to its subsidiaries.

AASB 2015-6 *Amendments to Australian Accounting Standards – Extending Related Party Disclosures to Not-for-Profit Public Sector Entities*

AASB 2015-6 amends AASB 124 *Related Party Disclosures* to extend the scope to include not-for-profit public sector entities. Implementation guidance is included to assist its application.

AASB 2015-7 *Amendments to Australian Accounting Standards – Fair Value Disclosures of Not-for-Profit Public Sector Entities*

AASB 2015-7 relieves not-for-profit public sector entities from certain disclosures of AASB 13 *Fair value* for assets within the scope of AASB 116 *Property, Plant and Equipment* that are held primarily for their current service potential rather than to generate future net cash inflows:

- For recurring and non-recurring fair-value measurements categorised within level 3 of the fair-value hierarchy, quantitative information about the significant unobservable inputs used in the fair-value measurement
- For recurring fair-value measurements categorised within level 3, the amount of the total gains and losses for the period included in profit or loss that is attributable to the change in unrealised gains or losses relating to the assets held at the end of the reporting period and the line item(s) in profit or loss in which those unrealised gains or losses are recognised, and
- For recurring fair-value measurements categorised within level 3, a narrative description of the sensitivity of the fair-value measurement to changes in unobservable inputs if a change in those inputs to a different amount might result in a significantly higher or lower fair-value measurement. Where there are interrelationships between those inputs and other unobservable inputs used in the fair-value measurement, the disclosure of a description of those interrelationships and of how they might magnify or mitigate the effect of changes in the unobservable inputs on the fair-value measurement will also not be required.

Appendix 3 – *Issued but not yet operative accounting standards*

The following standards and interpretations have been issued but are not yet effective for entities with years ending 30 June 2017.

1 January 2017

- AASB 2016-1 *Amendments to Australian Accounting Standards – Recognition of Deferred Tax Assets for Unrealised Losses*
- AASB 2016-2 *Amendments to Australian Accounting Standards – Disclosure Initiative: Amendments to AASB 107*
- AASB 2016-4 *Amendments to Australian Accounting Standards – Recoverable Amount of Non-Cash-Generating Specialised Assets of Not-for-Profit Entities*
- AASB 2016-7 *Amendments to Australian Accounting Standards – Deferral of AASB 15 for Not-for-Profit Entities*
- AASB 2017-2 *Amendments to Australian Accounting Standards - Further Annual Improvements 2014-2016 Cycle*

1 January 2018

- AASB 9 *Financial Instruments*
- AASB 15 *Revenue from Contracts with Customers*
- AASB 2016-3 *Amendments to Australian Accounting Standards – Clarifications to AASB 15*
- AASB 2016-5 *Amendments to Australian Accounting Standards – Classification and Measurement of Share-based Payment Transactions*
- AASB 2016-6 *Amendments to Australian Accounting Standards – Applying AASB 9 Financial Instruments with AASB 4 Insurance Contracts*
- AASB 2017-1 *Amendments to Australian Accounting Standards – Transfers of Investment Property, Annual Improvements 2014-2016 Cycle and Other Amendments (for-profit entities)*

1 January 2019

- AASB 16 *Leases*
- AASB 1058 *Income of Not-for-Profit Entities*
- AASB 2016-8 *Amendments to Australian Accounting Standards – Australian Implementation Guidance for Not-for-Profit Entities*
- AASB 2017-1 *Amendments to Australian Accounting Standards – Transfers of Investment Property, Annual Improvements 2014-2016 Cycle and Other Amendments*
- IFRIC 23 *Uncertainty over Income Tax Treatments*

1 January 2021

- AASB 17 *Insurance Contracts*

Major issued but not yet operative standards

AASB 9 *Financial Instruments*

AASB 9 will replace AASB 139 *Financial Instruments: Recognition and Measurement*.

The key changes include:

- Simplifying the general classifications of financial assets into those carried at amortised cost and those carried at fair value
- Permitting entities to irrevocably elect on initial recognition to present gains and losses on an equity instrument that is not held for trading in other comprehensive income
- Simplifying the rules for embedded derivatives, including removing the requirements to separate and fair-value embedded derivatives for financial assets carried at amortised cost
- Requiring an entity that chooses to measure a financial liability at fair value to present the portion of the change in its fair value due to changes in the entity's own credit risk in other comprehensive income, except when it would create an 'accounting mismatch'
- Introducing a new model for hedge accounting that permits greater flexibility in the ability to hedge risk, particularly with respect to non-financial items, and
- Requiring impairment of financial assets carried at amortised cost based on an 'expected loss model' (replacing the 'incurred loss' model).

Also there are consequential amendments to AASB 7 *Financial Instruments: Disclosure*.

AASB 15 *Revenue from Contracts with Customers*

AASB 15 provides a revised principle for recognising and measuring revenue from goods and services. Under AASB 15, revenue is recognised in a manner that depicts the transfer of promised goods or services to customers in an amount that reflects the consideration to which the provider of the goods or services expects to be entitled.

To give effect to this principle, AASB 15 requires a 5-step revenue-recognition model:

- Identify the contract(s) with a customer
- Identify the performance obligations under the contract(s)
- Determine the transaction price
- Allocate the transaction price to the performance obligations under the contract(s), and
- Recognise revenue when (or as) the entity satisfies the performance obligations.

AASB 15 also provides additional guidance to assist entities in applying the revised principle to licences of intellectual property, warranties, rights of return, principal/agent considerations and options for additional goods and services.

For further information see Special GAAP Report *AASB 15 Revenue from Customer Contracts – the effective date approaches* (www.gaap.com.au).

AASB 16 *Leases*

AASB 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases. The objective is to ensure that lessees and lessors provide relevant information in a manner that faithfully represents those transactions. This information gives a basis for users of financial statements to assess the effect that leases have on the financial position, financial performance and cash flows of an entity.

Under AASB 16 there is no longer a distinction between finance and operating leases for lessees. Lessees will now recognise a right-to-use asset and lease liability onto their statements of financial position with two exceptions (short-term leases and low-value items). Effectively, this means the vast majority of operating leases as defined by AASB 117 *Leases* that are not recognised for the moment on the statement of financial position will be required to be recognised.

For further information see Special GAAP Report *AASB 16 Look before you lease* (www.gaap.com.au).

AASB 1058 *Income of Not-for-Profit Entities*

AASB 1058 establishes principles for not-for-profit entities that apply to transactions where the consideration to acquire an asset is significantly less than fair value principally to enable an NFP to further its objectives and transactions involving the receipt of volunteer services.

AASB 1058 is likely to have a significant impact on NFP income recognition where AASB 15 *Revenue from customer contracts* does not apply. Entities should consider how the following areas are likely to affect them: assets received below fair value; transfers received to acquire or construct non-financial assets; grants received; prepaid rates; and leases entered into at below-market rates.

IFRS 17 *Insurance Contracts*

The International Accounting Standards Board has issued IFRS 17 *Insurance Contracts* that will help investors and others to understand better insurers' risk exposure, profitability and financial positions.

The standard applies to insurance companies as well as contracts. Many non-insurance entities have insurance contracts.

IFRS 17 has an effective date of 1 January 2021 but companies may apply it earlier.

The AASB will consider IFRS 17 for adoption in Australia by the end of July. If adopted, it will replace AASB 1023 *General Insurance Contracts* and AASB 1038 *Life Insurance Contracts*.

Minor issued but not yet operative standards

AASB 2014-10 *Amendments to Australian Accounting Standards – Sale or Contribution of Assets between an Investor and its Associate or Joint Venture*

AASB 2014-10 amends AASB 10 *Consolidated Financial Statements* and AASB 128 *Investments in Associates and Joint Ventures* to clarify the accounting for the sale or contribution of assets between an investor and its associate or joint venture by requiring:

- A full gain or loss to be recognised when a transaction involves a business, whether it is housed in a subsidiary or not, and
- A partial gain or loss to be recognised when a transaction involves assets that do not constitute a business, even if these assets are housed in a subsidiary.

AASB 2016-1 *Amendments to Australian Accounting Standards – Recognition of Deferred Tax Assets for Unrealised Losses*

AASB 2016-1 amends AASB 112 *Income Taxes* to clarify the requirements on recognition of deferred tax assets for unrealised losses on debt instruments measured at fair value. Several new examples are included to illustrate the existing AASB 112 requirements.

AASB 2016-3 *Amendments to Australian Accounting Standards – Clarifications to AASB 15*

AASB 2016-3 amends AASB 15 *Revenue from Contracts with Customers* to clarify the requirements on identifying performance obligations, principal versus agent considerations and the timing of recognising revenue from granting a licence. In addition, it provides further practical expedients on transition to AASB 15.

AASB 2016-4 *Amendments to Australian Accounting Standards – Recoverable Amount of Non-Cash-Generating Specialised Assets of Not-for-Profit Entities*

AASB 2016-4 amends AASB 136 *Impairment of Assets*.

The amendments include:

- Removal of references to depreciated replacement cost as a measure of value-in-use, and
- Clarification that the recoverable amount of primarily non-cash-generating assets, which are typically specialised in nature and held for continuing use of their service capacity, is expected to be materially the same as fair value determined under AASB 13 *Fair Value Measurement*. With the consequence that AASB 136 *Impairment of Assets* does not apply to such assets that are regularly revalued to fair value under the revaluation model in AASB 116 *Property, Plant and Equipment* and AASB 138 *Intangible Assets*, and AASB 136 applies to such assets accounted for under the cost model in AASB 116 and AASB 138.

AASB 2016-5 *Amendments to Australian Accounting Standards – Classification and Measurement of Share-based Payment Transactions*

AASB 2016-5 amends AASB 2 *Share-based Payment*.

The amendments address:

- The accounting for the effects of vesting and non-vesting conditions on the measurement of cash-settled share-based payments
- The classification of share-based payment transactions with a net settlement feature for withholding-tax obligations, and
- The accounting for a modification to the terms and conditions of a share-based payment that changes the classification of the transaction from cash-settled to equity-settled.

AASB 2016-6 *Amendments to Australian Accounting Standards – Applying AASB 9 Financial Instruments with AASB 4 Insurance Contracts*

AASB 2016-6 amends AASB 4 *Insurance Contracts*.

It permits issuers of insurance contracts to choose to:

- Apply the 'overlay approach' that involves applying AASB 9 *Financial Instruments* and also applying AASB 139 *Financial Instruments: Recognition and Measurement* to eligible financial assets to calculate a single-line item adjustment to profit or loss so that the overall impact on profit or loss is the same as if AASB 139 had been applied, or
- Be temporarily exempt from AASB 9 when those issuers' activities are predominantly connected with insurance, provided they make additional disclosures to enable users to make comparisons with issuers applying AASB 9.

AASB 2016-7 *Amendments to Australian Accounting Standards – Deferral of AASB 15 for Not-for-Profit Entities*

AASB 2016-7 amends the mandatory effective date (application date) of AASB 15 for not-for-profit entities so that AASB 15 is required to be applied by such entities for annual reporting periods beginning on or after 1 January 2019 instead of 1 January next year.

IFRIC 23 *Uncertainty over Income Tax Treatments*

The International Accounting Standards Board has issued IFRIC 23 *Uncertainty over Income Tax Treatments* to specify how to reflect uncertainty in accounting for income taxes.

It may be unclear how tax law applies to a particular transaction or circumstance or whether a taxation authority will accept a company's tax treatment. IAS 12 *Income Taxes* specifies how to account for current and deferred tax but not how to reflect the effects of uncertainty. IFRIC 23 provides requirements that add to the requirements in IAS 12 by specifying how to reflect the effects of uncertainty in accounting for income taxes.

The interpretation is effective from 1 January 2019.

The AASB has not yet issued an Australian equivalent to IFRIC 23.

Appendix 4 – *Lessons from ASIC review of 31 December 2016 financial reports*

The detailed findings reported by ASIC were:

Issue	Finding
Asset values and impairment testing	Determining the carrying amount of cash generating units (CGUs): Cases where entities: • Appear to have identified CGUs at too high a level despite cash inflows being largely independent, resulting in cash flows from one asset or part of the business being incorrectly used to support the carrying values of other assets • Did not include all assets that generate the cash inflows in the carrying amount of a CGU, such as inventories and trade receivables and tax balances, and • Incorrectly deducted liabilities from the carrying amount of a CGU. *Reasonableness of cash flows and assumptions:* There continue to be cases where the cash flows and assumptions used in determining recoverable amounts are not reasonable or supportable having regard to matters such as historical cash flows, economic and market conditions, and funding costs. In particular: • Assumptions derived from external sources were not assessed for consistency and relevance, and • Forecast cash flows did not appear reasonable and had exceeded actual cash flows for several reporting periods. *Use of fair value:* ASIC still sees entities using discounted cashflow techniques to estimate fair value where the calculations are dependent on a large number of management inputs. Where it is not possible to reliably estimate the value that would be received to sell an asset in an orderly transaction between market participants, the entity may need to use the asset's value-in-use as its recoverable amount. *Impairment indicators:* Some entities are not having sufficient regard to impairment indicators such as significant adverse changes in market conditions and reported net assets exceeding market capitalisation. *Disclosures:* ASIC is still finding that several entities do not make necessary disclosures of: • Sensitivity analysis where there is limited excess of an asset's recoverable amount over the carrying amount and where a reasonably possible change in one or more assumptions could lead to impairment • Key assumptions, including discount rates and growth rates, and • For fair values, the valuation techniques and inputs used. These disclosures are important to investors and other users of financial reports given the subjectivity of these calculations/ assessments. They enable users to make their own assessments about the carrying values of an entity's assets and risk of impairment given the estimation uncertainty associated with many asset valuations.
Consolidation accounting	Enquiries were made of five entities on their non-consolidation. In one case, an entity relied on the exemption from consolidation for investment entities and recognised investments in controlled entities at fair value, but the entity may not meet the definition of an 'investment entity'.
Amortisation of intangible assets	ASIC enquired of three entities covering the non-amortisation of intangible assets or the period over which the assets were amortised.
Revenue recognition	ASIC is following up a matter concerning the recognition of revenue on contracts that involve the provision of services in the future.
Tax accounting	ASIC is making enquiries of two entities concerning their accounting for income tax and in particular where it appears that future taxable income may not be sufficient to recover deferred tax assets.
Estimates and accounting-policy judgements	ASIC observed instances where entities needed to improve the quality and completeness of disclosures on estimation uncertainties and significant judgments in applying accounting policies. The disclosure requirements are principle-based and should include all information necessary for investors and others to understand the judgements made and their effects. This may include key assumptions, reasons for judgements, alternative treatments, and appropriate quantifications. These disclosures are important to allow users of financial reports to assess an entity's reported position and performance.