

# JR news

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## 2008 Financial Reporting Update

**For June balance date entities the 2008 reporting season is almost upon us. As in previous years, there have been numerous changes to Accounting Standards, Accounting Interpretations, the Corporations Act and ASIC requirements which will need to be considered in complying with financial reporting requirements this year.**

In this newsletter we provide an overview of certain key changes, including new disclosure requirements of AASB 7 Financial Instruments: Disclosures. We also provide an overview of the key changes to AASB 3 Business Combinations which will be effective from 1 July 2009.

## AASB 7 Financial Instruments: Disclosures

**The most significant new challenge for many entities in 2008 will be compliance with AASB 7. For some entities, with only a few non-complex financial instruments, compliance may be relatively simple. For others, however, meeting the challenges of AASB 7 will not be so straight forward.**

Directors and management also need to consider the current economic environment. With increased financial market volatility, rising interest rates and tightening credit, there has been an increase in the scrutiny of financial disclosures, particularly those now dealt with by AASB 7. As such, directors and management have a greater incentive to ensure compliance with its requirements. No one wants to be in the media spotlight: facing criticism for poor disclosure, a market price crash and class actions.

### Overview

AASB 7 replaces the disclosure requirements previously found in AASB 132 and also introduces a number of new disclosures relating to:

- the significance of financial instruments for an entity's financial position and performance;
- the nature and extent of risks arising from financial instruments to which an entity is exposed; and
- how those risks are managed.

Some of the challenges in complying with AASB 7 include:

- Determining the appropriate level of disclosure – too much detail may make the financial report less useful and “bury” important information. On the other hand, too little detail may result in non-disclosure of relevant information and lead to questions or criticism from financial report users such as shareholders, financiers, analysts and regulators.
- Determining the appropriate qualitative disclosures – this encompasses identifying relevant risks, the objectives, policies and processes for managing those risks and the methods used to measure them. This may be challenging for some entities, particularly those without any formal or documented risk management system.
- Understanding and accepting the disclosure of potentially sensitive information – for example, details of an entity's approach to financial risk management – the disclosures might highlight weaknesses in some entity's risk management systems.

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- Collating the information required for disclosure – for entities with a few non-complex financial instruments this may be relatively simple. For others, however, identifying, gathering and analysing the information, including comparatives in 2008, may be more difficult and time consuming. This will particularly be so for entities with more complex financial instruments, such as those measured at fair value using a valuation technique.

## Application

AASB 7 applies to all reporting entities for annual reporting periods beginning on or after 1 January 2007. In complying with its requirements, it should be noted that:

- The disclosures and level of detail will vary from entity to entity depending, in part, on:
  - the materiality of the relevant information;
  - the nature and complexity of an entity's financial instruments;
  - the nature and extent of risks arising from financial instruments to which an entity is exposed; and
  - the information provided internally to key management personnel (as AASB 7 requires summary quantitative data about exposure to risk to be disclosed based on information provided to such personnel).

- AASB 7 applies to all financial instruments except for certain limited scope exclusions.
- There is no relief from making parent entity disclosures.
- When first applying AASB 7 comparatives will need to be shown.

## Disclosures

Below we have provided an overview of some of the new disclosures required by AASB 7. A more detailed paper is available on request.

### Significance of financial instruments

For many entities the required disclosures relating to the significance of financial instruments are similar to the old AASB 132 disclosures. One change that will effect many entities is a requirement to disclose a reconciliation of changes in an allowance account for each class of financial assets when the assets are impaired and the impairment is recorded in such an account. For trade debtors, for example, the reconciliation may be shown as follows:

Movements in the allowance for impairment of trade debtors	2008 \$	2007 \$
Balance at beginning of the year	XX	XX
Allowance for impairment recognised	XX	XX
Trade debtors written-off	(XX)	(XX)
Balance at the end of the year	XX	XX

### Nature and extent of risks

For many entities the more significant key changes relate to disclosure of the risks that arise from financial instruments and how they have been managed. These risks include, but are not limited to, credit risk, liquidity risk and market risk.

AASB 7 defines these risks as follows:

<b>Credit risk</b>	The risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation.
<b>Liquidity risk</b>	The risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities.
<b>Market risk</b>	The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: currency risk, interest rate risk and other price risk.

Key changes include those described below.

### Qualitative disclosures

For each type of risk arising from financial instruments, an entity is required to disclose:

- the exposures to risk and how they arise;
- its objectives, policies and processes for managing the risk and the methods used to measure the risk; and
- any changes in (a) or (b) from the previous period.

AASB 7's implementation guidance suggests that the qualitative information an entity might disclose includes a description of:

- the entity's exposures to risk and how they arose. This might describe exposures both gross and net of risk transfer and other risk-mitigating transactions.
- the entity's policies and processes for accepting, measuring, monitoring and controlling risk, which might include:
  - the structure and organisation of the entity's risk management function, including a discussion of independence and accountability;
  - the scope and nature of the entity's risk reporting or measurement systems;
  - the entity's policies for hedging or mitigating risk, including its policies and procedures for taking collateral; and
  - the entity's processes for monitoring the continuing effectiveness of such hedges or mitigating devices.

- the entity's policies and procedures for avoiding excessive concentrations of risk.

### Quantitative disclosures

For each type of risk arising from financial instruments, an entity is required to disclose:

- summary quantitative data about its exposure to that risk at the reporting date based on the information provided internally to key management personnel of the entity;
- specified disclosures to the extent not provided in (a), unless the risk is not material; and
- concentrations of risk, if not apparent from (a) and (b).

### Credit risk

In addition to the maximum exposure to credit risk and description of collateral held, an entity is now required to disclose by class of financial instrument:

## AASB 3 Business Combinations

**AASB 3 has been revised with the new standard applicable prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 July 2009.**

### Key changes

Key changes from the existing standard include:

- The acquirer measuring any non-controlling interest (currently called minority interest) in the acquiree either at fair value or as the non-controlling interest's proportionate share of the acquiree's net identifiable assets. Currently, only the latter is permitted.
- Changes to the recognition criteria for intangible assets acquired in a business combination. All acquired intangible assets are to be recognised separately from goodwill – there is no reliable measurement "out".
- Acquisition related costs the acquirer incurs in connection with a business combination must be accounted for separately from the business combination, which usually means they will be expensed (rather than included in goodwill).
- Consideration transferred by the acquirer, including contingent consideration, will be measured and recognised at fair value at the acquisition date. Subsequent changes in the fair value of contingent consideration classified as liabilities will be recognised in accordance with the relevant accounting standard, which will normally mean the changes are recognised through profit or loss (rather than by adjusting goodwill).
- For business combinations achieved in stages, having the acquisition date as the single measurement date was extended to include

the measurement of goodwill. An acquirer will remeasure any equity interest it holds in the acquiree immediately before achieving control at its acquisition-date fair value and recognise the resulting gain or loss, if any, in profit or loss.

### AASB 127 Consolidated and Separate Financial Statements

AASB 127 was revised concurrently with AASB 3. Key changes from the existing AASB 127 include:

- An entity must attribute income to the owners of the parent and to the non-controlling interests even if this results in the non-controlling interests having a deficit balance.
- Requirements added to specify that changes in a parent's ownership interest in a subsidiary that do not result in the loss of control must be accounted for as equity transactions.
- Requirements added to specify how an entity measures any gain or loss arising on the loss of control of a subsidiary. Any such gain or loss is recognised in profit or loss. Any investment retained in the former subsidiary is measured at its fair value at the date when control is lost.

As you can see, the revised standards introduce a number of significant changes. Some are helpful as they clarify matters not dealt with by, or uncertainties within, the existing standards. However, for some a number of the changes, particularly the expensing of transaction costs, will be difficult to accept.

- (a) information about the credit quality of financial assets that are neither past due nor impaired; and
- (b) the carrying amount of financial assets that would otherwise be past due or impaired whose terms have been renegotiated.

**Credit quality**

AASB 7's implementation guidance says that in disclosing information about the credit quality of financial assets that are neither past due nor impaired, an entity might disclose the following:

- (a) an analysis of credit exposures using an external or internal credit grading system;
- (b) the nature of the counterparty;
- (c) historical information about counterparty default rates; and
- (d) any other information used to assess credit quality.

**Financial assets past due or impaired**

An entity is required to disclose by class of financial asset:

- (a) an analysis of the age of financial assets that are past due as at the reporting date but not impaired;
- (b) an analysis of financial assets that are individually determined to be impaired as at the reporting date, including the factors the entity considered in determining that they are impaired; and
- (c) for the amounts disclosed in (a) and (b), a description of collateral held as security and other credit enhancements and, unless impracticable, an estimate of their fair value.

**Liquidity risk**

An entity is required to disclose:

- (a) a maturity analysis for financial liabilities that shows the remaining contractual maturities; and
- (b) a description of how it manages the liquidity risk inherent in (a).

In presenting the contractual maturity analysis, an entity may provide a table similar to table 1:

Guidance as to preparation of the contractual maturity analysis is given in AASB 7 Appendix B. For example, it says:

- In preparing the contractual maturity analysis an entity uses judgement to determine an appropriate number of time bands.
- When a counterparty has a choice of when an amount is paid, the liability is included on the basis of the earliest date on which the entity can be required to pay.
- The amounts disclosed in the maturity analysis are the contractual undiscounted cash flows .

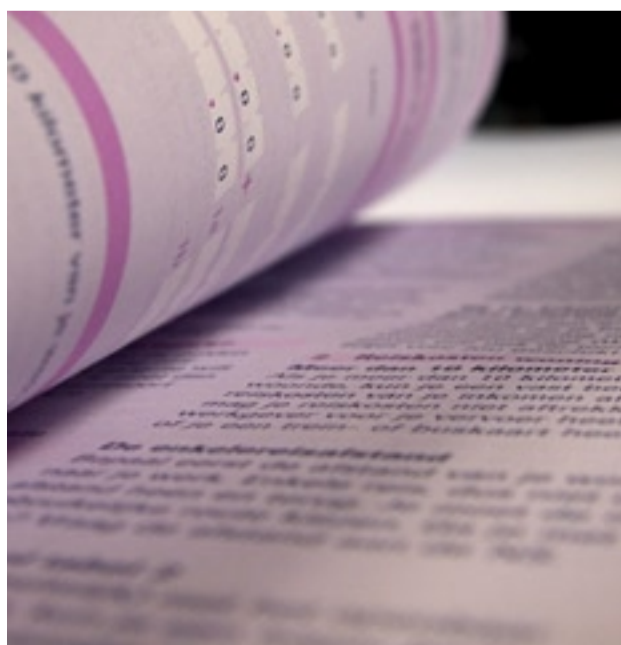


Table 1

	Carrying Amount \$	Total Contractual Cash Flows \$	Less than 6 Months \$	6 – 12 Months \$	1 – 2 Years \$	2 – 5 Years \$	Over 5 Years \$
<b>Derivative financial liabilities</b>							
Interest rate swaps settled net	XX	XX	XX	XX	XX	XX	XX
<b>Forward exchange contracts settled gross</b>							
Outflow	XX	XX	XX	-	-	-	-
Inflow	-	(XX)	(XX)	-	-	-	-
<b>Other financial liabilities</b>							
Trade payables	XX	XX	XX	-	-	-	-
Bank overdraft	XX	XX	XX	-	-	-	-
Bank loans-secured	XX	XX	XX	XX	XX	XX	XX
Finance lease liabilities	XX	XX	XX	XX	XX	XX	XX

Table 2

	Carrying Amount \$	Interest Rate Risk				Foreign Exchange Risk				Other Price Risk			
		- 0.5%*		+ 0.5%*		- 10%*		+ 10%*		- 10%*		+ 10%*	
		Profit	Equity	Profit	Equity	Profit	Equity	Profit	Equity	Profit	Equity	Profit	Equity
Cash	XXX	XX	XX	XX	XX	-	-	-	-	-	-	-	-
Trade receivables	XXX	-	-	-	-	-	-	-	-	-	-	-	-
Other receivables	XXX	-	-	-	-	XX	XX	XX	XX	-	-	-	-
<b>Equity investments:</b>													
- held for trading	XXX	-	-	-	-	-	-	-	-	XX	XX	XX	XX
- available for sale	XXX	-	-	-	-	-	-	-	-	XX	-	-	XX
Trade payables	XXX	-	-	-	-	XX	XX	XX	XX	-	-	-	-
Borrowings	XXX	XX	XX	XX	XX	-	-	-	-	-	-	-	-

\* Because the factors affecting market risk vary depending on the specific circumstances of each entity, the appropriate range to be considered in providing a sensitivity analysis of market risk varies for each entity and for each type of market risk.

In relation to liquidity management, AASB 7's implementation guidance indicates:

- If an entity manages liquidity risk on the basis of expected maturity dates, it might disclose a maturity analysis of the expected maturity dates of both financial liabilities and financial assets (in addition to the required contractual maturity analysis).
- The factors an entity might consider in describing how it manages the liquidity risk inherent in the contractual maturity analysis. These include whether the entity:
  - (a) expects some of its liabilities to be paid later than the earliest date on which it can be required to pay
  - (b) holds financial assets for which there is a liquid market and that are readily saleable to meet liquidity needs; and
  - (c) has committed borrowing facilities or other lines of credit (e.g. stand-by credit facilities) that it can access to meet liquidity needs.

**Market risk**

AASB 7 requires an entity to disclose:

- (a) a sensitivity analysis for each type of market risk to which the entity is exposed at the reporting date, showing how profit or loss and equity would have been affected by changes in the relevant risk variable that were reasonably possible at that date;
- (b) the methods and assumptions used in preparing the sensitivity analysis; and
- (c) changes from the previous period in the methods and assumptions used, and the reasons for such changes.

An exception to this requirement is where an entity prepares a sensitivity analysis, such as value-at-risk, that reflects interdependencies between risk variables and uses it to manage financial risks. In that case, the entity may use that sensitivity analysis in place of the analysis specified above.

In presenting the sensitivity analysis, an entity may provide a table similar to Table 2:

Other types of presentation are allowed. For example, AASB 7's implementation guidance provides an alternative sensitivity analysis presentation.

Guidance as to the preparation of the sensitivity analysis is given in AASB 7 Appendix B. For example, it says:

- The sensitivity analysis is required to show the effect on profit or loss and equity of reasonably possible changes in the relevant risk variable (e.g. prevailing market interest rates, currency rates, equity prices or commodity prices). For this purpose:
  - (a) entities are not required to determine what the profit or loss for the period would have been if relevant risk variables had been different. Instead, entities disclose the effect on profit or loss and equity at the reporting date assuming that a reasonably possible change in the relevant risk variable had occurred at the reporting date and had been applied to the risk exposures in existence at that date; and
  - (b) entities are not required to disclose the effect on profit or loss and equity for each change within a range of reasonably possible changes of the relevant risk variable. Disclosure of the effects of the changes at the limits of the reasonably possible range would be sufficient.
- In determining what a reasonably possible change in the relevant risk variable is, an entity should consider:
  - (a) the economic environments in which it operates. A reasonably possible change should not include remote or 'worst case' scenarios or 'stress tests'; and
  - (b) the time frame over which it is making the assessment. The sensitivity analysis shall show the effects of changes that are considered to be reasonably possible over the period until the entity will next present these disclosures, which is usually its next annual reporting period.

**Summary**

AASB 7 introduces a number of significant new disclosures some of which have been outlined above. For some entities, compliance will be relatively straight forward. For other entities, such as those with more complex financial instruments and diverse operations, compliance will be more difficult. In complying with AASB 7's requirements, it is necessary to consider the application guidance to the standard as well as the implementation guidance.

## Other Changes for 2008

These include:

### Accounting Standards

#### AASB 101 Presentation of Financial Statements

The revised standard removes various Australian specific disclosure requirements and includes new disclosure requirements regarding an entity's objectives, policies and processes for managing capital. These capital management disclosures include:

- a description of what an entity manages as capital;
- summary quantitative data as to what an entity manages as capital, including financial liabilities considered to be part of capital;
- how an entity meets its objectives for managing capital; and
- details as to externally imposed capital requirements, including compliance therewith and consequences of non-compliance.

#### AASB 2007-4 Amendments to Australian Accounting Standards arising from ED151 and Other Amendments

This standard, which is applicable for annual reporting periods beginning on or after 1 July 2007, makes amendments to many existing standards: introducing options available under IFRSs that were originally deleted by the AASB, eliminating various Australian specific disclosure requirements and making various editorial amendments.

Key amendments include:

- inserting the option to use the indirect method for presenting cash flow statements under AASB 107 Cash Flow Statements; and
- inserting the options in AASB 120 Accounting for Government Grants and Disclosure of Government Assistance to record non-monetary grants at nominal amounts and to present assets and expenses net of related grants; and

### Interpretations

#### Interpretation 10 Interim Financial Reporting and Impairment

This interpretation requires that an entity not reverse an impairment loss recognised in a previous interim period in respect of goodwill or an investment in either an equity instrument or a financial asset carried at cost.

#### Interpretation II AASB 2 – Group and Treasury Share Transactions

This interpretation addresses whether certain types of share-based payment transactions with employees (or other suppliers of goods and services) should be accounted for as equity settled or as cash-settled transactions under AASB 2. It also specifies the accounting in a subsidiary's financial statements for share-based payment arrangements involving equity instruments of the parent.

### Corporations Act 2001

For 2008 changes to the Corporations Act, related regulations and AASB 124 Related Party Disclosures will impact the disclosure of key management personnel remuneration by companies that are disclosing entities.

In summary:

- Section 300A has been amended to apply to any company that is a disclosing entity. Previously, it only applied to listed companies.
- Companies that are disclosing entities will now have to include the key management personnel remuneration disclosures required by AASB 124 in the remuneration report. Previously, listed companies had a choice as to whether such disclosures were transferred to the remuneration report.
- The entire remuneration report must now be audited for compliance with Section 300A.

### ASIC Class Orders

#### Class Order 98/1418 Wholly-owned entities

Class order 98/1418, which provides certain wholly-owned subsidiaries with relief from the requirements to prepare and lodge an audited financial report, has been amended. Changes include:

- removal of the requirement for a three year compliance history with the financial reporting requirements of the Corporations Act 2001;
- replacement of the requirement to lodge an annual notice with a requirement to lodge a notice when relief is first applied, or when the holding entity changes and when the company ceases to apply the relief; and
- reducing or removing certain other requirements.

The changes will enable more companies to rely on the relief and reduce the administrative work for group companies.

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

Under this class order any disclosing entity with a first financial year of 8 months or less is relieved from the requirement to prepare and lodge a half-year financial report and directors' report for that financial year on condition that:

- (a) the disclosing entity informs the market (in the case of a listed disclosing entity) or ASIC (in the case of an unlisted disclosing entity) that the entity intends to rely on the relief under the class order; and
- (b) the directors' report for the first financial year states that the entity relied on the relief under the class order and explains the effect of the relief.

### Other matters

In addition to the changes noted above, there are various other new accounting standards and interpretations which have been issued but are not yet effective. Consideration should be given as to whether there are any benefits from early application of these standards and interpretations. If not applied, AASB 108 requires disclosure of this fact and known or reasonably estimable information relevant to assessing the possible impact on application.



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