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Financial Reporting Update - 30 June 2017

Agenda

- What you need to know for 30 June 2017
- On the horizon
  - Changes applicable from 1 July 2017
  - Projects update

Changes Effective for 30 June 2017

		Application Date
AASB 1057	Application of Australian Accounting Standards	30 June 2017
AASB 2014-3	Amendments to AASB 11 – acquisition of interest in joint operation	30 June 2017
AASB 2014-4	Use of revenue-based depreciation methods	30 June 2017
AASB 2014-6	Amendments to AASB 141 & 116 – Bearer Plants	30 June 2017
AASB 2014-9	Equity Method in Separate Financial Statements	30 June 2017

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Changes Effective for 30 June 2017

		Application Date
▪ AASB 2015-1	Annual Improvements 2012-2014	30 June 2017
▪ AASB 2015-2	Amendments to AASB 101 - Disclosure Initiative	30 June 2017
▪ AASB 2015-5	Investment Entities - consolidation exemption	30 June 2017
▪ AASB 2015-6	Extending related party disclosures to NFP public-sector entities	30 June 2017
▪ AASB 2015-7	Fair value disclosures of NFP public-sector entities	30 June 2017

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Changes Effective for 30 June 2017

AASB 2015-2 Amendments to AASB 101 - Disclosure initiative

- Relief from
  - summarising significant accounting policies in a single note
  - including minimum disclosures required by other standards if that information is not material to users
- Allows flexibility in ordering or grouping notes
  - Systematic manner
    - operating activities
    - measurement bases
    - in order of appearance in primary statements
- Decluttering examples
  - 64 pages to 41 pages (23 pages, 36% reduction)
  - 75 pages to 46 pages (29 pages, 38% reduction)

On the horizon

Changes Effective after 1 July 2017

		Application Date
▪ AASB 2016-1	Recognition of DTA for unrealised losses on debt instruments	1 January 2017
▪ AASB 2016-2	Amendments to AASB 107	1 January 2017
▪ AASB 2016-4	Recoverable amount of specialised assets of NFPs	1 January 2017
▪ AASB 2016-5	Amendments to AASB 2	1 January 2018
▪ AASB 2014-10	Sale or contribution of assets between an investor and associate	1 January 2018

Changes Effective after 1 July 2017

		Application Date
▪ AASB 9	Financial Instruments	1 January 2018
▪ AASB 15	Revenue from Contracts with Customers	1 January 2018 *
▪ AASB 1058	Income of Not-for-profit Entities	1 January 2019
▪ AASB 16	Leases	1 January 2019
▪ AASB 2017-1 ▪ AASB 2017-2	Annual Improvements 2014–2016 Cycle	1 January 2018
▪ Interpretation 22	Foreign Currency Transactions and Advance Consideration	1 January 2018

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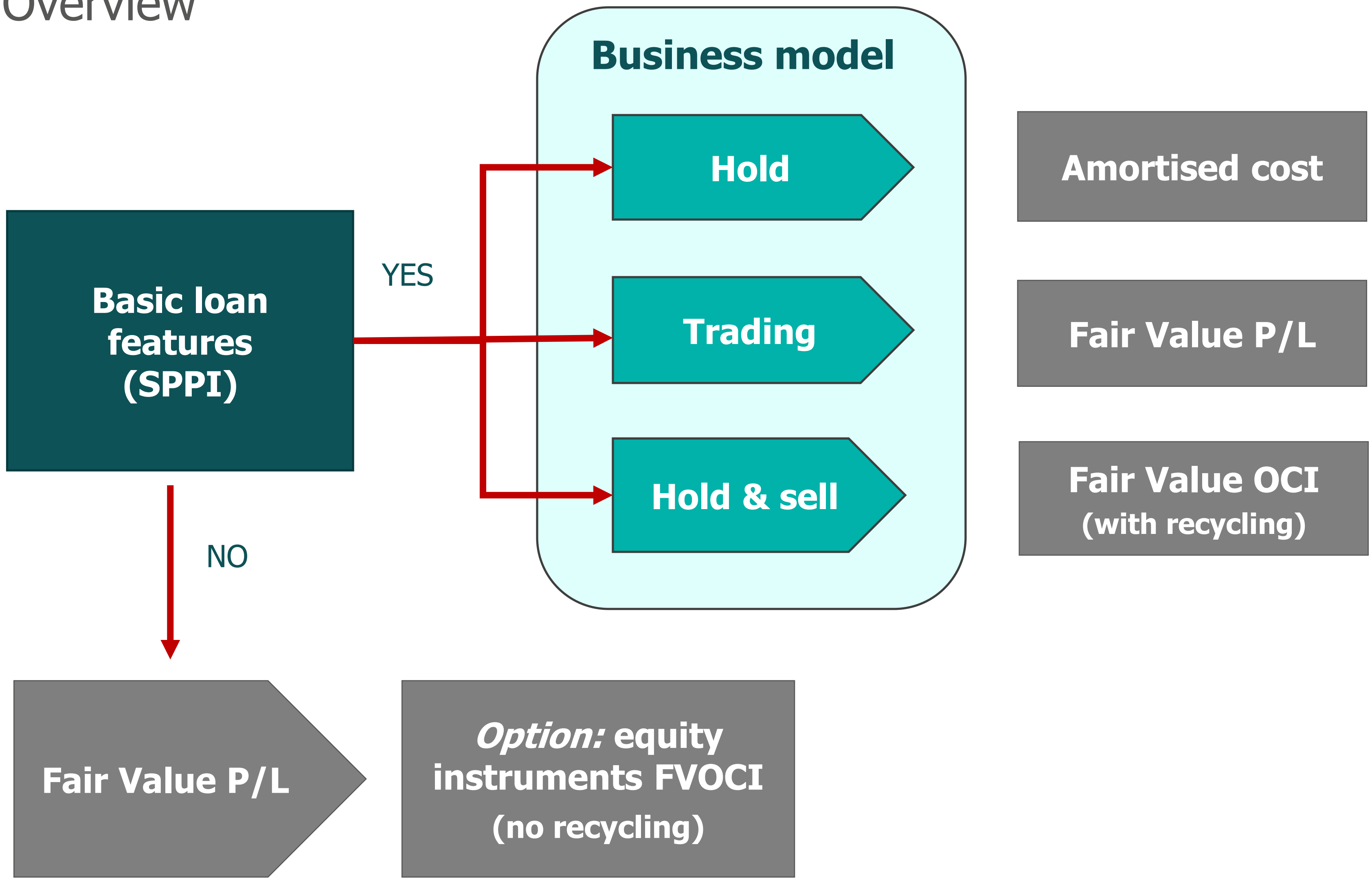
AASB 9 Financial Instruments

Financial Asset Classification

Overview



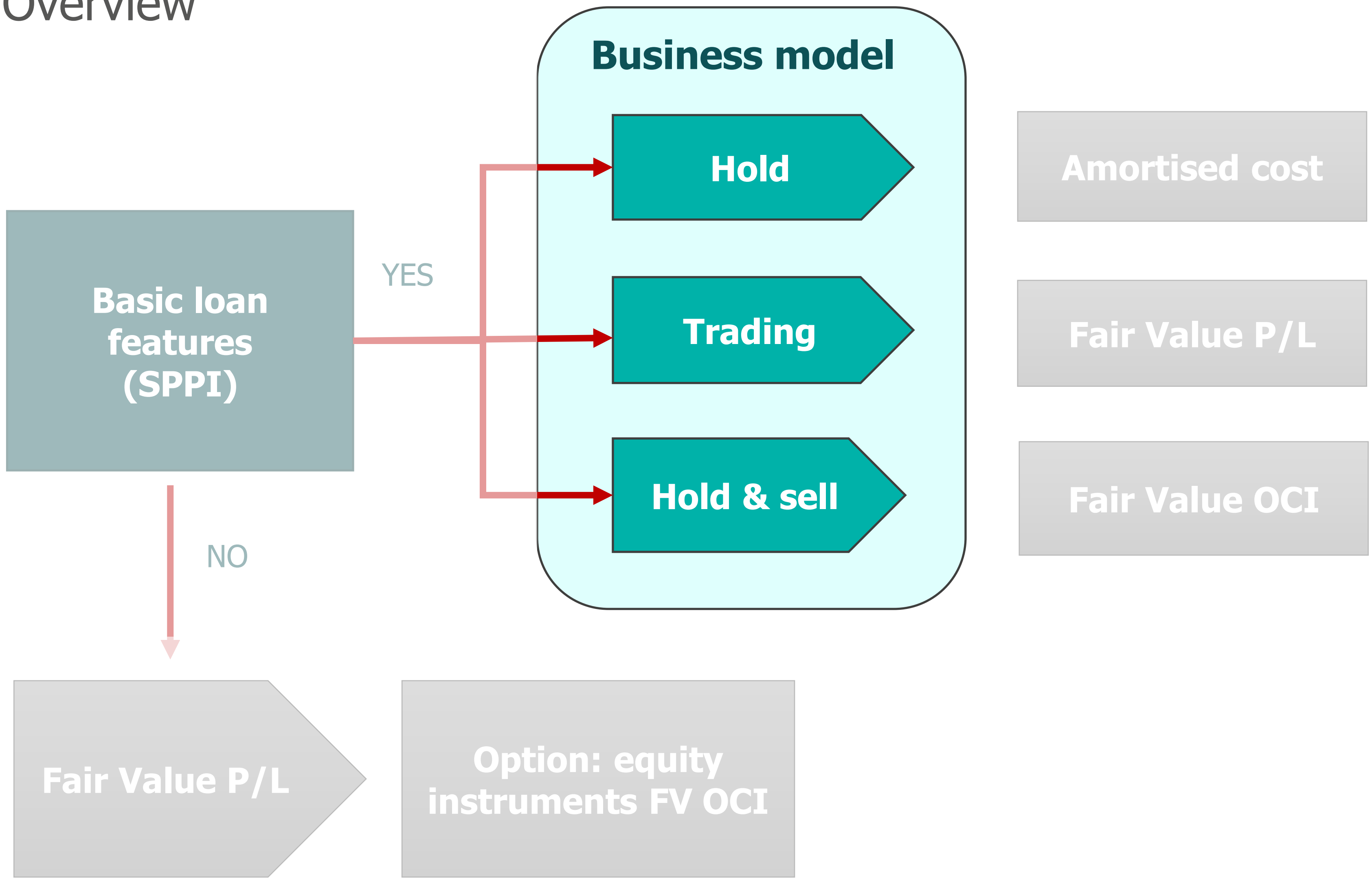
Basic Loan Features

Contractual cash flow characteristics test

- Must be Solely Payments of Principal and Interest (SPPI)
- ‘Interest’ includes elements relating to:
  - the time value of money
  - credit risk
  - liquidity risk
  - a profit margin and servicing costs
- Embedded features
  - Eg, conversion option into shares
  - Fails SPPI unless non-genuine or *de minimus*

Financial Asset Classification

Overview

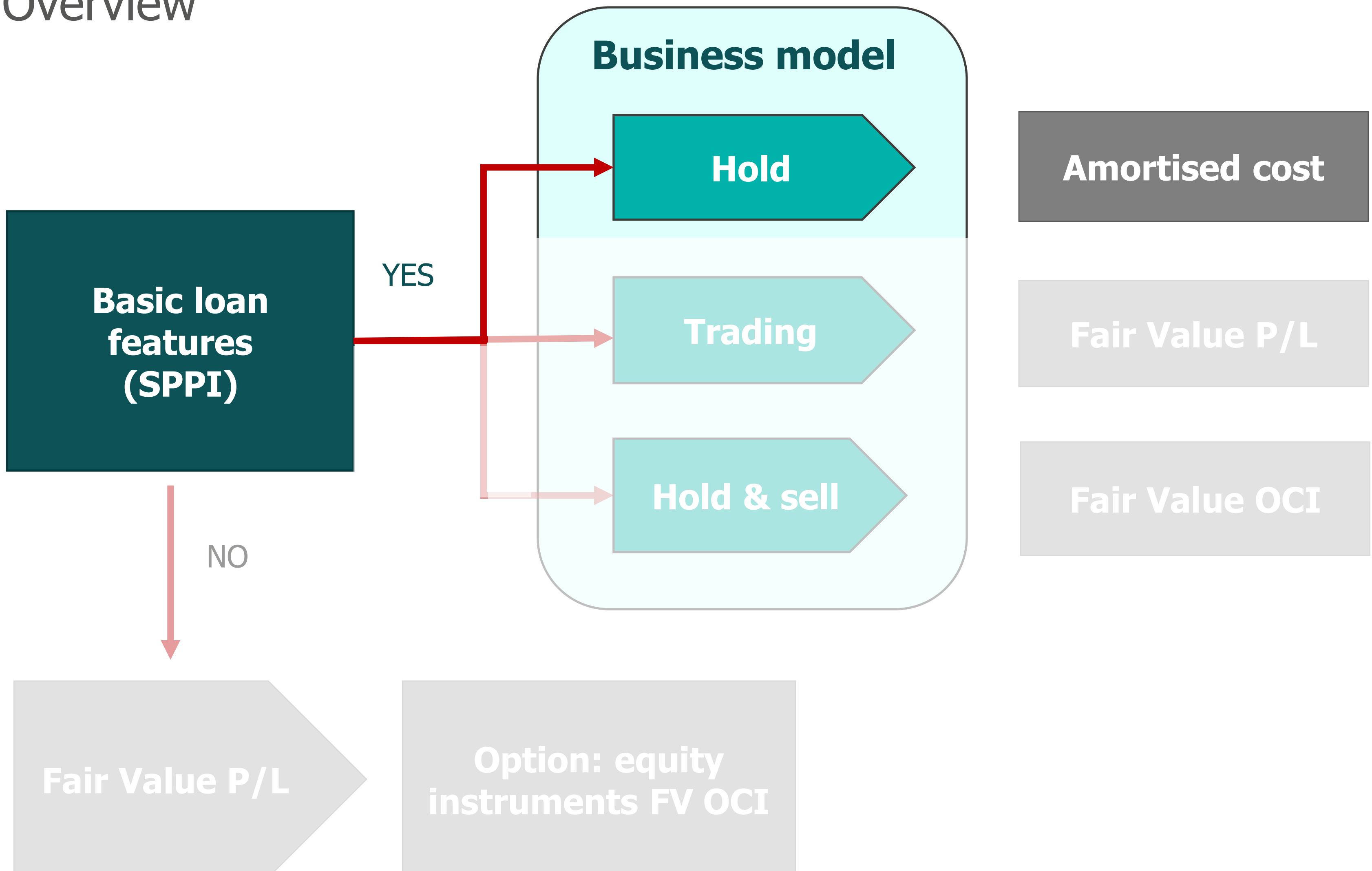


Business model test

- How groups of financial assets are managed together to achieve a particular business objective
- How they generate cash flows
  - Collecting contractual cash flows;
  - Selling / trading; or
  - Both hold and trade
- Based on fact not intention

Financial Asset Classification

Overview



Financial Assets at Amortised Cost

Examples

- Trade receivables arising under AASB 15 *Revenue from Contracts with Customers*
- Loans from a subsidiary or its parent
  - whether interest-free or interest bearing
- Other loans and receivables
- Government or corporate bonds
- Cash and cash equivalents
- Assets that are not SPPI and therefore FVPL
  - Convertible bonds/notes
  - Bonds with non-cumulative interest
  - Loans with inverse floating interest rate

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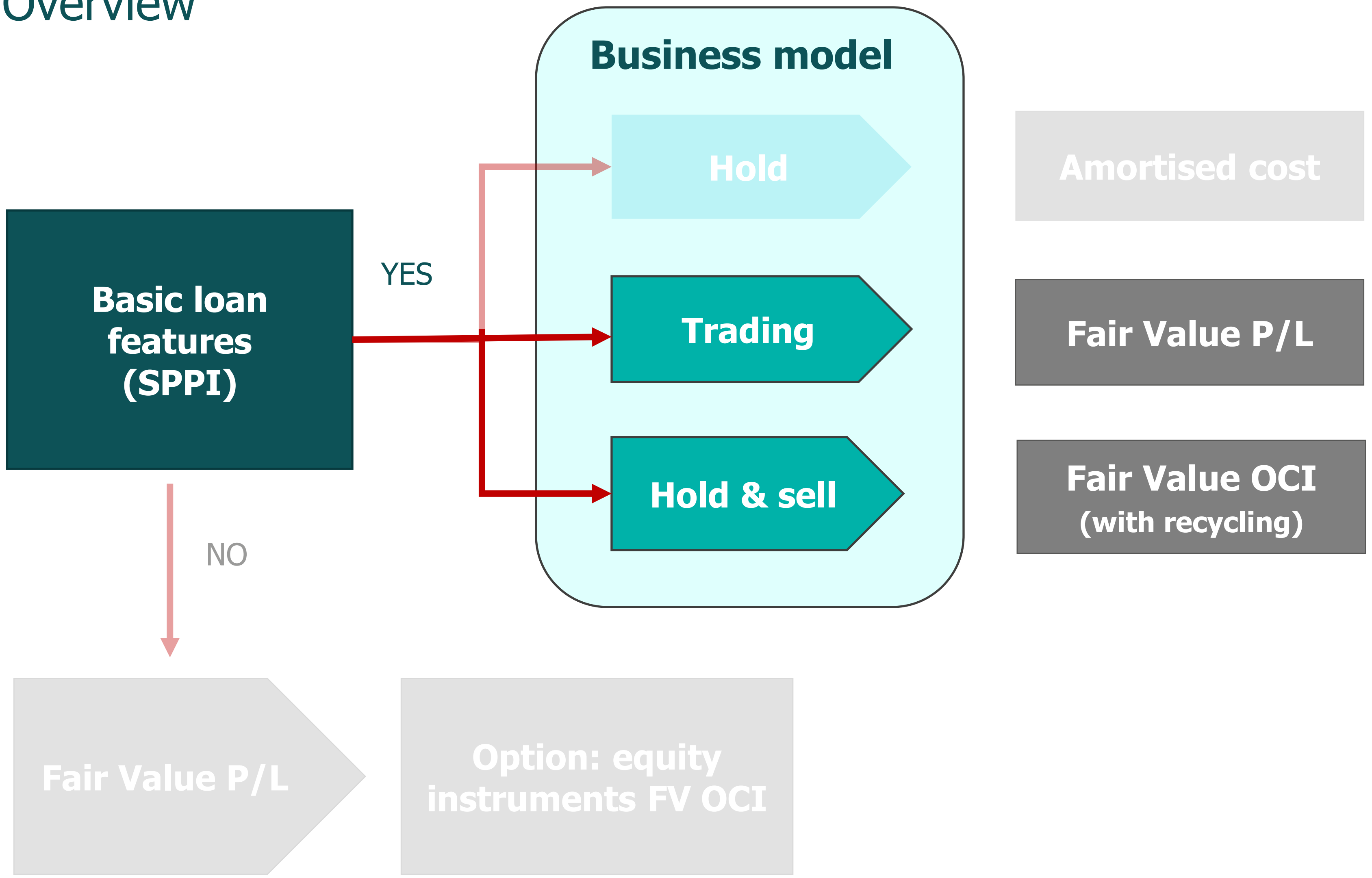
Financial Asset Classification

Overview



Basic loan features (SPPI)

Business model - example

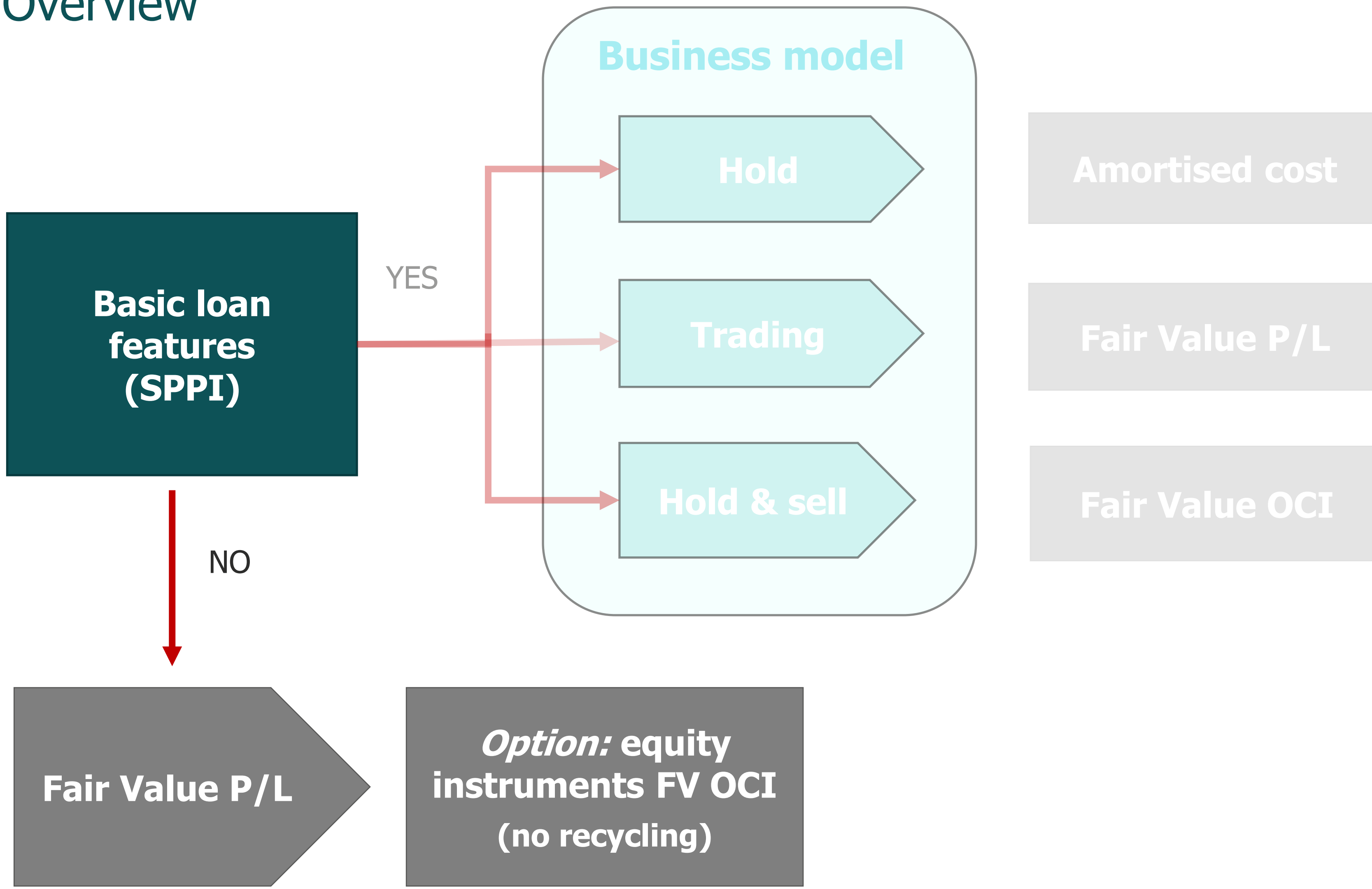
- An entity holds an investment portfolio containing fixed-interest government and corporate bonds and other short-term deposits. The entity's intention is to preserve capital and generate an appropriate return to fund future activities and operations.

- Its business model may be either:

1. Buy, hold to maturity, reinvest	Amortised cost
2. Actively trade to benefit from changes in bond prices	Fair value through P/L
3. Hold to collect interest and trade	Fair value through OCI

Financial Asset Classification

Overview



Financial Assets at Fair Value

- Any financial asset that
  - fails SPPI test
  - designated as FVTPL at initial recognition
  - managed on a fair value basis
- FV change recognised in profit and loss
  - Only exception **equity investments** can be designated FVOCI
    - Only if not held for trading
    - Irrevocable election
    - On an instrument-by-instrument basis
    - No recycling to P/L
    - No separate impairment recognition
- AASB 139 exception to measure some unlisted investments at cost removed

Financial Asset Classification

Summary

- Simple assets and arrangements unchanged
  - Trade receivables & some equity investments
- Business model test may affect some arrangements
  - Investment portfolios
- No FV measurement exclusion for some unlisted investments
- AASB 139 impairment test for AFS assets removed
  - No recycling of profit/loss on disposal of FVOCI equity instruments

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Impairment of financial assets

Impairment of Financial Assets

Approaches

1. Simplified approach
    - Trade receivables (AASB 15) and designated lease receivables
2. General approach
    - Most loans and debt securities
    - Long-term loans
    - Related party loans
3. Purchased or originated credit-impaired approach

- Expected loss model (AASB 9) vs incurred loss model (AASB 139)

Impairment of Financial Assets

Simplified approach

- Always used for trade receivables
- Need to elect for lease receivables
- Recognition of lifetime expected loss
- Using supportable forward looking assumptions
- For example:

Ageing	Debtors $	Loss rate	Expected loss $
<30 days past due	576,000	1.0%	5,760
31-60 days past due	325,000	2.0%	6,500
61-90 days past due	260,000	5.0%	13,000
> 90 days past due	85,000	7.5%	6,375
	$1,246,000		$31,635

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Impairment of Financial Assets

General approach

- Recognise expected credit losses in two steps
  1. Arising from default events 'that are possible' within the next 12 months;
     - Based on probability weighted risk of default in the next 12 months
     - Reasonable and supportable forecast future conditions
  2. For a significant increase in credit risk, lifetime expected loss
     - Rebuttable presumption: significant increase in credit risk if more than 30 days past due

- Not the actual cash flows expected to be lost
- Because 'expected credit loss' defined as weighted average of credit losses based on risk of default, unless that weighting is zero, there will be some allowance recognised

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Differences to AASB 139

Category	Area	Change
Classification	Amortised cost classification	No concept of ‘tainting’ as with ‘held-to-maturity’ classification
	Four categories of financial assets under AASB 139 replaced	▪ More assets will be FVPL ▪ Use of FVOCI narrower than AFS
	Unlisted investments	Previous exception to measure at cost removed. Must be at FV
Impairment	Expected credit losses	Need to consider risk adjusted probability of default
	Impairment of equity investments	No separate P/L recognition

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AASB 9

Next steps

- Begin assessment and analysis of current arrangements
- Assess potential changes in measurement and classification
- Consider the judgements and assumptions
  - Implications on internal systems and data capture
- Understand transitional provisions
- Hedge accounting and financial liabilities

AASB 15 Revenue from Contracts with Customers

Application

Effective dates

For-profit entities:	Years beginning on or after 1 January 2018
Not-for-profit entities:	Years beginning on or after 1 January 2019

Apply either:

1) Fully retrospectively with comparatives
2) Retrospectively from date of initial application

Revenue model

Step 1	Identify the contract(s) with customer
Step 2	Identify the performance obligations
Step 3	Determine the transaction price
Step 4	Allocate the transaction price to the performance obligations
Step 5	Recognise revenue when (or as) the entity satisfies a performance obligation

Identify performance obligations

A promise in a contract to transfer either a good or service to a customer that is distinct, or a series of distinct goods or services that are substantially the same and have the same pattern of transfer to the customer

Step 1: is the good or service *capable of being distinct*

and

Step 2: is the good or service *distinct in the context of the contract*

Customer can benefit from the good or service on its own;
or
Customer can use the good or service with other readily available resources

Is the good or service highly dependent on, or highly correlated with, or significantly modifies or customises other promised goods or services in the contract

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Determine the transaction price

- The amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties

- Transaction price reflects:
  - Consideration paid or payable by the customer
  - Non-cash consideration (recognised at fair value)
  - Significant financing components (time value of money)
  - Variable consideration and price concessions (rebates, discounts, credits, etc)
  - Doesn’t factor credit risk

Transaction price

Variable consideration

- Only included to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur
  - Need to reassess and remeasure over the term of the contract
  - Test is written in the context of the contract, not ‘significant’ to the entity as a whole

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Transaction price

Estimating variable consideration

- Rights of return
- Price concessions
  - Volume rebates, discounts
- Sales-based and usage-based royalties
- Distributors or resellers
  - Partial recognition before end-sale has occurred
- Contingent fees
  - litigation or regulatory outcomes
- Commodities that settle based on future market prices or final assay

Allocate the transaction price

- Allocate the transaction price to each performance obligation on the basis of relative stand-alone selling prices of each distinct good or service (or distinct groups)

There's no such thing as a free lunch!

Total transaction price must be allocated across all the identified performance obligations

Allocate the transaction price

Example

Retailer Coy sells Product A for $200. As part of the sale, Retailer Coy gives the customer a 30% discount voucher for any future purchases up to $250 in the next six months.

Retailer Coy accounts for the promise to provide the incremental discount as a separate performance obligation in the sale of Product A.

Retailer Coy estimates an 80% likelihood that a customer will redeem the voucher and that a customer will, on average, purchase $150 of additional products.

Consequently, Retailer Coy's estimated stand-alone selling price of the discount voucher is $36 ($150 average additional purchase x 30% discount x 80% likelihood of additional purchase).

The stand-alone selling prices of Product A and the discount voucher and the resulting allocation of the $200 transaction price are as follows:

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Allocate the transaction price

Example

Performance obligations	Stand-alone price	
Product A	$ 200	
Discount voucher	$ 36	
Total	$ 236	
Allocated transaction price		
Product A	$ 169	($200 ÷ $236 x $200)
Discount voucher	$ 31	($36 ÷ $236 x $200)
Total	$ 200	

Defer and recognise $31 relating to the voucher as & when it is used

Recognising revenue

- Recognise revenue as the performance obligations are satisfied
  - At a point in time (typically for goods); or
  - Over time (typically for services)

- Performance obligation satisfied over time where:
  - Customer simultaneously receives and consumes the benefits as the entity performs; or
  - Entity creates or enhances the customer’s asset(s) as it performs; or
  - Does not create an asset with alternative use to the supplier and it has right to payment for work to date

Non-refundable up-front fees

- Does the initial fee relate to the transfer of a good or service? or
- Advance payment for future goods or services?
- Does fee give a *material right* with respect to future transactions
  - Renewal option at lower price than new customers
  - In the context of the transaction
  - Effectively paid in advance for future services

Potential areas of change

Matter	Current treatment	AASB 15
Up-front & non-refundable fees	Generally recognise	Likely defer
Goods with right of return (distributors; wholesale; retail)	Generally recognise on sale	Only recognise revenue to which the entity expects to be entitled
Multiple elements	Not always identified	Identify distinct performance obligations
Allocate revenue	No mandated method	Standalone selling prices

Potential areas of change – cont'd

Matter	Current treatment	AASB 15
Variable consideration	Recognise when probable and measure reliably	Recognise to the extent highly probable significant reversal will not occur
Licences and IP	Initially or over licence term depending on nature	Could be recognised later and progressively at different amounts
Franchise arrangements	Recognise elements that reflects the purpose for which the fees are charged	Could be recognised later and progressively at different amounts
Tender costs	Costs of securing a contract deferred if probable contract will be obtained	Only directly attributable incremental costs deferred

Summary

- Remember the principle
- Timing of some revenue will change
- Measurement of some revenue will change
- Understand implications of transition options
  - Start date 1/1/2017?
- Implications for NFPs?
- Much more complexity for certain types of revenue
- Have a plan to assess impacts / diagnostic
  - Will systems/processes need to change to capture data ?
  - Consider impacts on forecasts, ratios, covenants, etc

Income of Not-for-profit Entities

AASB 1058 - Core principle

Debit

Asset

−

Credit

- Contract revenue or contract liability (AASB 15)
- Equity contribution
- Lease liability
- Financial liability
- Provision
- Decrease in other assets

=

Income

recognised immediately

Recognising the asset

Is consideration significantly less than FV?

YES

NO

Recognise asset at cost of acquisition

Discount principally to further NFP objectives?

YES

Recognise asset at fair value

Difference to current standards

Recognised at FV only where acquired at no cost or nominal consideration

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Donation elements

Assets acquired at less than fair value

- Assume a NFP acquires land & buildings for $1.0m

Currently

Recognise L&B at cost of $1.0m

AASB 1058

Consideration significantly less than fair value ?

- Intent to make a gift or contribution?
- Understanding the transaction

Below market leases - example

- NFP enters a ten year lease for the use of a building. To assist the NFP achieve its objectives, the lessor only requires fixed lease payments of only $1 per annum. At the inception of the lease, the fair value of the right to use the leased property for ten years is $360,000.

Existing lease standard

- Lease classified as operating lease
- Continue current operating lease accounting
- No lease asset, liability or income recognised

New lease standard

NFP recognises:

- a lease asset at its fair value of $360,000;
- Lease liability of $7; and
- the difference recognised as income at inception of the lease

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Recognising the credit

AASB 15

Enforceable contract with customer

and

includes Performance Obligations

Yes

Apply AASB 15

- recognise revenue when each PO satisfied

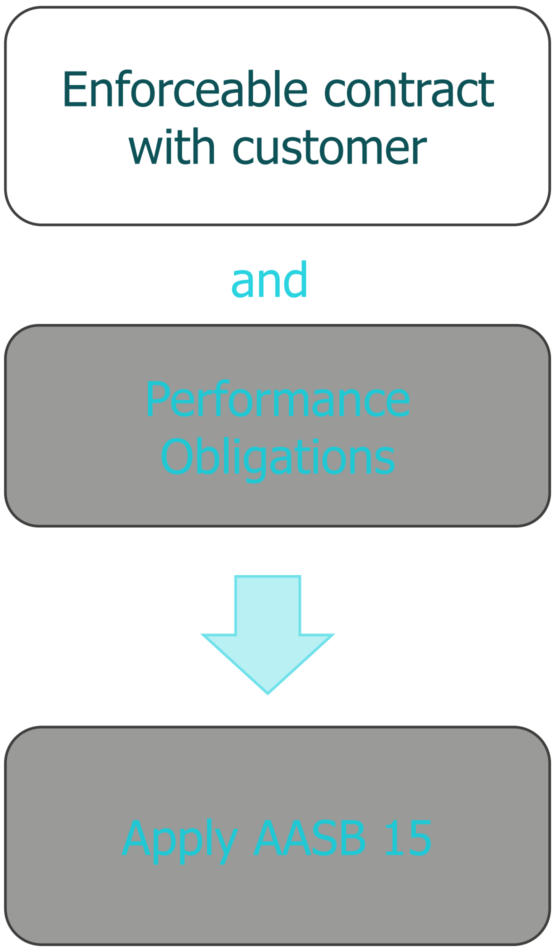
No

Apply AASB 1058 Income of Not-for-Profit Entities

Recognise asset and:

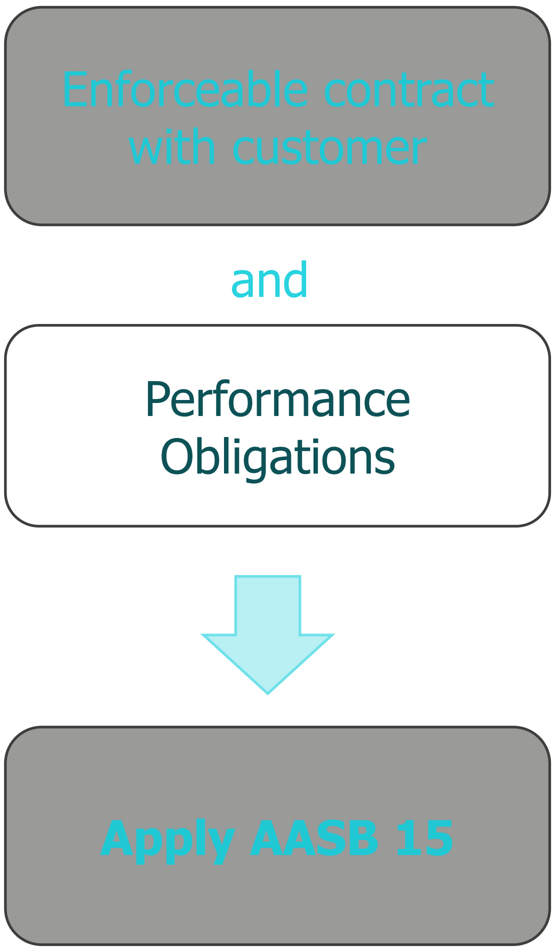
- other income;
- any liability;
- contribution by owners

Enforceability



- AASB 15 hurdle for enforceability
  - specific performance
  - legal or equivalent means
- Can be:
  - Return of consideration for non-performance
  - Significant penalty for non-performance
- Enforceability depends on capacity / ability to exercise customer’s rights
  - Ignores history or intention to enforce rights

Performance obligations



- Sufficiently Specific Promise
  - Nature or type of goods/services
  - Cost, value or quantity
  - Period over which to perform
  - Must enable determination of whether performed
- Not performance obligations
  - unspecified goods or services over time alone
  - moral obligations
  - economic compulsion

Issues

- Assessing enforceability of arrangements
  - enforceability vs history or counterparty intent
- Identifying performance obligations
  - are obligations sufficiently specific?
  - constructive obligations
  - moral obligations and economic compulsion
- Conditions with no time period
  - Perpetual gifts (capital preserved)
  - Control of asset vs restriction on use of asset
- Undocumented related party arrangements
- Identifying donation components in arrangements
- Choice of transition options

What does it all mean?

- Donations, grants, gifts in scope of AASB 15
  - recognise as obligations satisfied
- Unenforceable arrangements out of scope of AASB 15
- Time-only or unspecified conditions out of scope of AASB 15
  - recognise on control of asset
- Below market arrangements
- Different treatment for capital grants
- Bequests
  - control of asset
  - satisfaction of conditions
- Up-front fees

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In summary...

- Narrow changes for June 2017
- Major changes affecting 2018-2019
- Establish project plans to assess impacts of future changes

- For further information:
  - contact your Nexia advisor or molde@nexiaaustralia.com.au
  - webinars and publications at www.nexia.com.au

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