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A&A Accounting Technical

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Clarity in financial reporting

Disclosing the adoption of new accounting standards in half-year financial statements

Talking points

- Both AASB 9 *Financial Instruments* and AASB 15 *Revenue from Contracts with Customers* are mandatorily effective for annual periods beginning on or after 1 January 2018. For many entities, the first financial statements reflecting adoption of these significant standards will be a half-year report for the six months to June 2018. AASB 16 *Leases* is also available for early adoption in 2018 financial statements.
- The detailed disclosure requirements of AASB 9, AASB 15 and AASB 16 do not apply to condensed half-year financial statements prepared in accordance with AASB 134 *Interim Financial Statements*. However, that Standard does require disclosure of the effects of changes in accounting policy.
- Judgement will be required in determining the appropriate level of disclosure, including on the level of aggregation which is appropriate, which may differ depending on the extent of the changes resulting from the new Standards.
- Certain specific disclosure requirements on revenue have been added to AASB 134 on adoption of AASB 15, these apply in the year of adoption and in subsequent years.

For more information please see the following websites:

www.IASplus.com

www.deloitte.com

The disclosure requirements of AASB 134 on changes in accounting policy

Each of AASB 9 (by means of consequential amendments to AASB 7 *Financial Instruments: Disclosure*, notably paragraphs 42I-S on the initial application of AASB 9), AASB 15 and AASB 16 include extensive disclosure requirements both in respect of transition to the requirements of the new Standard and its application on an ongoing basis. However, these requirements do not apply directly to condensed half-year financial statements prepared in accordance with AASB 134, which are only required to include disclosures as required by AASB 134 itself.

AASB 134.16A(a) requires "a statement that the same accounting policies and methods of computation are followed in the half-year financial statements as compared with the most recent annual financial statements or, if those policies or methods have been changed, a description of the nature and effect of the change." Changes in accounting policy resulting from adoption of new accounting standards are subject to this requirement.

AASB 134.15C also expresses a broader principle that "[w]hen an event or transaction is significant to an understanding of the changes in an entity's financial position or performance since the last annual reporting period, its half-year financial report should provide an explanation of and an update to the relevant information included in the financial statements of the last annual reporting period."

Determining the appropriate disclosures necessary to satisfy these requirements as well as investor expectations of information on changes in, for example, reported revenue and profit will necessitate the application of judgement as the appropriate level of disclosure will differ depending on the extent and nature of the changes resulting from each new Standard.

In making this assessment, entities should also take account of any additional requirements on the disclosure of changes in accounting policies applied by the Australian Securities and Investments Commission (ASIC), including (but not limited to) the Australian Prudential Regulation Authority (APRA) applicable to financial institutions on first-time adoption of AASB 9. For example, in its media release for the June 2018 reporting period, ASIC stated that the half-year financial reports must disclose the nature and effect of changes in accounting policies from applying the new standards.

Applying these requirements to changes arising from AASB 9, AASB 15 and AASB 16

In assessing the necessary disclosures in their half-year financial statements, entities should consider, inter alia, the need to provide information on the following.

The new accounting policies applied

At a basic level, the disclosures should include a meaningful explanation of the new accounting policies themselves, which will not have been included in the description of accounting policies in the previous annual report (December 2017 for a calendar year-end entity). As always, a high quality description of an accounting policy will not simply repeat the requirements of the relevant accounting standard, but will explain how those requirements have been applied to the entity's particular facts and circumstances, for example:

- In respect of AASB 15, how the five-step model for revenue recognition applies to each significant revenue stream, including how contracts are disaggregated into their component performance obligations and whether revenue from each performance obligation should be recognised over time or at a specific point in time (and, if so, at which point in time).
- In respect of AASB 9, whether each significant class of the entity's financial assets is classified as at amortised cost, fair value through profit or loss or fair value through other comprehensive income and how the expected credit loss model has been applied.
- In respect of AASB 16, how the revised definition of a lease applies to the entity's significant contracts to use, or take the output from, physical assets.

The transitional method adopted and any practical expedients used

AASB 15 and AASB 16 provide a choice between full retrospective adoption and adoption from a 'date of initial application' i.e. 'modified retrospective adoption' (1 January 2018 for a calendar-year entity applying the new Standard for the first time in 2018) with an adjustment to equity reflecting the change in net assets arising at that date. AASB 9 requires retrospective application but allows for certain decisions on, for example, the designation of financial assets and liabilities to be taken at the date of initial application and in certain cases provides relief from full retrospective measurement of, for example, fair value and expected credit losses.

Each Standard also provides a number of practical expedients that entities may apply either on transition (for example, to 'grandfather' the assessment of whether existing contracts meet the definition of a lease) or on an ongoing basis (for example, on the recognition of short-term leases under AASB 16 and the identification of significant financing components in revenue contracts under AASB 15).

When their effect is significant, disclosure of how an entity has applied the explicit choices provided by new Standards would normally be appropriate.

The key judgements and estimates applied

Each of the new standards requires the application of careful judgement and the use of estimation. For example:

- AASB 15 requires significant judgements to be made around, amongst other things, the estimation of variable consideration and the constraint on its recognition, the 'stand-alone selling price' of performance obligations used in allocation of consideration to the components of a contract and whether (and, if so, how) consideration should be recognised as work is performed rather than at a single point in time.

- AASB 9's expected credit loss model requires forecasts of future credit losses (rather than, as under AASB 139 *Financial Instruments: Recognition and Measurement*, only the identification of incurred losses), together with an assessment of credit risk to determine whether expected lifetime or 12-month expected credit losses should be included in the loss allowance.

- AASB 16 requires judgement in identifying whether a right-of-use asset and lease liability should be recognised and, if so, the measurement of those balances. Significantly, this requires determination of the lease term and the identification of a suitable discount rate.

Whilst the requirements of AASB 101 *Presentation of Financial Statements* on key judgements and sources of estimation uncertainty do not apply to condensed half-year financial statements, an indication of the judgements taken in applying these complex new requirements can enhance the value of the disclosures provided.

The quantitative effects

When previously stated figures are restated or cumulative effect is recognised in equity at the date of initial application of a new standard, those changes should be disclosed and explained.

For annual financial statements, disclosure of the effect of changes in accounting policy on the current year financial statements is required (albeit, the new standards offer some relief from this general requirement of AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*). This requirement is not included in AASB 134, but entities should consider whether quantitative or qualitative information on the current year effect on, for example, revenue recognised in the half-year period is necessary to provide, as per AASB 134.16A(a), an understanding of "the effect of the change."

Thinking it through

AASB 134.16A(a) does not replicate the specific requirement of AASB 15.C8 to disclose in annual financial statements "the amount by which each financial statement line item is affected in the current reporting period by the application of [AASB 15]" or of AASB 108.28(f) to disclose "the amount of the adjustment for each financial statement line item affected." Judgement will be required to determine the appropriate level of disclosure and aggregation necessary to provide users with an understanding of the effects of new standards applied. However, we would recommend the application of paragraph AASB 15.C8 in the half-year financial statements upon adoption of AASB 15.

In addition, whilst not directly applicable to condensed half-year financial statements, the transitional disclosures required in annual financial statements might be referred to in considering whether any more specific quantitative disclosures should be provided. In particular, for financial institutions there may be an expectation from investors that the change in loss allowance on application of AASB 9 (to be disclosed in annual financial statements per AASB 7.42P) will be disclosed before the 2018 annual report is published.

Disclosure requirements added to AASB 134 on adoption of AASB 15

Two specific disclosure requirements have been added to AASB 134 in respect of accounting under AASB 15, being:

- significant impairment of contract assets; and

- a disaggregation (as required in the annual financial statements) of revenue depicting how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors, together with sufficient information to understand the relationship between that disclosure and revenue disclosed in a segmental analysis.

These disclosures are required both in half-year financial statements in the year in which AASB 15 is adopted and in subsequent years.

AASB 134 also requires that certain disclosures on the fair value of financial instruments from AASB 13 *Fair Value Measurement* and AASB 7 be provided in half-year financial statements. Whilst these requirements were not added by AASB 9, they may need to be revised if the population of assets and liabilities measured at fair value changes on application of the new Standard.

Presentation and restatement of comparative information

The requirements for comparative information in condensed half-year financial statements are, like those for disclosure, included in AASB 134 itself and are only to provide a statement of financial position at the end of the preceding financial year and a statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows for the comparable period(s) in the previous financial year. Unlike in annual financial statements, there is no requirement to provide an additional comparative statement of financial position when a change in accounting policy is applied retrospectively.

When comparative information will be changed in the annual financial statements due to retrospective application of AASB 9 (if not impracticable) or AASB 15 or AASB 16 (if that option is chosen), the comparative information provided in condensed half-year financial statements should likewise be restated with appropriate, quantitative disclosure and explanation of those changes.

Further information

The effects of AASB 9, AASB 15 and AASB 16 can be many and varied depending on the precise nature of an entity's transactions. A suite of resources on each standard is available via www.IASplus.com, whilst your local Deloitte specialist can be contacted in respect of assistance with projects to implement new accounting requirements.

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