Tips to improve the quality of financial statements

ACCOUNTING STANDARDS BOARD

Disclaimer

***The views and opinions expressed in this presentation are those of the individual. Official positions of the ASB on accounting matters are determined only after extensive due process and deliberation*.**

Focus areas

- Apply materiality.
- Review and amend accounting policies.
- Disclose judgements, assumptions, estimates and uncertainties.
- Disclose effect of not yet effective Standards.

ACCOUNTING STANDARDS BOARD

Apply materiality

- The Standards of GRAP only apply to material items.
- Applies to recognition, measurement, presentation and disclosure.
- Applying materiality ≠ leave out of the financial statements!

  - means alternative accounting treatment

Examples of applying materiality

Applying materiality to…	What it means…
Recognition	• Expensing low-value assets. • Capitalising servitudes as part of the cost of an asset rather than recognition as an intangible asset.
Measurement	• Expensing transaction costs when measuring financial instruments. • Using contractual interest rate instead of effective interest rate when transaction costs immaterial (assume market related).

Examples of applying materiality

Applying materiality to…	What it means…
Presentation	Not separately presenting a line item that is immaterial on the statement of financial performance or position, even if required by GRAP 1.
Disclosure	Not providing detailed credit risk disclosures if an entity only has a bank account and immaterial receivables.

Apply materiality

- Apply ASB Guideline on The Application to Materiality in Financial statements.
- Identify users.
- Identify their information needs.
- Identify what is material → set thresholds (quantitative) and criteria (qualitative).
- Discuss with management and oversight structures.

Review and amend accounting policies

Some basic questions to ask…

- Are there policies for material transactions and events?
- Do the policies deal with transactions and events that occur at your entity?
- Do the policies simply repeat the principles in the Standards?
- Do the policies explain how the principles in the Standards have been applied? …

What we see....☹

Non-exchange revenue

Revenue comprises gross inflows of economic benefits or service potential received and receivable by an entity, which represents an increase in net assets, other than increases relating to contributions from owners.

Conditions on transferred assets are stipulations that specify that the future economic benefits or service potential embodied in the asset is required to be consumed by the recipient as specified or future economic benefits or service potential must be returned to the transferor.

Restrictions on transferred assets are stipulations that limit or direct the purposes for which a transferred asset may be used, but do not specify that future economic benefits or service potential is required to be returned to the transferor if not deployed as specified. Stipulations on transferred assets are terms in laws or regulation, or a binding arrangement, imposed upon the use of a transferred asset by entities external to the reporting entity.

What to improve…☺

- What non-exchange revenue does the entity have? Examples: transfers, grants, donations, equitable share allocations, fines, levies/fees and taxes….

- Are there transactions with conditions and restrictions? If yes, explain which transactions have conditions or restrictions. For example, grants and donor funding arrangements have conditions….

- Are there stipulations? If yes, how imposed on the entity and the impact for specific transactions? Example, DORA, binding arrangement…

What we see....☹

Recognition of non-exchange revenue

An inflow of resources from a non-exchange transaction recognised as an asset is recognised as revenue, except to the extent that a liability is also recognised in respect of the same inflow.

As the entity satisfies a present obligation recognised as a liability in respect of an inflow of resources from a non-exchange transaction recognised as an asset, it reduces the carrying amount of the liability recognised and recognises an amount of revenue equal to that reduction.

What to improve…☺

- When does an entity have a present obligation, i.e. a conditions? Link to transactions with conditions…

- At what point does the entity obtain control of a resource? Examples: budget or specific tax legislation becomes effective for the year, an arrangement has been concluded with a donor, or an offence is committed for fines….

What we see....☹

Measurement of non-exchange revenue

Revenue from a non-exchange transaction is measured at the amount of the increase in net assets recognised by the entity. When, as a result of a non-exchange transaction, the entity recognises an asset, it also recognises revenue equivalent to the amount of the asset measured at its fair value as at the date of acquisition, unless it is also required to recognise a liability. Where a liability is required to be recognised it will be measured as the best estimate of the amount required to settle the obligation at the reporting date, and the amount of the increase in net assets, if any, recognised as revenue. When a liability is subsequently reduced, because the taxable event occurs or a condition is satisfied, the amount of the reduction in the liability is recognised as revenue.

What to improve…☺

- How was the fair value of the asset determined for the different types of non-exchange transactions? Examples: fair value of equitable share allocations are determined using the amounts specified in budget legislation; the fair value of non-monetary assets using the equivalent price to replace an asset of the same age, condition, etc.
- When and how are the conditions satisfied and the liability reduced? Examples should explain what conditions exist and how/when the entity fulfils them.

Note: If an entity does not have taxes, this reference should be omitted.

What we see….☹

Gifts and donations, including goods in-kind

Gifts and donations, including goods in kind, are recognised as assets and revenue when it is probable that the future economic benefits or service potential will flow to the entity and the fair value of the assets can be measured reliably.

What to improve…☺

- What types of gifts and donations are received? In this case the entity did not have any in either the prior or current year, and therefore the accounting policy should have been deleted.
- When does the entity believe that it is probable that the entity will receive the benefit? Examples: what specific point does control arise for the gifts and donations received by the entity.
- How has fair value been determined for the specific gifts and donations received? Have any significant judgements been applied? If fair value could not be determined reliably, why not?

Disclose judgements, assumptions, estimates and uncertainties

What to disclose?

Disclose information on:

- Key assumptions concerning the future.
- Key sources of estimation uncertainty → where there is a significant risk of material adjustment to assets and liabilities in the next reporting period as a result of uncertainty in valuation at this reporting date.

What to disclose?

Key Assumptions and Judgements: Electricity generation assets

These financial statements report the value of electricity generation assets at $17.2 billion (2018: $15.9 billion). The assets are made up mainly of hydro, thermal stations and wind farms owned by three electricity generation mixed ownership model entities. There are a range of reasonable judgements and assumptions that could be used in estimating the fair value of these assets. These judgements and assumptions predominantly relate to future revenue streams (eg, wholesale electricity prices, generation volumes) and operating expenses, as well as the discount rate used to calculate the present value of those revenues and expenses. The assumptions and sensitivity analysis of these are set out in note 16. These key assumptions are subject to significant uncertainties driven by unobservable market data, such as growth expectations within various sectors of the economy, planned capital projects and varying risk factors. These assumptions interact dynamically with each other. For example, wholesale electricity prices can affect the amount of generation volumes and operating costs

Meridian Energy

Key input		**Sensitivity range**	**Valuation Impact on fair value of generation assets**
NZ Generation volumes	13,520 GWh p.a to 15,500 GWh p.a	+/- 250 GWh	$240 million / ($240) million
Operating expenditure	$291 million p.a. (in real terms)	+/- $10 million p.a.	$153 million / ($153) million
EBITDAF earnings multiple	12.6 x EBITDAF	+/- 0.5x	$395 million / ($395) million

Genesis Energy

Key input		**Sensitivity range**	**Valuation Impact on fair value of generation assets**
Wholesale electricity price path	$91/MWh to $127/MWh referenced to the Otahuhu 220KV location node from July 2019 to July 2039 (in nominal terms)	+/- 10%	$579 million / ($579) million
Generation volume	2,820 GWh to 6,732 GWh per annum, the low end of the range relates to periods where there is no thermal generation	+/- 10%	$415 million / ($415) million
Discount rate	Pre-tax equivalent discount rate of 9.9%	+/- 1%.	($334) million / $387 million

Mercury NZ

Key input		**Sensitivity range**	**Valuation Impact on fair value of generation assets**
Future wholesale electricity price path	$75/MWh to $106/MWh (in real terms)	+/- 10%	$833 million / ($837) million

Disclose information about impact of not yet effective Standards

Impact of newly effective Standards

Need to disclose:

- Existence of issued but not yet effective Standards.
- Known or reasonably estimable information to assess possible impact of application in that period.

What to disclose?

- Only those Standards that are relevant to your entity.
- Information on potential impact, for example, recognition of new or different items, changes in values of items.
- Review Directive 5 for list.

Keep informed

Keep informed

- FAQs.
- COVID-19 - www.asb.co.za/covid-19/
- Newsletter.
- Social media.
- Translations of Standards.

Keep informed

Accounting Guidelines by OAG – https://oag.treasury.gov.za

Contact details

Tel: (011) 697-0660

Fax: (011) 697-0666

Email: info@asb.co.za

Website: www.asb.co.za

ACCOUNTING STANDARDS BOARD