WK Financial Reporting Update

A brief round-up of the changes during the first four months of 2015

The end of 2014 and the first few weeks of 2015 have been busy for the standard setters, with two new standards and a number of amendments issued. Further details on all of these changes, and the text of the standards themselves can be found at www.aasb.gov.au.

Final Financial Instruments standard issued

The long awaited complete version of IFRS/AASB 9 *Financial Instruments: Recognition and Measurement* was issued in Australia in late December 2014, operative for periods beginning on or after 1 January 2018. Most of the significant changes have occurred in the treatment of financial assets. The only change in respect of financial liabilities was to require that where an entity's own debt is carried at fair value the impact of changes in fair value should be included in other comprehensive income rather than the profit and loss account. This avoids the counter-intuitive inclusion in profits of the impact of the decline in an entity's own debt if its credit rating deteriorated, which was present in IAS 39/AASB 139.

The project to replace IAS 39/AASB 139 has resulted in a staged issue of the new standard which has three sections.

- Recognition and measurement is determined by the entity's business model for managing the assets and the characteristics of its cash flows. In particular financial assets are subject to one classification approach which avoids bifurcation of assets. This approach is based on understanding the conjunction of the business model and the contractual cash flows of the asset. The way the asset is managed in the business determines how the asset is to be accounted for: at amortised cost, fair value through the profit and loss account or fair value through other comprehensive income. The intent is to provide a simpler set of classification rules and a means of reflecting the assets in the financial statements in a manner that reflects their business purpose.

- Impairment has moved to a 3-stage "expected loss" approach, to avoid the delay in recognising impairment noted during the financial crisis. By allowing anticipation of the need to make provision against financial assets the standard will introduce a degree of prudence not present in IAS 39 with its emphasis on "incurred" losses. Arguably, this is a more useful presentation of the state of a business' financial assets.
    - At inception, the entity recognises "12 month expected credit losses" (the effect of the entire expected lifetime credit loss on an asset weighted by the probability that this loss will occur in the next 12 months).
    - If the credit risk increases significantly, the model moves to Stage 2. At Stage 2, "lifetime expected credit losses" (an expected present value measure of losses that arise if a borrower defaults on their obligation throughout the life of the financial

instrument. They are the weighted average credit losses with the probability of default as the weight. This measure includes the impairment calculated at Stage 1)
    - If the credit risk increases to the point where it is considered credit impaired, the model moves to Stage 3. At this stage a financial asset is generally individually assessed and interest is calculated based on the amortised cost. Stage 2 losses are still recognised on these assets. There is guidance on measuring expected credit losses and assessing increases in credit risk.
- Hedge accounting under IFRS/AASB 9 is aligned more closely with risk management and the provisions were first published in November 2013. Hedging is now permitted for components of non-financial assets (eg the oil price component of jet fuel) and eligibility for hedge accounting is proved using the entity's risk management data. The IASB is still working on a separate project on accounting for macro hedging.

IFRS/AASB 9 is operative for periods beginning on or after 1 January 2018, with early adoption permitted. A project summary is available from the IASB's website http://www.ifrs.org/current-projects/iasb-projects/financial-instruments-a-replacement-of-ias-39-financial-instruments-recognitio/documents/ifrs-9-project-summary-july-2014.pdf.

The new revenue standard at last

Another project that has been long in preparation is the new revenue standard, IFRS/AASB 15, issued in Australia in December 2014. The new standard pulls together into one place and one coherent approach material from the existing revenue and construction contracts standards, IAS 18/AASB 118 and IAS 11/AASB 111 and a number of interpretations.

For many entities recognising sales or services revenue, earned within a short time-frame, the change in standard will have no impact, but where contracts are more complex or longer in duration, such as combined sales and service contracts, the new standard provides an approach to analysing the contract with the customer and determining when revenue is recognised and existing arrangements should be reviewed to ensure they continue to comply under the new standard. (Note that the outcome of applying the IFRS/AASB 15 approach, however, may well be the same as was determined under the old standards and interpretations.) The steps are:

- Identify the contract (s) with the customer
- Identify the performance obligations in the contract
- Determine the transaction price
- Allocate the transaction price to the performance obligations
- Recognise revenue when each performance obligation is satisfied, ie when the customer has control of the physical item or service.

The new standard contains guidance on matters such as:

- What to do when there are modifications to the contract
- How to identify performance obligations – distinct or incidental?
- Allocating the transaction price, including estimating a stand-alone selling price in a composite contract
- Practical issues surrounding control.

The new standard is operative for periods beginning on or after 1 January 2017 with early application permitted. However, as comparatives for the previous year need to be prepared entities should be reviewing their arrangements with customers now to see whether they will be affected by the changes. The IASB have prepared a project summary which can be downloaded from their website to assist constituents http://www.ifrs.org/Current-Projects/IASB-Projects/Revenue-Recognition/Documents/IFRS-15/Revenue-from-Contracts-Project-summary-Feedback-Statement-May-2014.pdf.

Amendments to a variety of standards, both major and minor

The AASB has also reissued a large number of amendments to its standards, most of which were previously made by the IASB. While early adoption of changes is generally permitted, preparers need to take care that early adoption does not bring with it an obligation to apply other standards early and need to keep a close eye on the text of the underlying standard they are applying. Great care is taken by the AASB in issuing compilations and consequently issuing them takes time.

- AASB 2014-5 Amendments to Australian Accounting Standards arising from AASB 15, operative from 1 January 2017;
- AASB 2014-6 Amendments to Australian Accounting Standards – Agriculture: Bearer Plants, operative from 1 January 2016;
- AASB 2014-7 Amendments to Australian Accounting Standards arising from AASB 9 (December 2014), operative from 1 January 2018;
- AASB 2014-8 Amendments to Australian Accounting Standards arising from AASB 9 (December 2014) – Application of AASB 9 (December 2009) and AASB 9 (December 2010), operative from 1 January 2015;
- AASB 2014-9 Amendments to Australian Accounting Standards – Equity Method in Separate Financial Statements, operative from 1 January 2016;
- AASB 2014-10 Amendments to Australian Accounting Standards – Sale or Contribution of Assets between an Investor and its Associate or Joint Venture, operative from 1 January 2016;
- AASB 2015-1 Amendments to Australian Accounting Standards – Annual Improvements to Australian Accounting Standards 2012-2014 Cycle, operative from 1 January 2016;
- AASB 2015-2 Amendments to Australian Accounting Standards – Disclosure Initiative: Amendments to AASB 101, operative from 1 January 2016;
- AASB 2015-3 Amendments to Australian Accounting Standards arising from the Withdrawal of AASB 1031 Materiality, operative from 1 July 2015;
- AASB 2015-4 Amendments to Australian Accounting Standards – Financial Reporting Requirements for Australian Groups with a Foreign Parent, operative from 1 July 2015;
- AASB 2015-5 Amendments to Australian Accounting Standards – Investment Entities: Applying the Consolidation Exception, operative from 1 January 2016;
- AASB 2015-6 Amendments to Australian Accounting Standards – Extending Related Party Disclosures to Not-for-Profit Public Sector Entities, operative from 1 July 2016.

AASBs 2014-5, 2014-7 and 2014-8 contain consequential amendments needed as a result of issuing AASB/IFRS 9 on financial instruments and AASB/IFRS 15 on revenue.

AASB 2014-6 makes changes to AASB 116/IAS 16 *Property, Plant and Equipment* and AASB 141/IAS 41 *Agriculture* in that it includes a new separate definition for *bearer plants* and requires them to be accounted for as property, plant and equipment.

AASB 2014-9 amends AASB 127/IAS 27 *Separate Financial Statements* to allow entities to use equity accounting in their separate financial statements when accounting for associates or joint ventures. It also includes consequential amendments to AASB/IFRS 1 on first time adoption of the international standards and AASB 128/IAS 28 Investments in Associates and Joint Ventures

AASB 2014-10 amends AASB/IFRS 10 Consolidated Financial Statements and AASB 128/IAS 28 to address an inconsistency between the requirements in AASB 10 and those in AASB 128 (August 2011 version), in dealing with the sale or contribution of assets between an investor and its associate or joint venture. The amendments require:

(a) a full gain or loss to be recognised when a transaction involves a business (whether it is housed in a subsidiary or not); and
(b) 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 2015-1's amendments are putting through the amendments made in the IASB's Annual Improvements Cycle 2012 to 2014. The standard covers such issues as:

- Changes in methods of disposal;
- Servicing contracts;
- Applicability of the amendments to AASB 7 Financial Instruments: Disclosures to condensed interim financial statements;
- Discount rate: Regional market issue; and
- Disclosure of information 'elsewhere in the interim financial report'.

AASB 2015-2 makes amendments to AASB 101 (IAS 1) *Presentation of Financial Statements* arising from the IASB's Disclosure Initiative project. It clarifies that entities should not be disclosing immaterial information.

AASB 2015-3 completes the AASB's project to remove Australian guidance on materiality from Australian Accounting Standards, thereby aligning the text of the AASB standards even more closely with that of the IASB. Materiality as a concept, however, continues to be highly relevant in effective financial reporting and has played a key part in the IASB's Disclosure Initiative.

AASB 2015-4 aligns the relief available in AASB 10 *Consolidated Financial Statements* and AASB 128 *Investments in Associates and Joint Ventures* in respect of the financial reporting requirements for Australian groups with a foreign parent.

AASB 2015-5 amends AASB 10, AASB 12 *Disclosure of Interests in Other Entities* and AASB 128 arising from the IASB's narrow scope amendments exempting Investment Entities from the requirement to consolidate entities they might otherwise appear to control.

AASB 2015-6 extends the scope of AASB 124 *Related Party Disclosures* to include not-for-profit public sector entities, such as governments and councils, and includes implementation guidance.

This amending standard does not reflect a change to the underlying IAS 24, as the IASB's standards only apply to for-profit entities.

IN THE PIPELINE

AASB Exposure Drafts

The AASB has issued **ED 258** *Disclosure Initiative* (Proposed amendments to AASB 107) and **ED 259** *Classification of Liabilities* (Proposed amendments to AASB 101), both of which incorporate IASB exposure drafts. ED 258 proposes amendments to the disclosures supporting the statement of cash flows to improve information about an entity's financing arrangements and liquidity and ED 259, which proposes to clarify the requirements for distinguishing between current and non-current liabilities. We have written in support of both exposure drafts.

Leasing

Readers will be aware that the IASB has been working on a project to revise the leasing standard and remove the distinction between operating and finance leases, a project that has been running since the days of the G4+1 group of standard setters in the 1990s. While the IASB and FASB have been working together on the project it is unlikely that they will issue identical standards.

In March, in response to calls for information on the practical impacts of the proposed new standard, the IASB published a short paper *Leases: Practical implications of the new leases standard* [http://www.ifrs.org/Current-Projects/IASB-Projects/Leases/Documents/Practical-implications-Leases-Standard-Project-Update-March-2015.pdf] to assist constituents in preparing for a new standard and clarify where the IASB and FASB differ. As expected, the new standard will contain just one method for accounting for leasing, but the IASB plan to allow exceptions for short term and low value leases. The paper contains examples of the effect of the proposals on balance sheet, income statement and cash flow statement of a retailer, an airline and a distributer.