Technical Accounting Alert

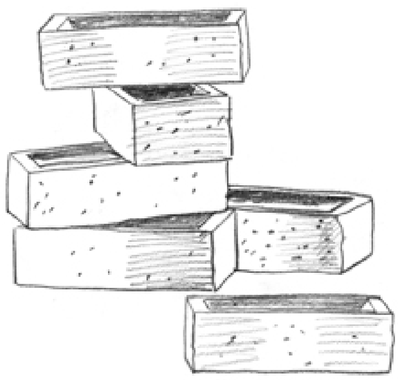
What's New for 30 June 2008

Introduction

This TA Alert provides information regarding changes to accounting standards and other legislation / requirements related to financial reporting which have recently occurred.

This Alert also includes upcoming changes which require specific consideration prior to their implementation date

Contents:



1. AASB 7 Reminder

AASB 7 *Financial Instruments: Disclosures* is effective for annual reporting periods commencing on or after 1 January 2007 and therefore affected 31 December 2007 year ends and will affect 30 June 2008 year ends.

The information below provides only a snapshot of the requirements of AASB 7 since a detailed TA Alert 2008-02 is included on the Grant Thornton Australia website.

AASB 7 is a disclosure standard only and therefore non reporting entities may opt out of the requirements of AASB 7.

This standard requires a significant level of disclosure relating to the financial risks (for example: credit, liquidity and market risk) faced by the entity and the strategies implemented by the entity to mitigate these risks.

Each entity will be exposed to different levels of financial risk and therefore the disclosures have to be client-specific rather than using generic words.

The majority of AASB 7 quantitative disclosures will require different formatting than those previously required by AASB 132 and possible more detailed extraction of data in the trial balance since these disclosures are not likely to be based on reports currently produced by the accounting system.

The following matters should be considered and acted on as soon as possible:

- Obtaining comparative information to be disclosed in the current year financial report;
- Ensuring that the accounting systems can extract the relevant information in the correct format from the general ledger;
- Educating management team to enable them to identify risks that the entity is facing and how they are managed;
- Forming a view on the volatility of underlying market factors to identify a reasonably expected movement in market risks, for example interest rates and exchange rates specific to the entity.

Whilst we understand there will be considerable additional effort required to compile the AASB 7 disclosures; we believe these disclosure will provide useful information to the users of general purpose financial reports.

Further guidance, tools and information to assist clients with the implementation of AASB 7 *Financial Instruments: Disclosure* are available from www.grantthornton.com.au, your local Grant Thornton Australia contact or a member of the National Audit Support team at NAS@grantthornton.com.au

2. Impairment considerations for 30 June 2008

It is important to remember that the existence of impairment indicators should be assessed at each reporting date for most assets held by an entity.

Impairment indicators are internal or external factors which could affect the amount of economic benefits that an entity derives from the asset or the fair value of the asset.

The market conditions leading up to the June reporting date, being:

- increased interest rates: 7.25% (6.25% at June 2007);
- higher inflation (4.2% for the year to March 2008 compared to 2.4% for the year to March 2007);
- lower share market value and uncertainty surrounding market turbulence (ASX All Ords 5,560 - June 2008 compared to 6,311 (June 2007))
- increased oil prices

suggest it is more likely that impairment indicators will be evident in entities whereas in previous reporting periods; these indicators have not necessarily been an issue.

If impairment indicators exist, or on an annual basis for intangible assets with indefinite lives, goodwill and intangible assets not yet in use, the recoverable amount of the asset should be calculated in order to determine whether an impairment loss exists.

Specific issues

Some specific items which should be considered and determined in this environment are:

- The market capitalisation of listed entities should be calculated and compared to the value of their net assets since if net assets are higher than this would be a strong impairment indicator;
- The cash flows used for the value in use calculations will need to be amended for assets with associated borrowings given that cost of capital has increased with increased interest rates;
- Where assets have been purchased overseas or assets are held to support sales/purchases overseas, consideration should be given as to how the exchange rate movements have affected asset values and associated cashflows.

How is recoverable amount calculated?

Recoverable amount is calculated as the higher of an asset's (or cash-generating unit's) fair value less costs to sell and its value in use.

FV less costs to sell:

The price in an arm's length transaction less the costs of disposal.

Value in use:

Determined by reference to the discounted net cash flows expected to be derived from the asset. This involves estimating future cash inflows and outflows to be derived from continuing use of the asset and its ultimate disposal. An appropriate discount rate is applied to those future cash flows.

Once calculated, recoverable amount is compared to carrying amount. Where recoverable amount is lower than the carrying amount of the asset, there is an impairment loss which is recognised in the income statement.

There are a number of disclosure requirements relating to impairment of assets and where a recoverable amount test is performed, these disclosures should be compiled.

Tips and traps

- Recoverable amount is the higher of fair value less costs to sell and value in use, therefore if the fair value less costs to sell is easy to obtain and is higher than the carrying amount then there is no need to calculate value in use.

- Not for profit entities may have the ability to use depreciated replacement cost as value in use if certain criteria are met.

- Entities are required to base cash flow projections on the most recent financial budgets/forecasts approved by management but excluding any estimated future cash inflows or outflows expected to arise from future restructurings or improving the asset's performance.

- Cash flow projections should cover a maximum of 5 years unless a longer period can be justified and should not include information regarding future reorganisations or enhancements of assets.

- Discount rate to be used is a pre-tax rate specific to the entity and discount rate is most likely higher for 30 June 2008 than in prior years.

- Management should be able to explain significant differences between the fair value of assets and the value in use calculation.

3. Remuneration disclosures – listed entities only

There have been some recent changes to legislation to reduce the duplication of related party remuneration disclosures for listed entities which are discussed further below:

3.1 Simpler Regulatory Bill

The Simpler Regulatory Bill which amended the Corporations Act in respect of the location of remuneration disclosures are effective for 30 June 2008.

Further detail can be found in the newsletter on remuneration disclosures on www.grantthornton.com.au

3.2 AASB 2008 -4 *Amendments to Australian Accounting Standard – Key Management Personnel Disclosures by Disclosing Entities*

The AASB has issued AASB 2008-4 which exempts disclosing entities that are companies from complying with certain key management personnel disclosures contained in AASB 124 *Related Party Disclosures* with the aim of removing the duplicated disclosures both in the Notes to the Financial Statements and in the Directors' Report.

These companies are already required to provide certain key management personnel disclosures in the remuneration report under section 300A of the Corporations Act and Corporations Regulation 2M.3.03, and the existing ASIC Class Order relief, exempting such Companies from the AASB 124 requirements contained in the Corporations Act will not be available for 30 June 2008 year ends.

AASB 2008-4 is effective for annual reporting periods ending on or after 30 June 2008, however can be early adopted by entities for financial reporting periods beginning on or after 30 June 2007, but which end before 30 June 2008.

The relief provided in AASB 2008-4 will exempt disclosing entity companies from complying with paragraphs Aus25.2 to Aus25.6, 25.7.1 -25.7.2 of AASB 124, however, these entities will still be required to comply with the other 'Aus' paragraphs of AASB 124, dealing with KMP holdings and transactions in options, rights and equity instruments, loans from the entity and other transactions and balances.

Paragraph 16 of AASB 124 will continue to apply which requires disclosure of KMP compensation in total and for each prescribed category (short-term employee benefits, post-employment benefits, other long-term benefits, termination benefits and share-based payment).

Further information on both of these amendments can be found in the remuneration disclosures TA Alert 2008-09 included on www.grantthornton.com.au or on the National Extranet.

4. AASB 8 *Operating Segments*

4.1 Unlisted Entities

AASB 8 has a narrower scope and applies only to listed entities and those in the process of listing. This means that unlisted entities are now exempt from the segment reporting requirements under AASB 8.

It is likely that unlisted entities will receive significant benefit from **early adopting** AASB 8 since the segment disclosures are able to be removed from the financial statements.

A directors minute for early adoption is required and the financial statements should disclose this fact.

An example minute is:

"*In accordance with s334(5) of the Corporations Act, the Directors are early adopting the following accounting standards:*

- AASB 8 *Operating Segments*
- AASB 2007-3 (note this standards contains consequential changes arising from the issue of AASB 8)"

4.2 Listed Entities

AASB 8 requires listed entities to provide segment information based on the 'management approach', i.e. the method that management use to identify and measure segments. The standard setters believe that this approach will provide users with insight on how the decision makers of the entity run their business.

This may result in different segments being identified from those currently disclosed under AASB 114 *Segment Reporting*. This also represents opportunity for cost saving as entities may be able to utilise their existing management reporting information instead of producing a separate set of segment information to comply with AASB 114 requirements.

AASB 8 is applicable for financial reporting periods beginning on or after 1 January 2009 but may be early adopted.

More detailed information on AASB 8 is included in the segment reporting TA Alert 2008-03 which can be found on Grant Thornton Australia's website www.grantthornton.com.au or on the National Extranet.

5. ASIC Class Orders

ASIC has made a number of changes to some of the class orders relating to financial reporting; details of the changes have been documented below:

5.1 CO 98/98 Small proprietary companies which are controlled by a foreign company but which are not part of a large group

CO 98/98 is the class order that provides certain small foreign controlled proprietary companies relief from the requirement to prepare and lodge audited financial statements.

The thresholds for determining a large group are the same as those for determining large and small proprietary companies, i.e. meeting two of the three criteria $25m revenue, $12.5m gross assets and 50 employees.

Prior to these amendments, companies wishing to take advantage of the relief were required to lodge Form 384 each financial year they wished to do so. With the amendments, companies will generally only need to lodge Form 384 when they "Opt in" and "Opt out".

5.2 CO 98/1418 Financial reporting relief for wholly-owned entities

CO 98/1418 provides relief from the requirement to prepare, have audited and lodge financial reports to wholly owned subsidiaries which are a party to a deed of cross guarantee. Amendments described below were effective from 18 December 2007.

The five main amendments are:

1. Subsidiaries no longer need to have a three year compliance history with the financial reporting requirements of the Corporations Act when applying for relief (i.e. previous breaches of the Corporations Act with regards to financial reporting will not stop companies obtaining this relief now).

2. Companies are no longer required to lodge a notice of use of the relief each year (form 389), they lodge one ONLY in the first year of application. If form 389 has been previously lodged then no further forms are required to be lodged.

   The company will then only lodge a new notice if the group holding entity changes (via form 389) or when company ceases to apply the relief (via form 399).

   ASIC will adopt a No Action position in relation to past late lodgment or non-lodgment of ASIC Form 389. The No Action position will not preclude 3rd parties from taking legal action for breaches of the Corporations Act 2001 resulting from the company's failure to comply with conditions of the class order.

3. Removing the requirement that in order to initially qualify for relief, a lawyer or auditor needed to certify that none of the company's audit reports for the previous three years were qualified.

4. There is no longer a requirement for a statutory declaration when first entering into a deed of cross guarantee.

5. Whilst Directors still need to produce annual solvency statements, these are no longer required to be lodged and the solvency statement now needs to be signed by only one director (previously two directors were required to sign).

5.3 Class Order 08/15 Disclosing entities – half year financial reporting relief

ASIC has issued a new class order relieving a disclosing entity from the requirement to prepare and lodge a half-year financial report and directors' report during the first financial year of the entity, where that first financial year lasts for eight months or less.

Disclosing entities are required to prepare and lodge financial reports for each half-year and full financial year. ASIC has previously given case-by-case relief from preparing and lodging half-year reports to entities with a financial year of eight months or less. Relief for first financial years of eight months or less is now available under CO 08/15. This will save entities that can rely on CO 08/15 the cost of making individual applications for relief.

5.4 CO 08/10 Share and interest sale facilities

ASIC has issued a new class order relieving companies from the provisions of the Corporations Act to facilitate the operation of certain share and interest sale facilities.

Share and interest sale facilities are facilities that some companies and issuers of interests in managed investment schemes offer to their members from time to time. These sale facilities can provide an easy and cheap way for their members, especially those with small holdings, to dispose of their holdings at or near their current market value.

CO 08/10 provides relief from a range of provisions of the Act, and allows companies and product issuers to offer certain sale facilities and related facilities for the purchase of shares or interests, and reduce costs for those companies and product issuers by removing the need for them to apply to ASIC for individual relief before offering such facilities to their members.

The relief only applies to facilities where the shares or interests are sold in the ordinary course of trading on a licensed market or approved foreign market. The relief is also subject to other limitations and conditions.

The class order is effective from 25 March 2008.

5.5 CO 07/422 On-market buy-backs by ASX-listed schemes

ASIC has released CO 07/422 *On-market buy-backs by ASX-listed schemes*, and supplementary Regulatory Guide 101 *On-market buy-backs by ASX-listed schemes*. The class order provides relief from certain provisions of the Corporations Act to allow the responsible entity of a registered scheme listed on the Australian Securities Exchange to carry out on-market buy-backs of interests.

In order to be eligible for the relief a number of criteria must be met. These include:

- the scheme's constitution must give the responsible entity power to buy-back interests in the scheme;
- the buy-back must not materially prejudice the responsible entity's ability to pay the scheme's creditors;
- the buy-back must be carried out in the ordinary course of trading on the ASX;

- the responsible entity must comply with the ASX Listing Rules in relation to the buy-back as if the scheme were a company listed on the ASX;
- the responsible entity must not dispose of the interests it buys back and must ensure that, immediately after registration of the transfer to the responsible entity of interests bought-back, the interests are cancelled;
- member's approval must be obtained where the buy-back exceeds the '10/12 limit'. (The 10/12 limit refers to 10 per cent of the smallest number, at any time during the last 12 months, of interests in the scheme);
- a buy-back within the '10/12 limit' must be disclosed to the ASX; and
- any discretions in relation to the setting of the buy-back price must be exercised reasonably by the responsible entity, and the exercise of any discretions must be documented.

The related regulatory guide RG 101 further explains the relief ASIC has given in CO 07/422 and explains what a responsible entity should do when conducting on-market buy-backs of interests.

6. ASX and ASIC publication on continuous disclosure

6.1 Companies Updates 01/08 and 02/08

ASIC and the ASX have cooperated on the release of two Companies Updates to assist companies to meet their continuous disclosure obligations.

The first update - Companies Update 01/08 provides guidance on the disclosure obligations of listed entities when they seek a trading halt or suspension of their securities.

The second update - Companies Update 02/08 provides guidance on the disclosure of material information relating to the financing arrangements of listed entities and margin loans held by company directors.

The ASX and ASIC are working together to monitor disclosures, and will take enforcement action where necessary to ensure the market is fully informed. Directors have a duty under the Corporations Act to disclose to the company material personal interests on a matter relating to the company. ASIC expects all directors to have provided the company with all relevant information when a margin loan is entered into over securities in the company.

These updates are available from the ASX website:
http://www.asx.com.au/professionals/companies/companies_updates.htm

7. Standards issued but not yet effective

AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* requires entities to disclose the impact of standards issued but not yet effective.

The TA Alert 2005-05 provides details of all standards and interpretations which should be considered for the AASB 108 disclosure.

Note that some of the more significant standards to be included in this note; i.e. AASB 3, AASB 127 and AASB 101 (revised) have been discussed below.

7.1 AASB 3 *Business Combinations* and AASB 127 *Consolidated Financial Reports*

The AASB has issued revised versions of AASB 3 *Business Combinations* and AASB 127 *Consolidated and Separate Financial Statements* and a new standard AASB 2008-3 *Amendments to Australian Accounting Standards arising from AASB 3 and AASB 127*.

Both revised standards are based on the recently reissued International Accounting Standards, issued as a result of the joint project between the IASB and the US FASB. The objective of the project was to develop a single high quality accounting standard that would ensure that the accounting for business combinations is the same, regardless of whether an entity is applying IFRSs or US (GAAP).

The issue of the revised AASB 3 and AASB 127, necessitated consequential amendments to 20 other Standards and 2 Interpretations, hence the omnibus standard AASB 2008-3.

The new standards are effective for financial years commencing on or after 1 July 2009.

If an entity chooses to early adopt the revised AASB 3 and AASB 127 then they must also early adopt AASB 2008-3.

Note: early adoption of AASB 3 is permitted for for-profit entities only, as the AASB is conducting further research into the suitability of the revised AASB 3 requirements for mergers and acquisitions among not-for-profit entities.

7.1.1 AASB 3 *Business Combinations*

Some of the most significant amendments to AASB 3 include:

- **Acquisition costs –** additional costs to be expensed rather than being recognised against goodwill, including finder's fees, advisory, legal, accounting, valuation, and other professional or consulting fees.
- **Contingent consideration –** accounting for a contingent consideration where this changes as a result of a post-acquisition event.
- **Goodwill and non-controlling interest -** acquirers can measure any non-controlling interest (NCI) at either:
  - fair value or

  – the non-controlling interest's proportionate share of the net identifiable assets of the entity acquired available

  Non-controlling interest is the new term replacing "minority interest".

- **Step acquisition -** On the date that control is obtained, a trigger is activated to remeasure the fair values of the acquired entity's assets and liabilities, including goodwill, are measured.
- **Scope changes -** The revised AASB 3 applies to combinations of mutual entities and combinations without consideration (dual listed shares) which were previously excluded from the scope AASB 3.

7.1.2 AASB 127 *Consolidated Financial Reports*

The changes to AASB 3 required changes also to be made to AASB 127.

Some of the most significant amendments include:

- **Partial acquisition/ disposal of subsidiaries** – where control is retained, this is accounted for as an equity transaction with owners, and no gain or loss is recognised in the P&L. Where control is lost, the loss of control triggers remeasurement of the residual holding to fair value.
- **Partial disposals of associates and joint ventures** - If an investor loses significant influence over an associate, it derecognises the associate and recognises in profit or loss the difference between the sum of the proceeds received and any retained interest, and the carrying amount of the investment at the date significant influence is lost. Similar treatment applies when an investor loses joint control over a jointly controlled entity.
- **Attributing income to the NCI** - Total comprehensive income is allocated to the non-controlling interest (NCI) even if this results in the NCI having a deficit balance.

7.2 AASB 101 (Revised) *Presentation of Financial Statements*

The AASB has reissued AASB 101 with an effective date of annual reporting periods commencing 1 January 2009 which includes a number of changes; the most significant of these changes are discussed below.

- **Terminology changes** – harmonisation of Australian terminology with that contained in the International Standards
- **Presentation of comprehensive income** - entities must now present all non-owner changes in equity (that is, 'comprehensive income') either in one statement of comprehensive income or in two statements (a separate income statement and a statement of comprehensive income).
- **Changes to opening retained earnings** - where an entity makes a retrospective change in accounting policy, restates comparative information in the financial report or reclassifies items in the financial report, they must present an opening balance sheet / statement of financial position for the earliest comparative period.

Further details on revised AASB 101 is included in the AASB 101 TA Alert 2008-08 available on www.grantthornton.com.au or the National Extranet.

7.3 Other developments

The information below is brief overview of some other developments relevant in Australia; for further information on any of these standards / interpretations please contact a member of the National Audit Support team on NAS@grantthornton.com.au

7.3.1 AASB 2 *Share Based Payments.*

This standard has been revised to clarify that vesting conditions are service conditions and performance conditions only. Other features of a share-based payment are not vesting conditions.

8. Frequently asked questions

Question: Why are there so many standards being issued with an effective date in the 2009 / 2010 reporting period?

The IASB standards have been changing over a period of time which has meant that entities subject to the standards are suffering from change fatigue.

In order to address this issue, and to encourage more countries to adopt the IASB standards, or international equivalents, the International Accounting Standards Board has stated that they will maintain a no change period (unless there are significant errors which need to be corrected). New standards that are being issued have an effective date no earlier than annual reporting periods commencing on or after 1 January 2009.

Note, however that due to the AASB 108 requirement discussed in section 7, entities are still required to disclose the impact of these standards.

Further information

For further information or guidance on any of the articles included in this TA Alert, please contact your local Grant Thornton Australia contact or a member of the National Audit Support team at NAS@grantthornton.com.au