

A QUARTERLY PUBLICATION ON ACCOUNTING & AUDITING MATTERS

CLARITY

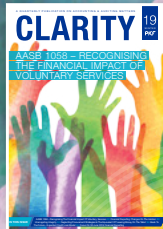
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PKF

AASB 1058 – RECOGNISING THE FINANCIAL IMPACT OF VOLUNTARY SERVICES

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WELCOME TO THE WINTER EDITION OF CLARITY



Welcome to our Winter 2019 edition of Clarity. Our aim is to deliver greater clarity and understanding to our clients on the current and emerging accounting and audit issues. We also look to provide thought leadership, and share our knowledge and expertise, in areas that will solve problems and create solutions for clients. We hope you find this edition of value and please feel free to contact your local Audit Partners for any further assistance.



Clayton Hickey
Partner
PKF Sydney & Newcastle
chickey@pkf.com.au



“Boards must carefully weigh the costs and burden of recording and calculating the required information with the benefits to be received.”

AASB 1058 – RECOGNISING THE FINANCIAL IMPACT OF VOLUNTARY SERVICES

Non-public sector Australian not-for-profit (NFP) entities will soon have the option to recognise the benefit of voluntary services received in their profit or loss account. What does this mean for those in the sector, and should boards be considering implementation of this choice?

Following on from Hayley Keagan's [article](#) on *Peppercorn Leases* in the Summer 2019 edition of Clarity, we look to explore another aspect of AASB 1058, that of voluntary services received. The standard applies to annual reporting periods beginning on or after 1 January 2019 but can be early adopted so long as AASB 15 is also implemented for the same period.



What does the new standard allow?

One of the key provisions that the standard brings is to allow entities to account for the fair value of volunteer services as income within profit or loss. This becomes an accounting policy choice and entities can account for all services or just particular classes of service in this way. Entities need to consider both those services that they have received for free, and those for which they have paid significantly less than fair value.

These voluntary services can only be recognised if the fair value of the service received can be measured reliably. It should be noted that while this is an accounting choice for most NFPs, it will remain mandatory for certain public sector entities in line with the existing requirements of AASB 1004.

Some voluntary services will be clearly identifiable, such as pro bono accounting or legal advice received. But entities will have to consider all of the other services they receive and for some entities this is expected to be quite difficult.

How are these accounted for?

It is anticipated that in most cases, the economic benefit of these volunteered services would be consumed as the services are acquired and so an equal charge would be shown in profit or loss which would negate any profit impact for a given period. However, in some circumstances, entities may be led to recognising additional assets where relevant recognition criteria are met.

As many NFP entities rely heavily on donated services to achieve their goals and objectives, it is thought that the provisions of this standard will result in more useful and relevant financial information for users. However, boards must carefully weigh the costs and burden of recording and calculating the required information with the benefits to be received.

What should entities be doing?

For entities with the greatest number of donated services, the burden of keeping track and performing appropriate fair value assessments will also be great.

Ultimately the additional information provided by these optional disclosures is expected to benefit users of financial statements and where there is little cost in obtaining that information, it would seem reasonable for boards to provide the additional disclosure. Where boards are less sure of the burden of providing the additional information, they may wish to consider discussing the voluntary services received in the trustees' report whereby more information can be provided to stakeholders but perhaps under a less strict framework.

Should you wish to explore the options above further, please contact your local PKF office. ■

FINANCIAL REPORTING CHANGES ON THE HORIZON

The Australian Accounting Standards Board has been busy over the last few months which has resulted in some proposed changes to accounting standards being released for comment.

The changes are summarised below:

Standard	ED 293	ED 291
Name	Disclosures in Special Purpose Financial Statements.	Not-for-Profit Entity Definition and Guidance.
Application date	Financial years ended 30 June 2020 (early application is encouraged).	On a date yet to be determined.
Detail of the proposed changes	<p>Additional disclosures will be required for those entities who prepare special purpose financial statements as follows:</p> <ul style="list-style-type: none"> The reason why Special Purpose Financial Statements are prepared, rather than General Purpose. If the entity is a parent entity and has not prepared a consolidated report, the reason for not consolidating (same requirements for associates and joint ventures). A statement as to whether the stated policies in the financial report comply with the requirements of accounting standards and where they do not comply with, a summary as to the extent of non-compliance. 	<p>Various accounting standards currently refer to not-for-profit entities. However, there is currently no clear definition which can be applied across all standards or for the financial report as a whole.</p> <p>Therefore, the AASB has performed a "clean up" of terminology and formally developed a definition of a not-for-profit entity, being:</p> <p>"an entity whose primary objective is to provide goods or services for community or social benefit and where any equity has been provided with a view to supporting that primary objective rather than for a financial return to equity holders."</p>
What prompted the changes?	Research conducted by the AASB assessing the impact on entities of transitioning from Special Purpose to General Purpose Financial Statements identified difficulties in interpreting the extent of compliance with accounting standards.	With the deferral of implementing the new revenue standard as well as the introduction of AASB 1058: <i>Income of Not-for-Profit Entities</i> as well as the upcoming changes for removing Special Purpose Financial Statements only being initially applicable to for-profit entities, a clear and easy to understand definition will assist organisations in determining whether they can access the differential reporting allowed to not-for-profit entities.
How might these changes apply to your organisation	<p>If you prepare Special Purpose Financial Reports and apply the recognition and measurement principles of accounting standards, including consolidation, then there will be minimal impact and PKF will be able to provide standard disclosure wording for complying with the changes.</p> <p>If you do not currently consolidate or depart from some of the requirements of accounting standards (such as not applying tax effect accounting) then more disclosure will be necessary and a tailored disclosure will need to be drafted.</p>	<p>If you are currently preparing financial statements as a not-for-profit entity, it is a good time to consider if the above definition still fits your purpose. If so, it is likely for there to be nothing further to do.</p> <p>We expect wording from the Financial Report to be updated to reflect this new definition, but PKF will be able to help entities establish any change to disclosure once the standard commences.</p>

The above changes seem to have the flavour of assisting with the AASB's project to remove Special Purpose Financial Reporting. If you missed our previous article on this project you can find it [here](#).

These changes are now out for comment and PKF is planning to submit a response to the AASB. If you would like to include your opinion or discuss the proposed changes in more detail, then please contact our Technical Financial Reporting Team. Submissions close early in August 2019 and so we encourage your feedback as soon as possible. ■



Hayley Keagan
Technical Director
PKF Sydney & Newcastle
hkeagan@pkf.com.au



*Audit your
thinking*

Think outside
the Big 4.

Discover the
PKF audit
difference.





Ken Weldin
Partner
PKF Melbourne
kweldin@pkf.com.au



“

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”

INTERROGATING INTEGRITY

Governance, culture and ethics have never been more relevant across Australian business. We have seen a growing lack of trust in institutions, in traditional structures and even in some cases in people's success. Noting that the full title of the Hayne Royal Commission featured the word 'misconduct', ethical business practices and corporate governance really do matter for today's boards and management teams. These expectations mean that governance, risk and compliance efforts need to move beyond the traditional 'tick the box' approach.

Against this context, boards and management, are racing to understand how they can ensure their corporate culture is one that inspires greater governance, risk and compliance efforts, across all levels of the business. In other words, *Interrogating Integrity* is a feature of strong contemporary governance, for all sectors, not just those operating in financial services.

Have the conversation sooner rather than later

It is quite rare that an organisation's ethical compass is called into question as to the result of a one-off catastrophic event. More often than not, it is a number of small issues that build up over time that lead a company into trouble.

From this, our experience working with companies stresses the importance of taking a proactive approach towards the matter of establishing and then improving governance.

When having these conversations, it can be tempting to take a light touch approach. But, in order to truly understand your business' risk you need be honest (brutally so) and interrogate your operations from the ground up, to ensure you are creating a culture and environment that promotes the highest levels of integrity.

Why things go wrong

- 1 Lacking behavioural integrity**
by creating a culture that does not encourage open transparency and accountability.
- 2 Too big a focus on fiscal performance**
which can lead to increased pressure to achieve results at the detriment of all else.

- 3 Ignorance** created from a lack of communication within an organisation or an aversion to dealing with difficult situations.
- 4 Inadequate controls** in place to identify and respond to issues when they arise.
- 5 The fraud triangle** – a term coined by Donald Cressey, a prominent criminologist, that theorises that most fraud cases are made up of three factors: **pressure** on individuals (personal or workplace), the opportunity to commit fraud and the ability to **rationalise** the crime.

The importance of culture

A strong culture is one that **listens** and **learns**. When reviewing your corporate culture ask:

- Do we encourage transparency and accountability?
- Do we have a common set of clearly communicated goals and objectives?
- Do we know who all of our stakeholders are?
- Are our communication practices relevant and effective?
- Do we have clear decision making structures in place?
- Do we have a consistent and fair approach to performance management?
- Are we overcomplicating or overthinking our culture measurement processes?
- Do we have appropriate escalation, investigation and disciplinary processes in place?
- Do our hiring processes consider our social license to operate?
- Do we provide the right level of training?

Reviewing your culture is not a set and forget exercise. Culture is a fluid concept and will naturally evolve and change over time with staff turnover, changing work pressures, new legislative requirements and changing technology. It is therefore imperative that regular checkpoints are scheduled in which to revisit the above questions and respond to any new red flags or capitalise on opportunities.

The most important thing is to have integrity related conversations focused on identifying how culture, value and ethics impact your organisation. And have these conversations regularly. ■

NEGLECTING PROCUREMENT STRATEGIES IS THE EQUIVALENT OF 'LEAVING MONEY ON THE TABLE'

Effective procurement strategies can help to reduce the risk of potential contract fraud and will also deliver robust processes that are flexible to your organisation's operating environment, delivering tangible value and opportunities. However, it is common to not have a strategy in place, leaving an organisation open to overcharging from your supplier base.

A previous client hired one of the PKF Integrity team members to establish a procurement strategy after the organisation had experienced a fraudulent incident and was leaving itself exposed. Four years later, this strategy resulted in the establishment of a procurement joint venture company that would provide a further tangible of \$43 million over five years.

Savings can be achieved by establishing an operational framework under which procurement will be implemented across the organisation. Focusing on four guiding principles in all procurement activities:

- 1 Value for money;
- 2 Leveraging contracted opportunities;
- 3 Being quality driven; and
- 4 Building strategic relationships.

These guiding principles form the cornerstone for all activities from developing business requirements, contract negotiation, tender management and supplier relationship management.

“...this strategy resulted in the establishment of a procurement joint venture company that would provide a further tangible of \$43 million over five years.”

Once the operational framework for all procurement activities is established, you can then identify quick wins around cost savings and process efficiencies, whilst also building medium to longer term goals to really lift procurement across the organisation. More importantly, effective procurement



strategies change the culture of an organisation, lifting the value and importance of spending the organisation's money ethically whilst removing any current instilled casual and/or adhoc approaches.

This change ensures professionalism and accountability across the business, sharpening the focus to ensure money is not 'left on the table' through tasks such as effective quoting, contract negotiation and supplier relationship management. These strategies bring dollars back to the business and give employees a sense of pride and satisfaction in delivering the right outcomes for the organisation.

For more information, please call David on 07 3839 9733. ■

David Morgan
PKF Integrity
Managing Director
david.morgan@pkf.com.au



“ Effective procurement strategies change the culture of an organisation, lifting the value and importance of spending the organisation's money ethically whilst removing any current instilled casual and/or adhoc approaches. ”





Tim Follet
Director
PKF Brisbane
tim.follett@pkf.com.au



“ The result of this new standard is that credit losses will be recognised earlier. It will no longer be appropriate for entities to wait for an incurred loss event to have occurred before credit losses are recognised. ”

BACK TO THE FUTURE – EXPECTED CREDIT LOSS MODEL

General provisioning of debtors was removed many years ago, never to return, or so we thought.

AASB 139 *Financial Instruments: Recognition and Measurement* previously required impairment allowances be measured according to an incurred loss model. Under this model, the recognition of credit loss allowances was triggered by loss event subsequent.

However, the new AASB 9 *Financial Instruments* (applicable for reporting periods beginning on or after 1 January 2018) impairment model requires impairment allowances to be based on the deterioration of credit risk since initial recognition. There is now a requirement to consider historic, current and other forward looking information to consider the expected credit losses of financial assets. This assessment now requires the use of quantitative criteria and experienced credit risk judgement. It does not require a loss to have already been incurred.

This new model appears to take a step back to the future, of general provisioning for loss allowances.

There are three different approaches to applying the new model under AASB 9:

- 1 **Simplified approach** – applied to trade receivables, contract assets and lease receivables.
- 2 **General approach** – applied to all financial assets classified at amortised cost or at fair value through other comprehensive income.
- 3 **Purchased or originated credit impaired approach** – applied to financial assets that are credit impaired at initial recognition.

Let's have a look at the practicalities of the simplified approach, which most trading entities will adopt. In this approach, we apply a simple five step provision matrix using an example of an entity with two categories of receivables:

Step 1 – group receivables by similar risks

- Category (A) \$400. Foreign based receivables with political risks.
- Category (B) \$600. Domestic trading receivables with limited risks.



Step 2 – determine period of historical loss rates

- Category (A) new customer base. Therefore, use last one year of data.
- Category (B) no change in customer base for last 10 years, therefore, use last 10 years of data.

Step 3 – determine historical loss rates over period in Step 2

- Category (A) 10% of debtors lost over last year.
- Category (B) 5% of debtors lost over last 10 years.

Step 4 – consider forward looking information and conclude on loss rate (judgement)

- Category (A) anticipated future 20% loss rate. Therefore apply 15% (10% past and 20% future).
- Category (B) anticipated future 5% loss rate. Therefore apply 5% (5% past and 5% future).

Step 5 – calculate expected credit loss

- Category (A) 15% at \$400 = \$60 provision.
- Category (B) 5% at \$600 = \$30 provision.

In this example, a total debtor's provision is recorded of \$90 (\$60 + \$30).

The result of this new standard is that credit losses will be recognised earlier. It will no longer be appropriate for entities to wait for an incurred loss event to have occurred before credit losses are recognised. Debtor provisions are expected to increase for reporting periods ending 30 June 2019.

For now, it is back to the future for debtor provisions. ■

FOCUS ON 30 JUNE 2019 FINANCIAL REPORTING

In mid-June ASIC issued its views on the matters that financial report preparers, Directors, management and auditors should consider of highest priority in the 30 June 2019 financial reporting cycle (through its 19-143 [Media Release Major financial reporting changes and other focuses](#)), calling on companies to focus on new requirements that can materially affect reported assets, liabilities and profits.

The views remain relatively consistent with those of previous advisories, released biannually by ASIC. However, the current release serves as a reminder to all 30 June 2019 financial report preparers that they adopt the full application of significant new accounting standards on revenue recognition and financial instrument values. Our clients and contacts will be aware that the impacts ought to have been considered – and necessary adjustments made – with effect from 1 July 2018 (indeed for some, from 1 January 2018). ASIC highlights that “*new accounting standards can significantly affect results reported to the market by companies, require changes to systems and processes, and affect businesses*”.

This indicates that ASIC focuses its attention on listed companies and other entities of public interest that ‘report to the market’. While true, we encourage our broader client and contact community to consider ASIC’s views as important to the breadth of the financial reporting obligations of that community.

We refer readers to our [Autumn 19 edition of Clarity](#) which discussed the AASB project to change the ‘conceptual framework’. This will, in turn, see the end of ‘special purpose financial statements’ for those required to prepare financial reports in accordance with accounting standards. Changes requiring them to be prepared as general purpose financial reports (albeit with the opportunity to utilise a reduced level of disclosure) will likely commence for reporting periods ending 31 December 2021 and 30 June 2022. Our advice is therefore that the preparers of all statutory financial reports be cognisant of the matters that ASIC (and PKF) believe should be of focus in financial statement preparation.

Those of heightened current focus are:

- **Impact of new accounting standards**
 - AASB 9 *Financial Instruments*, AASB 15 *Revenue from Contracts with Customers* apply from years commencing 1 January 2018 and AASB 16 *Leases*



applies from years commencing 1 January 2019, meaning that its impact must be disclosed in 30 June 2019 financial reports.

- **Impairment testing and asset values** – assessing the recoverability of the carrying amounts of assets such as goodwill, other intangibles and property, plant and equipment generally involve significant management judgement and estimation, their responsible challenge by Directors, and the scrutiny of the auditor.
- **Accounting policy choices** – policies affecting reported results are most critical, including revenue recognition, cost capitalisation, and impending policy changes arising from the new standards.
- **Tax accounting** – a proper understanding of both tax and accounting treatments drives how differences between the two affect tax assets, liabilities and expenses.
- **Material disclosures** – immaterial disclosures that may add unnecessary clutter do not concern ASIC; there is a focus on material information useful to users.

Your local PKF contacts are ready to provide further guidance in relation to the above-noted focus areas.

Footnote: Readers may be interested to review and comment on ASIC’s recently released SPFR-related [Exposure Draft ED293 Amendments to Australian Accounting Standards – Disclosure in Special Purpose Financial Statements of Compliance with Recognition and Measurement Requirements](#). ■



Steve Bradby
Partner
PKF Melbourne
sbradby@pkf.com.au



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About PKF

PKF brings clarity to business problems with simple, effective and seamless solutions that break down barriers for sustainable growth.

PKF Australia firms are members of the PKF International Limited (PKFI) network of legally independent firms in 440 offices, operating in 150 countries across five regions. PKFI is the 10th largest global accountancy network.

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PKF Australia's Audit & Assurance Contacts

Sydney

Scott Tobutt
Partner
02 8346 6000
stobutt@pkf.com.au

Brisbane

Liam Murphy
Partner
07 3839 9733
liam.murphy@pkf.com.au

Melbourne

Steven Bradby
Partner
03 9679 2222
sbradby@pkf.com.au

Perth

Simon Fermanis
Partner
08 9426 8999
sfermanis@pkfperth.com.au

Adelaide

Steven Russo
Partner
08 8373 5588
steven.russo@pkfsa.com.au

Canberra

Ross Di Bartolo
Partner
02 6257 7500
ross@pkfcanberra.com.au

Newcastle

Martin Matthews
Partner
02 4962 2688
mmatthews@pkf.com.au

Gold Coast

Grant Chatham
Partner
07 5553 1000
grant.chatham@pkf.com.au

New England North West

Marg van Aanholt
Partner
02 6768 4500
mvanaanholt@pkf.com.au



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