CLARITY

A QUARTERLY PUBLICATION ON ACCOUNTING & AUDITING MATTERS

PKF

22

WINTER

RESPONDING TO CHANGE IN THE NEW FINANCIAL YEAR

IN THIS ISSUE

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WELCOME TO THE AUTUMN EDITION OF CLARITY

Welcome to our WINTER 2022 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 and Assurance Partners for any further assistance.

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This is just our top 5 areas of focus on ASIC's radar. You can view all areas of focus here, and the results of ASIC's most recent review of financial reports here. You will see that the areas of focus align heavily with the areas of concern from ASIC's last review.

If you would like any assistance with aligning your financial reporting with ASIC's areas of focus, please reach out to your local PKF Audit representative. I

ASIC's big five

ASIC operates a financial reporting surveillance program, whereby they review a selection of financial reports of listed and other significant companies. As part of the surveillance program, ASIC announces the areas of financial reporting that they intend to focus on for the next round of reviews. ASIC's top 5 areas of focus for 30 June 2022 financial reports are summarised below, for your easy reference:

Area	The focus	What you can do
Asset values	ASIC will look to ensure assets are not inflated with a particular focus on those that require estimates. This serves as a good reminder that estimates present themselves in many assets, including impairment, fair values, ECLs provisions, inventory NRV.	• Perform impairment testing where necessary • Check that estimates are supportable by observable data • Update estimates for economic issues.
Provisions	ASIC is interested to see if all provisions are considered in a financial report and that amounts provided for are sufficient.	• Review all contracts for potential provisions or contingencies (ie warranties, make-good requirements, onerous conditions) • Ensure that estimated provisions take into consideration all likely outflows • Update estimates from prior periods for current conditions.
Solvency and going concern	With inflation and interest rates on the rise, it is a good time for ASIC to be focusing on solvency and going concern assessments.	• Prepare a going concern assessment that considers the impact of both internal and external factors • Perform solvency checks prior to signing the director's declaration • Reach out for help if you need it.
Subsequent events	ASIC will be checking whether events that have occurred subsequent are adjusting or disclosing events.	• Firstly, ensure you identify all subsequent events which may have an impact on the financial situation of the business • Refer to AASB 110 for guidance on what is adjustable and what is disclosing.
Disclosures in the director's report	ASIC has commented in several publications about the need for directors to sharpen their pencils when preparing their operating and financial review (OFR) commentary for the director's report. This is no doubt an area that will be highly scrutinised by ASIC for 30 June 2022.	• Refer to RG 247 which provides guidance on preparing an OFR • Review other publicly available information to ensure it is consistent with the message in your OFR • Ensure the OFR covers off on material business risks.

Drilling down on exploration and evaluation expenditure

Australia's resource and energy export earnings are forecast to hit a record of $425 billion in 2021–22. While new waves of COVID-19 cases and the Russian invasion of Ukraine are likely to have checked the global economic recovery (and hence commodity demand), Australian resource and energy export earnings are likely to be lifted by surging energy prices. **- Australian Government, Resources and Energy Release, March 2022**

Hence, AASB 6 (Exploration for and Evaluation of Mineral Resources) continues to be a significant and important standard in financial reporting in Australia.

Difference between AASB 6 and IFRS 6

Although there is IFRS 6 of the same name, AASB 6 includes specific 'Aus" paragraphs covering Australian-specific requirements and has a stricter set of rules related to the capitalisation of exploration and evaluation (E&E) expenditure.

One such Australian concept is an "area of interest", which paragraph Aus 7.2 defines as:

"an individual geological area whereby the presence of a mineral deposit or an oil or natural gas field is considered favourable or has been proved to exist".

The main instance of this is a single mine or deposit or a separate oil or gas field, which is applied to the expenditures incurred and testing for impairment. Hence, AASB 6 results in earlier impairment and/or derecognition of the E&E asset than under IFRS 6.

Example one: Rights of tenure are not current

Paragraph Aus 7.2 also states:

"Exploration and evaluation assets shall only be recognised…. if the rights to tenure of the area are current".

This means that application costs for tenements/permits prior to granting cannot be capitalised.

Example two: Capitalising general overheads

Paragraph Aus 9.4 states:

"General and administrative costs are allocated to, and included in, the cost of an exploration and evaluation asset, but only to the extent that those costs can be related directly to operational activities in the area of interest to which the exploration and evaluation asset relates."

Otherwise, these costs are expensed as incurred. Examples of such costs are directors' fees, salaries and general management expenses. An example of a capitalised cost is if the relevant person is also performing the role of exploration manager and competent person.

Also, at least one of the following two conditions needs to be met for a cost to be capitalised:

i. the exploration and evaluation expenditures are expected to be recouped through successful development and exploitation, or by sale; or

ii. exploration and evaluation activities in the area of interest have not at the reporting date reached a stage of reasonable assessment to determine the recoverable reserves, but active operations are continuing.

Impairment testing shall be undertaken when facts and circumstances suggest that the carrying amount of the E&E asset may exceed its recoverable amount.

Finally, even though costs can be fully capitalised per AASB 6 if the above conditions are considered, these can also be expensed as incurred or partially capitalised.

PKF Audit & Assurance has a number of experts in the mining and resources sector nationally. For any further guidance, please contact your local PKF Audit representative.

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"Australia's resource and energy export earnings are forecast to hit a record of $425 billion in 2021–22. While new waves of COVID-19 cases and the Russian invasion of Ukraine are likely to have checked the global economic recovery (and hence commodity demand), Australian resource and energy export earnings are likely to be lifted by surging energy prices."

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"The removal of special purpose financial statements is now effective, and most for-profit entitles will need to transition to general purpose financial statements. Are you ready?"

Time for change: transitioning from special purpose financial statements to general purpose financial statements

The removal of special purpose financial statements (SPFS) is now effective. Most for-profit entities will need to prepare their first general purpose financial statements (GPFS) for the year ended 30 June 2022 as the special purpose framework is no longer available to them. Making this change doesn't need to be daunting, as long as you understand the options available to you.

Those who are required to transition will now need to consider whether they are a tier 1 or tier 2 reporter under AASB 1053: *Application of Tiers of Australian Accounting Standards.*

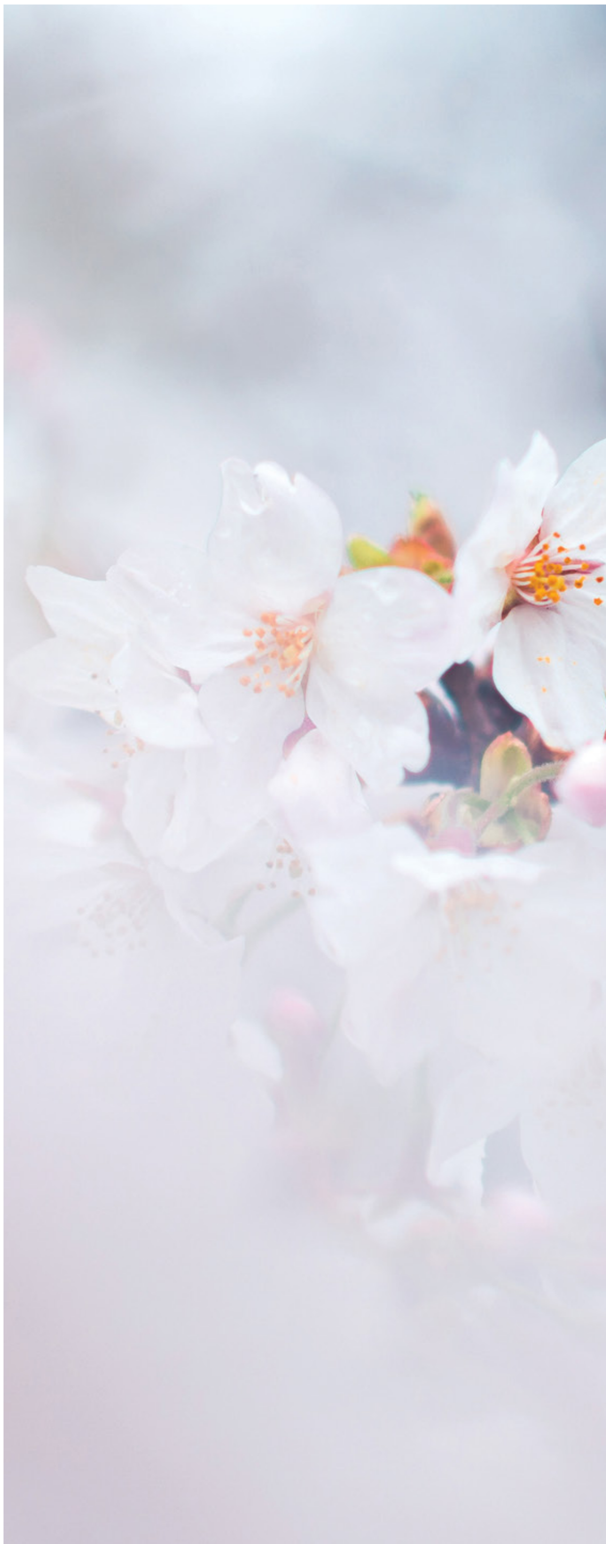
The assessment for tier 2 entities hinges on the definition of public accountability. An entity is deemed to have public accountability if:

- its debt or equity instruments are traded in a public market, or it is in the process of issuing such instruments for trading in a public market (eg on a stock exchange); or
- it holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses. (eg banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks).

Any entity that is considered a tier 2 reporter will have the option to prepare GPFS: Simplified Disclosures (GPFS-SDS), which requires significantly less disclosures than that of full GPFS. Tier 1 reporters will need to comply with the full suite of accounting standards and prepare full GPFS.

Next page is a summary to help guide you through your transition from SPFS to GPFS or GPFS-SDS. This applies to both tier 1 reporters and tier 2 reporters.

For any assistance with navigating the transition process, please reach out to your local PKF Audit representative. I



Extent of compliance with accounting standards in old SPFS		Options for transition
Full recognition and measurement including consolidation, only disclosure relief used.		Update disclosures only, no relief available.
Partial compliance with recognition and measurement and consolidation	AASB 108 approach: **Comparative information** • Full restatement of current and comparative periods i.e., apply all standards as if they have been adopted since the date of initial recognition of the balance. **Disclosures** • Line by line disclosures of impacts	AASB 1 approach: **Deemed cost** Fair value at the transition date or previous revaluation can be adopted for: • property, plant & equipment • investment property • right of use assets and • certain intangibles. **Short-cut consolidation method** This permits: • equity reconciliation showing the changes to retained earnings and • the goodwill in the previously unconsolidated subsidiaries to be determined at the date of transition. **Reset of cost of investments** • Permits unrecognised changes in the fair value of investments to be recognised.
No consolidation or equity accounting where subsidiaries or associates exist	AASB 108 approach: Full retrospective adjustment including restatement of business and investment acquisitions as at their initial acquisition date.	AASB 1 approach: Same as above, but also: **Reset of foreign currency translation reserve** • The cumulative translation differences for all foreign operations can be deemed to be zero at the date of transition. **Easier tracking of past acquisitions of foreign operations** • Allows fair value adjustments and goodwill measured using the entity's functional currency. The carrying amount (before depreciation, amortisation and impairment) do not change as a result of foreign exchange changes.

Control, adhere, adapt and comply

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"By shifting away from a costly and inefficient compliance approach that reacts to regulations, inspections and audit findings, an ERM solution can establish an embedded and sustainable risk management and compliance process that continually anticipates and proactively manages risk on an ongoing basis."

Technology today has the ability to assist businesses in addressing the issues of corporate governance, enterprise risk management (ERM), and corporate compliance (GRC). A businesses ERM system acts as the single source of truth for all corporate activities, including processes designed to handle an increasingly complex GRC regulatory compliance environment.

A properly implemented ERM system, configured for GRC requirements, can provide a more robust governance, risk and compliance program to protect organisations. Businesses should be able to confidently anticipate and act on customer, third party, compliance, enterprise and financial risk, while elevating corporate governance and controls across an organisation. When an ERM solution is setup with GRC requirements in mind, the solution gives businesses a competitive advantage, enabling them to make decisions confidently, in alignment with strategic objectives and risk tolerance.

Ensuring regulatory compliance

When installing an ERM system, ensure the environment is optimally configured for regulatory compliance. If it is, you can benefit from real-time regulatory compliance assessments, which provide instant notification of policy changes negatively impacting security, and actionable recommendations for improvements.

Maintain robust risk management

A modern and robust ERM solution ensures that you are in compliance with international IT and security standards and can adapt to new frameworks as they become relevant. These solutions streamline the documentation of you IT systems, resources, risks and controls, defines and manages periodic risk assessments, accumulates incidents, analyses and manages business continuity, and provides additional insight with the reports, KPI's and dashboards.

Enhance audit management

Companies are subjected to multiple types of audit and compliance, from internal governance to regulatory requirements to industry standards. Managing risk has become a complex matrix that organisations can no longer rely on spreadsheets, email, or basic collaboration software to perform.

Your ERM system should provide an automated solution that organises and centralises every step of the audit process: risk assessment, planning, fieldwork and testing, time and expense management, issue tracking, reporting and remediation.

Gain competitive advantage

An ERM solution, configured for GRC, transforms your governance, risk and compliance management to enable cost savings and improve business performance by standardising governance processes to enhance decision making and avoid unnecessary costs. By shifting away from a costly and inefficient compliance approach that reacts to regulations, inspections and audit findings, an ERM solution can establish an embedded and sustainable risk management and compliance process that continually anticipates and proactively manages risk on an ongoing basis. With this proactive approach to IT governance, risk and compliance, you have the opportunity to create a competitive advantage by using it as a differentiator in the marketplace.

PKF Digital delivers ERM solutions for Australian businesses, in partnership with NetSuite. The team of technology experts have assisted hundreds of small, mid-market and enterprise companies across diverse industries in achieving their business goals and building strength in their approach to corporate governance. Contact us today to explore how we can asssit your business. pkfdigital@pkf.com.au

Uncertainty on discount rates

In a period of economic unrest and rising interest rates, there are ongoing uncertainties that need to be considered in arriving at the appropriate discount rate.

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"In a period of economic unrest and rising interest rates, there are ongoing uncertainties that need to be considered in arriving at the appropriate discount rate."

What is a Discount Rate?

The discount rate refers to the rate of interest applied to future cash flows to determine their present value. The discount rate should reflect the market's present assessments of the time value of money for the periods until the end of the assets or liabilities useful life and the risks associated with the asset or liability. As a method for initial or subsequent measurement, this discount rate is used as a present value technique to calculate the fair value, value in use, or other current value of an asset or liability.

The Accounting Standards most impacted

The main accounting standards that include requirements in relation to discount rates are in the table below.

Uncertainty regarding appropriate Discount Rates

As the future cash flows from an asset or liability are frequently subject to uncertainty, due care should be taken with choosing the appropriate discount rate, as the following should be considered:

- The interest rates used to discount cash flows should be consistent with the perceived risk in the estimated cash flows
- Estimated cash flows and discount rates should be free of bias and unrelated factors to the asset or liability
- The estimated cash flows and discount rates should reflect various possible outcomes in terms of the amount or timing of those cash flows
- Consider the various series of future cash flows that the entity expects to derive from the asset or liability
- Consider using separate discount rates for different future periods when the value in use is sensitive to risk differences between periods.

Where the discount rates used have changed materially, companies must consider whether the effects of these changes must be disclosed.

For assistance with arriving at the appropriate discount rate, please contact your local PKF advisor. I

Accounting Standard	Application of Discount Rate
AASB 119, *Employee Benefits*	• Under the guidance of AASB 119, the discount rates are used to discount post-employment benefit obligations, as the P&L includes interest cost on the defined benefit obligation, thus interest cost is calculated using the discount rate.
AASB 136, *Impairment of Assets*	• Under the guidance of AASB 136, the discount rates are used to determine the recoverable amount / value in use of an asset on a pre-tax basis.
AASB 137, *Provisions, Contingent Liabilities and Contingent Assets*	• Under the guidance of AASB 137, the discount rates are used to determine the present value of the expenditures expected to be required to settle an obligation on a pre-tax basis.
AASB 13, *Fair Value Measurement*	• Under the guidance of AASB 13, discount rates are used to determine fair value.

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 separately owned firms in 440 offices, operating in 150 countries across five regions.

In Australia, PKF offers clients the expertise of more than 94 Partners and 750 staff, across audit, taxation and specialist advisory services.

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