

CLARITY

19

SUMMER

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PEPPERCORN LEASES –
AASB CHANGES
ADDING SPICE TO YOUR
BALANCE SHEET



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WELCOME TO THE SUMMER EDITION OF CLARITY



Welcome to our Summer 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.



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“ A peppercorn lease refers to leases of assets where the required lease payments are significantly below market value. ”

NFP SECTOR GETTING CAUGHT IN RED TAPE WITH PEPPERCORN LEASES

Upon release of [AASB 1058: Income of Not for Profit Entities](#) and [AASB 16: Leases](#), the not-for-profit sector identified a newly emerging area of accounting – the recognition of peppercorn leases on the balance sheet. These standards are effective from 1 January 2019 for all not-for-profit entities.

A peppercorn lease refers to leases of assets where the required lease payments are significantly below market value.

Example

A 99-year lease provided by Crown land for a nominal amount of \$1 per year would need to be accounted for using the following entry upon lease commencement:

Dr	Right-of-use asset	\$X
Cr	Liability	\$1
Cr	Income/ retained earnings	\$X

The amount allocated to the right-of-Use asset is to be determined by reference to its fair value in accordance with AASB 13: *Fair Value*.

Previously, AASB 1058 required assets acquired and held for an amount significantly below market value to be recognised at fair value, with the corresponding accounting entry (after accounting for any liability) recognised as income. At the same time, AASB 16 requires an asset be recognised for a right-of-use asset. The interaction of these two standards results in the need to recognise the right to use the leased asset at fair value.

Issues arose when trying to determine the fair value of these types of assets.

[AASB 13: Fair Value Measurement](#) requires the consideration of restrictions and specialised

nature of the peppercorn lease asset. Some of the issues that come about include:

- Restrictions to use the asset in a specified manner (e.g. to use crown land only for community purposes).
- Term of the lease, which in some instances can be for up to 99 years or perpetual.
- AASB 13 relies upon the presumption of assets being bought and sold, it thus becomes difficult to fit peppercorn leases into the fair value box.

Initial thoughts in trying to overcome the fair value problem have led many not-for-profits down the path of obtaining independent valuations of their peppercorn lease assets, resulting in a significant compliance cost as a direct result of the introduction of AASB 1058 and AASB 16.

Recently I attended the Australian Accounting Standards Board (AASB) meeting where members considered the issues arising in determining the fair value of these assets, noting the extent of peppercorn leases in the Australian not-for-profit sector. Following the meeting, further consultation occurred and consequently, the AASB released [Amendments to Australian Accounting Standards – Right-of-Use Assets of Not-for-Profit Entities](#). The amendments bring relief to some not-for-profit entities that have not yet delved into the valuation of peppercorns, but what other impacts does it have?

“Initial thoughts in trying to overcome the fair value problem have led many not-for-profits down the path of obtaining independent valuations of their peppercorn lease assets, resulting in a significant compliance cost as a direct result of the introduction of AASB 1058 and AASB 16.”

- **Comparability:** the amendments allow for choice of accounting policy. This could lead to some not-for-profit entities recognising significant assets and income related to peppercorns, whilst others have only discussion of the lease arrangement as disclosures in the notes to the financial statements.
- **How long is temporary:** the AASB has provided only a temporary change. The issue will need to be addressed again in the future.
- **Transparency:** without recognising the fair value of peppercorns, are we really demonstrating the true economic worth of the entity? Are disclosures sufficient to understand

the value and dependence from peppercorn leases?

Whilst PKF welcomes the AASB amendments, we believe there is more work to be done before creating a permanent solution.

- AASB 16 is intended to better show the financial leverage and working capital of the lessee – does recognising a peppercorn lease at fair value achieve this?
- Recognising a peppercorn lease asset at fair value on the balance sheet is not likely to demonstrate the not-for-profits reliance on the lease arrangement – perhaps disclosure regarding the arrangement is more important.

- The AASB intends to consider peppercorn lease issues as they apply to the private sector and public sector not-for-profit entities. This could result in a narrow application of the requirements.
- If you are a for-profit entity who has entered into a peppercorn lease, there is no scope to even consider fair valuing the peppercorn lease asset – this creates an inconsistent approach between the for-profit and not-for-profit sector for similar transactions.

If you are, or know of a not-for-profit that has peppercorn leases, subscribe to PKF updates to obtain developing information as it comes to light. ■

AASB 2018-8

Amendments to Australian Accounting Standards – Right-of-Use Assets of Not-for-Profit Entities

An overview:

- Provides an option to not apply the fair value measurement requirements to peppercorn leases;
- Applies to Government and Non-Government, not for profit entities;
- Provides additional disclosure requirements;
- Applicable from 1 January 2019, in line with the introduction of AASB 16: *Leases*;
- Early application permitted if also early adopting AASB 1058: *Income of Not for Profit Entities*; and
- Temporary option as further guidance is to be sought to find a permanent solution.





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“ There are a number of disclosure matters that you need to consider in relation to their impact on the interim half-year financial report. ”

INTERIM REPORTS – NEW DISCLOSURES FOR AASB 9 & 15

The new accounting standards for *Revenue (AASB 15)* and *Financial Instruments (AASB 9)* have now come into operation for years commencing after 1 January 2018. This not only effects the annual report but for disclosing entities, this will also impact the half year interim reports.

Most articles have discussed in detail the application of the measurement and recognition requirements of these standards, but little has been discussed on the relevant disclosures. In reference to a well-used cliché, “the devil is in the detail”.

The below diagram provides an overall summary of the steps to follow in the preparation of the financial report during the interim reporting process in relation to your consideration of disclosures relating to these new standards:



AASB 134 Disclosures

The purpose of AASB 134 is to provide minimal prescribed disclosures as an update to the most recent annual financial report. However, as this is the first period of operation of AASB 9 and 15, AASB 134 will require the disclosure of the following:

- Nature and effect of changes in accounting policies (AASB 134 paragraph 16A(a)); and
- *Disaggregation of revenue* (AASB 15 para 114 – 115).

Firstly, to address the nature and effect matter, we would expect to see disclosures of:

- New accounting policies for each revenue item identified (based upon the different performance obligations you have previously assessed) using consistent terminology from the standard, and description of financial instruments, including the application of impairment, if required; and
- Narrative disclosures about the impacts on the financial statements.

The next consideration is the disaggregation disclosure requirements within AASB 15 *Revenue from Contracts with Customers*. The standard provides further guidance on this application, which you will need to refer to AASB 15 B87 – B89. This highlights examples of categories that depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors. Examples of these are the



type of goods or service, geographical regions, market or type of customer, type of contract, contract duration, etc.

You also need to consider that you have provided adequate information to understand the relationship between the disaggregation revenue and segment revenue disclosed under AASB 8 *Operating Segments*.

Transitional Disclosures

AASB 15 provides a choice between full retrospective adoption and adoption from ‘a date of initial application’ (modified retrospective approach) with an adjustment to equity reflecting the change in net assets arising at that date. Whereas, AASB 9, in general, requires a retrospective application only. When their effect is significant, disclosure of how an entity has applied the relevant choices would be appropriate.

In addition, when comparative information will be changed in the upcoming annual financial report due to retrospective application of AASB 9 or AASB 15 (if that option is chosen), the comparative information provided in the interim half year financial report should likewise be restated with appropriate, quantitative disclosure and explanation of those changes.

What to do?

As you can see from the matters highlighted above, there are a number of disclosure matters that you need to consider in relation to their impact on the interim half-year financial report. Please do not hesitate to contact your local PKF representative to discuss any queries or further clarifications that you may have.

ASIC RELEASES PROPOSED INDUSTRY FUNDING FEES

After much anticipation and speculation, the Australian Securities and Investments Commission (ASIC) has released their Summary of 2017-2018 levies.

In 2017, the Federal Government passed laws whereby ASIC will recover most of its regulatory costs via levies from the industries that it regulates. The 2017-18 financial year is the first year that the 'Industry Funding Model' will operate, with invoices expected to be sent to affected parties in January 2019.

What industries are subject to levies?

Essentially, any industry that falls under oversight of ASIC will be subject to extra fees from ASIC. These include:

- Companies
- Deposit taking and credit providers
- Investment management
- Superannuation and related services
- Market infrastructure
- Market intermediaries
- Financial advisory
- Insurance

If your entity is a registered charity under the Australian Charities and Not-for-profits Commission (ACNC) then you will not be subject to a levy from ASIC.

What do industries need to do?

If your organisation is regulated by ASIC, you must register and maintain contact details on the [ASIC Regulatory Portal](#). You may also be required to submit business activity metrics via the portal between July and September each year.

ASIC will use this information each year to calculate each entity's share of the regulatory costs for the sectors in which they operate. The first collection on information occurred in 2018.

Unlike the self-assessment process for income tax returns, ASIC will calculate the levy and issue invoices in January each year.

How are levies calculated?

Levies issued by ASIC may be either a flat levy or graduated levy, depending on the type of entity within each industry. Of particular interest is that ASIC will calculate the levies by applying a sliding scale to many entities. Fees will vary



depending upon the metric used as the base for the calculation, depending on which industry sector the entity is in. For example, listed companies will pay a base fee plus a levy based on market capitalisation and financial advisory firms will pay a base fee plus a levy for each adviser.

ASIC has indicated that "a robust model" was used in determining the basis for each levy, but it remains to be seen what the feedback will be once the actual invoices are received.

The Summary of 2017-18 levies can be viewed on the [ASIC website](#).

Other costs

In addition to the extra levies to cover regulatory costs, ASIC has extended the user pays dictum by boosting fees to cover their compliance costs. There has been a substantial increase in fees that are applicable for forms lodged with ASIC that involve some form of decision by ASIC. For example, the fee to request approval for the resignation of an auditor of a public company by ASIC (Form 342) has increased from \$34 to \$3,487. This measure has been met with negativity to date, particularly for small unlisted public companies without significant resources to cover these costs. It also unwinds, to an extent, the positive measures ASIC implemented three years ago to reduce the red tape associated with the resignation process through allowing resignations to occur outside of a company's annual general meeting. Accordingly, the accounting industry has passed on this feedback to ASIC.

Should you have any questions about ASIC's new funding model please contact your local PKF office. ■



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“ In 2017, the Federal Government passed laws whereby ASIC will recover most of its regulatory costs via levies from the industries that it regulates. ”



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“ IFRS 9 introduces a number of choices to the application of hedge accounting, and its overall objective is to improve the value of financial statements in decision-making by capturing the impact of an entity's risk management strategies on its financial operations. ”

TO HEDGE OR NOT TO HEDGE UNDER IFRS 9

Effective in Australia and New Zealand, IFRS 9 *Financial Instruments* has become the mandatory accounting standard for financial instruments.

However, the hedge accounting component of IFRS 9 continues to remain optional. Furthermore, entities who conduct hedge accounting may continue reporting under IAS 39. Given this choice, why would entities make the effort to transition?

The motivation lies in hedge accounting's restructure from a set of arbitrary rules to a principles-based standard. IFRS 9 introduces a number of choices to the application of hedge accounting, and its overall objective is to improve the value of financial statements in decision-making by capturing the impact of an entity's risk management strategies on its financial operations.

Under IFRS 9 entities have access to the following benefits:

• Removal of the 80-125% effectiveness test

The 80-125% quantitative effectiveness test has been replaced with a principles-based test. To qualify for hedge accounting under IFRS 9, entities must demonstrate that an economic relationship exists between the hedged item and the hedging instrument.

• More risks and hedging instruments qualify

Following the removal of the 80-125% effectiveness test, more hedged risks and hedging instruments will qualify for hedge accounting, including aggregated exposures, layers of a monetary or physical transactions, net positions, and equity instruments at fair value through other comprehensive income. Where separately identifiable and reliably measured, risk components of non-financial items can also now be designated as hedged items.

• Reduced volatility in the income statement

IFRS 9 introduces recognition for the time value of money in hedging instruments. Because the time value of certain hedging instruments is recognised in other comprehensive income, only the amortised portion will show in the income statement. The impact of the amortization on profit or loss will be consistent from year to year, resulting in reduced volatility in the financial statements.

The costs involved in applying IFRS 9 include:

• Increased administrative costs

Entities must perform ongoing analysis to ensure that the hedge relationships continue to meet the entity's risk management objectives and that an economic relationship continues to exist between the hedging instrument and hedged item. This, along with the requirement to discount hedge instruments for the time value of money, will likely increase the administrative cost of the hedge accounting regime.

• Removal of voluntary discontinuation of hedge accounting

Although an entity could voluntarily discontinue hedge accounting under IAS 39, this concession no longer exists under IFRS 9.

Mandatory application of IFRS 7

Regardless of which standard the entity adopts for hedge accounting purposes, the application of IFRS 7 *Financial Instruments: Disclosures* is now mandatory from periods beginning 1 January 2019. These disclosure requirements are aligned with IFRS 9, and entities will need to follow the process outlined in IFRS 9 in order to prepare the required disclosures.

In summary, whilst there may be an increased administrative cost associated with IFRS 9, this is offset by the fact that entities must follow the mandatory disclosure requirements of IFRS 7. The adoption of IFRS 9 presents a stronger opportunity for reporting entities to communicate their risk management strategy through their financial statements, and this can only result in improved information for users.

Please do not hesitate to contact your local PKF representative to discuss any queries or further clarifications that you may have. ■

** The above content applies to Australian entities reporting under the equivalent Australian standards AASB 9 and AASB 7, which came into effect for financial periods beginning on or after 1 January 2018. New Zealand equivalents become effective for financial periods beginning on or after 1 January 2019.*

DATA ANALYSIS – IS YOUR ORGANISATION STILL SITTING ON THE SIDELINE?



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We live in a world where data is all around us – collected as we use our personal devices, as we create and sell in our workplaces, and by government through statutory reporting. Being able to see through the vast swarths of data is an ever-increasing concern for most organisations, yet surprisingly this is not just a recent phenomenon. Back in 1985, educator and technology theorist Neil Postman noted this trend and coined the term “information-action ratio” – the correlation between information people receive and the relevance to their actions/lives. His words seem somewhat prophetic in the age of big data:

“The tie between information and action has been severed. It comes indiscriminately, directed at no one in particular, disconnected from usefulness; we are glutted with information, drowning in information, have no control over it, don’t know what to do with it”.

This is where data analytics can provide solutions to cut through the background noise and provide insights and intelligence surrounding a system, process or organisation. Let’s take a lighter look at the capabilities of data analytics by using these powers to make a prediction about the upcoming Australian Open, celebrating its 107th edition in Melbourne this January.

Model Building

The building blocks for any model is historical data, so the details of all previous winners in the Open era were analysed in order to determine which aspects had the greatest correlation. This resulted in a model of seven distinct features, with notable correlation between prior year record, age and surface percentage. When this was applied retroactively to the list of champions, we see the highest value matching Novak Djokovic’s near unbackable form leading into the 2016 edition, but the lowest value shows just how remarkable the victory of Mark Edmondson – the last Australian to win the Open – was in 1975 (with only seven professional career matches prior to the tournament!).

Forecasting

So how does our model perform with the current data for the Association of Tennis Professionals (ATP) Top 100? Unsurprisingly, given their continued dominance of men’s tennis, the top three

remains the same with Djokovic (1), Nadal (2) and Federer (3) all sitting within two percentage points of one another, and head and shoulders above the competition.

Big movers in the Top 10 are Raonic (5)[+13], Nishikori (6)[+3] and Dimitrov (10)[+9]. As for the local contingent, Nick Kyrgios is primed for a big run with our model having him ranked 11th, up an impressive 24 places on his ATP ranking.

Name	Model Ranking	Movement
Djokovic Novak	1	0
Nadal Rafael	2	0
Federer Roger	3	0
del Potro Juan Martin	4	1
Raonic Milos	5	13
Nishikori Kei	6	3
Cilic Marin	7	0
Thiem Dominic	8	0
Zverev Alexander	9	-5
Dimitrov Grigor	10	9
Kyrgios Nick	11	24

Data analytics can be of immeasurable assistance for organisations of any size. Regardless of the capabilities or maturity level of your own internal functions, tailored solutions can be provided to help your organisation across the full data analytics spectrum, including benchmarking, forecasting, reporting and internal process improvement. The key, making reference to Postman’s information-action ratio above, is to get the right information to the right people to make the right decision.

Our data analytics experts at PKF would be happy to discuss how your business can make the most of their data. ■



“ Being able to see through the vast swarths of data is an ever-increasing concern for most organisations, yet surprisingly this is not just a recent phenomenon. ”



About PKF

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

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