

# fasttrack

Financial Accounting Standards & Technical

Grant Thornton 

## What's new for June 2007 financial reporting?

It is generally all good news particularly following the adoption of International Financial Reporting Standards (IFRS) in 2006. So, one can catch breath in 2007 with only minimal changes to the applicable Accounting Standards.

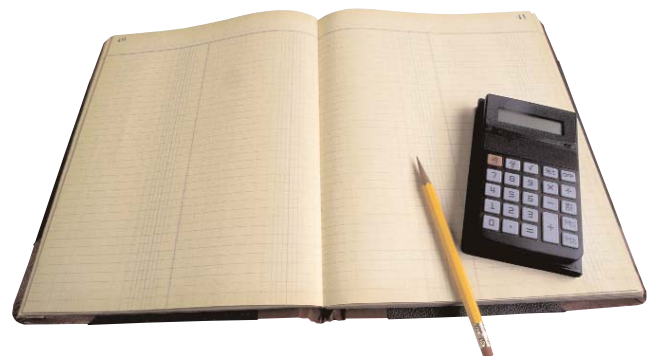
However, now is the opportunity to go back and consider whether the various first time accounting disclosures made in 2006 could be further improved following a year of IFRS experience.

Guidance on International Financial Reporting Standards is now available electronically from Grant Thornton International's (GTI) Example Financial Statements. These can be accessed at [www.granthornton.com.au](http://www.granthornton.com.au).

These specimen financial statements also include the latest international thinking on some of the newer disclosures that will apply after 2007 but

which in the Australian context can be adopted earlier. These include:

- capital amendment disclosures (AASB 101/IAS 1)
- the complex disclosure requirements of AASB 7/IFRS 7
- the newly released AASB 8/IFRS 8 Segment Reporting Standard



## Disclosure of **new standards** not yet applied

Whilst the new Standards do not have to be adopted until 2009 or later, there is a catch in the Accounting Policies Standard AASB 108 which requires disclosure of all new or amended Accounting Standards and their likely financial impact on the financial statements when first applied. As at the date of this newsletter the following disclosures need to be considered.

### Accounting standards

AASB No.	Title	Issue Date	Operative Date
7	Financial Instruments: Disclosures	Aug 2005	1 Jan 2007
8	Operating Segments	Feb 2007	1 Jan 2009
101	Presentation of Financial Statements (Amended)	Oct 2006	1 Jan 2007
123	Borrowing Costs (Amended)	June 2007	1 Jan 2009
2007-4	Amendments to Australian Accounting Standards arising from ED 151 and Other Amendments [AASB 1, 2, 3, 4, 5, 6, 7, 102, 107, 108, 110, 112, 114, 116, 117, 118, 119, 120, 121, 127, 128, 129, 130, 131, 132, 133, 134, 136, 137, 138, 139, 141, 1023 & 1038]	April 2007	1 July 2007
2007-5	Amendments to Australian Accounting Standard – Inventories Held for Distribution by Not-for-Profit Entities [AASB 102]	May 2007	1 July 2007

These Australian Accounting Standards have been issued or amended and are applicable to the parent and consolidated group but are not yet effective. They have not been adopted in preparation of the financial statements at reporting date.

### AASB & UIG interpretations

No.	Title	Issue Date	Operative Date (Annual reporting periods beginning on or after)
4	Determining whether an Arrangement contains a Lease [revised]	Feb 2007	1 Jan 2008
10	Interim Financial Reporting and Impairment	Sept 2006	1 Nov 2006
11	AASB 2 – Group and Treasury Share Transactions	Feb 2007	1 Mar 2007
12	Service Concession Arrangements	Feb 2007	1 Jan 2008
129	Service Concession Arrangements: Disclosures [revised]	Feb 2007	1 Jan 2008

## Analysis of the changes...

The following standards will be adopted by the entity during the first annual reporting period after the effective date of each pronouncement.

### AASB 7

This Standard requires disclosure of:

- a) the significance of financial instruments for an entity's financial position and performance. These disclosures incorporate many of the requirements previously in AASB 132 Financial Instruments: Disclosure and Presentation; and
- b) qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about credit risk, liquidity risk and market risk. The qualitative disclosures describe management's objectives, policies and processes for managing those risks.

The quantitative disclosures provide information about the extent to which the entity is exposed to risk, based on information provided internally to the entity's key management personnel. Together, these disclosures provide an overview of the entity's use of financial instruments and the related risk.

Adoption of AASB 7 is likely to result in increased financial instrument disclosures particularly those regarding the credit quality of financial assets but will not impact on amounts presented in the financial statements.



## Analysis of the changes...continued

### AASB 8

This Standard:

- a) specifies how an entity should report information about its operating segments in annual financial reports and, as a consequential amendment to AASB 134 Interim Financial Reporting, requires an entity to report selected information about its operating segments in interim financial reports. It also sets out requirements for related disclosures about products and services, geographical areas and major customers
- b) requires an entity to report financial and descriptive information about its reportable segments. Reportable segments are operating segments or aggregations of operating segments that meet specified criteria. Operating segments are components of an entity about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. Generally, financial information is required to be reported on the same basis as is used internally for evaluating operating segment performance and deciding how to allocate resources to operating segments
- c) requires an entity to report a measure of operating segment profit or loss and of segment assets. It also requires an entity to report a measure of segment liabilities and particular income and expense items if such measures are regularly provided to the chief operating decision maker. It requires reconciliations of total reportable segment revenues, total

profit or loss, total assets, liabilities and other amounts disclosed for reportable segments to corresponding amounts in the entity's financial statements

- d) requires an entity to report information about the revenues derived from its products or services (or groups of similar products and services), about the countries in which it earns revenues and holds assets, and about major customers, regardless of whether that information is used by management in making operating decisions. However, the Standard does not require an entity to report information that is not prepared for internal use if the necessary information is not available and the cost to develop it would be excessive
- e) requires an entity to give descriptive information about the way the operating segments were determined, the products and services provided by the segments, differences between the measurements used in reporting segment information and those used in the entity's financial statements, and changes in the measurement of segment amounts from period to period

AASB 8 will result in a change in the segment disclosures presented in the financial report such that the segments presented will not be based on primary and secondary segments but reflect those segments and amounts regularly reviewed by the entity's chief operating decision maker. While the amounts presented in the financial statements will not change the amounts presented in the segment reporting note may differ to those

currently presented as a result of AASB 8 requiring the amounts presented to be based on those seen by the entity's chief operating decision maker.

### AASB 101 (Amended)

An entity shall disclose information that enables users of its financial report to evaluate the entity's objectives, policies and processes for managing capital.

The entity discloses the following:

- a description of what it manages as capital;
- when an entity is subject to externally imposed capital requirements:
  - the nature of those requirements
  - how those requirements are incorporated into the management of capital
  - how it is meeting its objectives for managing capital
- summary quantitative data about what it manages as capital
- any changes in above from the previous period
- whether during the period it complied with any externally imposed capital requirements to which it is subject
- when the entity has not complied with such externally imposed capital requirements, the consequences of such non-compliance

Adoption of these amendments is likely to result in increased disclosures particularly those regarding the entity's objectives, policies and processes for managing capital but will not impact on amounts presented in the financial statements.

## Analysis of the changes...continued

### AASB 123

In relation to borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset, AASB 123 as issued in July 2004 permitted entities to either:

- a) immediately recognise them as an expense; or
- b) capitalise them as part of the carrying amount of a qualifying asset.

Under this Standard, only the capitalisation treatment is permitted.

Adoption of the revised AASB 123 will result in the capitalisation of all interest expenses on qualifying assets. The entity has been unable to assess (as at authorisation of this financial report) the financial impact of this change on the entity's financial report in the period of initial application.

### AASB 2007-4

These amendments arise as a result of the AASB decision that, in principle, all options that currently exist under IFRSs should be included in the Australian equivalents to IFRSs and additional Australian disclosures should be eliminated, other than those now considered particularly relevant in the Australian reporting environment.

Adoption of AASB 2007-4 will result in reduced disclosures within the financial report of the entity in particular those relating to defined benefit superannuation plans and interim financial reporting. AASB 2007-4 also provides the entity with additional recognition, measurement and presentation alternatives. The entity has not decided on the possible adoption of these alternatives and has therefore been unable to assess (as at authorisation of this financial report) the financial impact of this change on the entity's financial report in the period of initial application.

### AASB 2007-5

Paragraph Aus9.1 of AASB 102 issued in July 2004 requires inventories held for distribution by not-for-profit entities to be measured at the lower of cost and current replacement cost. This Standard changes paragraph Aus9.1 to require inventories held for distribution by not-for-profit entities to be measured at cost, adjusted when applicable for any loss of service potential. An explanatory paragraph Aus9.2 is added to make it clear that identifying and measuring a loss of service potential based on the

existence of a current replacement cost that is lower than cost remains an appropriate approach for many entities.

Adoption of AASB 2007-5 is unlikely to have a material impact on the entity's financial report as the entity will continue to use current replacement cost that is lower than the cost to identify and measure a loss of service potential.

### Interpretation 4 (revised)

This Interpretation specifies criteria for determining whether an arrangement is, or contains, a lease. The determination is based on an assessment of whether fulfilment of the arrangement is dependent on the use of a specific asset and whether the arrangement conveys a right to use the asset. Further, reassessment of whether an arrangement is, or contains, a lease is based on whether there is a change in the contractual terms of the arrangement, exercise of a renewal option, an extension of the arrangement, a change in the determination of whether fulfilment is dependent on a specified asset or a substantial change to the asset.

If an arrangement contains a lease, the parties to the arrangement apply the requirements of AASB 117 Leases to the lease element of the arrangement, unless exempted from those requirements by the Standard. Accordingly, if an arrangement contains a lease, that lease is classified as a finance lease or an operating lease. Other elements of the arrangement not within the scope of AASB 117 are accounted for in accordance with other Standards.

Adoption of Interpretation 4 (revised) is unlikely to have a material impact on the entity's financial report as the entity has no current or expected arrangements which would fall within the scope of this interpretation.



## Analysis of the changes...continued

### Interpretation 10

AASB 134 Interim Financial Reporting requires an entity to apply the same accounting policies in its interim financial report as are applied in its annual financial report. It also states that measurements for interim reporting purposes are made on a year-to-date basis so that the frequency of reporting does not affect an entity's annual results.

However, this Interpretation clarifies that an entity cannot reverse an impairment loss recognised in a previous interim period in relation to goodwill or an investment in an equity instrument or in a financial asset carried at cost. This approach is consistent with the impairment reversal prohibitions in AASB 136 Impairment of Assets and AASB 139.

Adoption of Interpretation 10 is unlikely to have a material impact on the entity's financial report as the entity has not experienced any impairments of the type described in interpretation 10 during any interim financial period.

### Interpretation 11

This Interpretation addresses whether certain types of share-based payment transactions with employees (or other suppliers of good and services) should be accounted for as equity-settled or as cash-settled transactions under AASB 2. For example, the Interpretation clarifies that when an entity's employees are granted rights to the entity's equity instruments either by the entity or its shareholders, the transactions are accounted for as equity-

settled transactions. This is so whether the entity chooses to or is required to buy the equity instruments from another party or the shareholders provide the necessary equity instruments.

This Interpretation also specifies the accounting in a subsidiary's financial statements for share-based payment arrangements involving equity instruments of the parent.

Adoption of Interpretation 11 is unlikely to have a material impact on the entity's financial report as the entity has not entered into any transactions of the type described by Interpretation 11.

### Interpretation 12

This Interpretation addresses service concession arrangements under which private sector entities participate in the development, financing, operation and maintenance of infrastructure for the provision of public services, such as transport, water and energy facilities.

If the operator provides construction or upgrade services the consideration received or receivable by the operator shall be recognised at its fair value. The consideration may be rights to:

- a financial asset, or
- an intangible asset

Adoption of Interpretation 12 is unlikely to have a material impact on the entity's financial report as the entity has not entered into any transactions of the type described by Interpretation 12.

### Interpretation 129 (revised)

Prescribes disclosure requirements for service concession arrangements including:

- description of the arrangement
- rights and obligations
- renewal and termination options
- changes to the arrangements during the period
- how the arrangement is classified
- revenue and profit/loss recognised in the period on exchanging construction services for a financial or intangible asset

Adoption of Interpretation 129 (revised) is unlikely to have a material impact on the entity's financial report as the entity has not entered into any transactions of the type described by Interpretation 129 (revised).

Note that what we have presented here is not an exhaustive list of accounting standards that have been issued but not yet effective, but rather, represents the standards most likely to have a material impact on Australian organizations. The majority of applicable standards which have not been included on this list make wording or other minor changes to accounting standards.

Grant Thornton also produces an Australian Model Financial Accounts book and CD-Rom, which not only includes templates for various types of entities but also checklists and background guidance. Further details of this publication can be obtained from your local audit engagement partner.

## Significant **standards changes** for June 2007

### **AASB 8 Operating Segments**

Although this Standard has an applicability date of financial years ending on or after 1 July 2009, the fact that it now is restricted to essentially listed companies means that all reporting entities that are not listed, can adopt AASB 8 now and avoid the necessity to provide segment reporting that applied under the former AAS 114 standard.

AASB 3 Business Combinations now has a scope restriction for businesses under common control. What this means is that where there is an internal reconstruction within a group, the accounting can be at current (book) values rather than fair values with consequent adjustments for good will, etc.

### **AASB 121 The Effects of Changes in Foreign Exchange Rates**

A monetary item can be denominated in any currency and still be part of the reporting entity's net investment in a foreign operation, and the entity that has a monetary item receivable from or payable to a foreign operation may be any subsidiary of the group.

### **AASB 139 Financial Instruments**

Three amendments to the most complicated and convoluted Standard ever issued!

- a) clarification that financial guarantee contracts are caught by AASB 139 and must be fair valued although if the contract was previously accounted for as an insurance contract, an election can be made to continue to account for individual contracts on an insurance basis
- b) restrictions on designating financial assets and liabilities at fair value in the Profit and Loss so that it must be for an accounting mismatch or is part of the documented risk management/investment strategy; and
- c) cash flow hedge accounting of forecast intragroup transactions now allowed

### **AASB Interpretations**

- 4 Leases - use substance over form to determine if it is a lease
- 5 Decommissioning, restoration and environmental rehabilitation costs are a liability
- 8 Share based payments resulting in equity issued includes the value of any goods or services received
- 9 Reassessment of embedded derivatives where there is a change in the host contract



## Simpler regulatory systems act

As detailed in Grant Thornton's May 2007 FastTrack, the increase in the threshold size tests for large proprietary companies by a 2.5 factor will be particularly welcomed by many SMEs. The new size tests for large proprietary companies (two out of three) that apply for 30 June 2007 are:

- consolidated revenue \$25 million or more
- consolidated gross assets \$12.5 million or more
- 50 or more employees

The Government has also ensured that the threshold size tests can be regularly updated via the Corporations Regulations so we should not have to wait for another 10 years for the tests to be updated.

However, if any former large proprietary companies had been grandfathered (not required to lodge financial details with ASIC), consideration needs to be given as to whether the companies might later exceed the size tests and hence need an audit to continue to satisfy future grandfathering. Once an audit is no longer conducted, any grandfathering relief is lost for all time.

The new threshold size test also applies to registered foreign companies and proprietary companies that are controlled by a foreign company. ASIC Class Order Relief has been announced and will be finalised in August. Companies that are foreign controlled and are now small will need to lodge the usual Form 384 within four months after year end or by 31 October 2007 to get the threshold relief for their 2007 and 2008 financial reports.

Apart from the increase in the threshold tests for large proprietary companies, the other significant reform that also applies for 30 June 2007 is the default option for companies to make their annual reports available on the internet unless a shareholder requests a mailed printed copy.

What will not apply until 2008 is the tidying up of the directors and executives remuneration disclosures. Although the Act has consolidated some of the current disclosure requirements in the Accounting Standards, the AASB needs to amend its existing Standards so that the Corporations Regulations can pick up those remaining requirements, and this will not happen immediately.

### Late Amendments to Auditing Standards

While this is not normally an issue that clients have to worry about, the implications of the Auditing and Assurance Standards Board's 28 June 2007 decision to amend the format of the Auditors' Report will have implications for those Companies that are adopting AIFRS. The Auditors' Report is now required to include an additional statement of the auditors' opinion, when a company has included a statement of compliance with IFRS in the notes to the financial statements as required by AAS 101.

This amendment was seen as necessary to recognise that Australian financial statements are in accordance with both the Australian equivalent to IFRS and IFRS itself. A minor change is also being made in the Governance section of the auditors report to make it clear that Directors are responsible for 'establishing' and maintaining internal controls relevant to the preparation and presentation of the financial statements.

## Significant **standards changes** for June 2007

### Reform for Financial reporting for unlisted public companies

The Government has released a Discussion Paper seeking comments by 3 August 2007 on the concept of a threshold size test for smaller non-listed public companies. Whilst the Discussion Paper does not identify any preferred threshold size tests, the statistics on the number of quite small unlisted public companies, do support some differential relief.

Of the 11,000 companies limited by guarantee (e.g. sporting clubs and associations), around 40% have assets and revenues under \$200,000 and the number jumps to just over 60% if a cut off of \$1 million is used. Similarly other unlisted public companies that have a share capital are also quite economically insignificant with between 30% and 40% of such companies having less than \$1 million in assets or revenues.

Unlisted public companies are currently required to be audited and lodge financial statements with ASIC. Given the AASB's proposal to eliminate the reporting entity concept in favour of an IFRS for SMEs, there appears to be strong grounds for exempting the smaller, unlisted, and particularly the companies limited by guarantee, from what is currently costly financial reporting requirements which are likely to become much more expensive if International Accounting Standards are made to apply in the future.

Whilst such reforms will not apply until at least 2008, the current Government and Grant Thornton are both supportive of reducing unnecessary red tape. A copy of the discussion paper is available on the Treasury website at:

<http://www.treasury.gov.au/contentitem.asp?NavId=037&ContentID=1269>

### IFRS for SMEs

As detailed in Grant Thornton's May 2007 FastTrack, the AASB has issued the International Accounting Standards Board's (IASB) February 2007 IFRS for SMEs Exposure Draft (ED) as an Invitation to Comment for Australian comment (due 1 September 2007). Initial feedback locally and globally is that the ED/ITC is still too complicated for SMEs and even medium size businesses. Hopefully the IASB will significantly simplify the ED when it gets to the Standard stage. Ideally it should be re-exposed for comment in 2008.

The AASB's proposed application clauses have also been subject to much criticism with the AASB's determination to eliminate the more simplified non-reporting entity reporting which has operated successfully for some 15 years, not being at all popular. This also appear at odds with the Commonwealth Government's red tape reduction program which is designed to simplify financial reporting requirements for the SME market, and generally relieve most Australian businesses from unnecessary regulatory burden.

We are encouraging clients to consider the Invitation to Comment and the ED and provide direct comment back to the AASB by the closing date of 1 September 2007 or provide feedback to Grant Thornton. A copy of the IFRS for SMEs ED can be obtained from the AASB's website [www.aasb.com.au](http://www.aasb.com.au)

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