

Financial Focus

Audit and Accounting Matters for Schools

McLean Delmo is proud to bring you the latest in our series of Not-For-Profit technical bulletins - *Financial Focus* – a newsletter covering a range of Audit and Accounting issues specifically relevant to your School.

This information may be useful to a number of position holders within your School including Business or Finance Managers, CEOs, CFOs, or members of your Audit Committee or Board of Management.

We hope you enjoy reading *Financial Focus*.

Significant Changes to Lease Accounting

The current accounting models for operating leases and finance leases and their distinctions may soon be history. An exposure draft, ED 2010/9 Leases, published by the International Accounting Standards Board (IASB) in August 2010, intends to develop a new single model for lease accounting to ensure that all assets and liabilities arising under lease contracts are recognised in the statement of financial position.

The new “right-of-use” model is applied to all leases and brings operating leases from “off-balance-sheet” to “on-balance-sheet”. This is a fundamental change to lease accounting. As a result of the change, assets and liabilities will be recognised for the first time. The changes in expense nature (interest and amortisation) may also have impacts on financial analysis. Entities with debt covenants will need to pay attention to these possible impacts and consequences.

There will clearly be differences for lessees and lessors to consider when accounting for their particular leases. In the following discussion, we introduce the basic concepts of the new lessee accounting model. For the purpose of this discussion, lessor accounting and other complex scenarios are not covered.

Lessee Accounting

As a lessee, you now need to simultaneously recognise a “right-of-use” of an underlying leased asset (underlying asset) and a corresponding liability to make lease payments (liability) in your financial records as at the commencement of the lease term.

The liability is initially measured at the present value of the lease payments (taking into account the longest lease term that is more likely than not to occur, contingent rentals, etc), discounted using the lessee’s incremental borrowing rate or, if it can be readily determined, the rate the lessor charges the lessee. This liability is subsequently measured at amortised cost using the effective interest rate method.

In other words, whilst the lease would have been classified as an “operating lease” under the previous accounting approach, when the lease payments are expensed as they incur, the lessee now needs to also recognise interest expense as a part of the lease payments.

The “right-of-use” amount, which is initially equal to the liability plus any initial direct costs, is amortised on a systematic basis over the lease term, or the useful life of the underlying asset if shorter. The “right-of-use” is presented as if it is a tangible asset within property, plant and equipment, and disclosed separately. The “right-of-use” is subject to an impairment test at each reporting date in accordance with AASB 136.

Effective Date and Transition

It is anticipated that this forthcoming standard will be finalised within the financial year ending 30 June 2012. The ED itself does not propose an effective date or whether early adoption is permitted. A retrospective approach is provided in the ED: the date of initial application is the beginning of the first comparative period presented in the first financial statements in which the entity applies this new accounting standard. As a result, a third column for comparatives in the statement of financial position may be required.

Lease Accounting may be a complex issue for you so we recommend that you seek expert advice to ensure you have your leasing arrangement structured appropriately. For more advice please call McLean Delmo.



Level 3, 302 Burwood Road, PO Box 582, Hawthorn Victoria 3122
T 61 3 9018 4666 F 61 3 9018 4799 www.mcleandelmo.com.au

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Reduced Disclosure Requirements

In June 2010, the Australian Accounting Standards Board ('AASB') introduced the Reduced Disclosure Requirements ('RDR') Framework. It applies to the annual reporting periods beginning on or after 1 July 2013. However, certain Schools may opt for early adoption of the RDR.

How it works

Reporting entities which are currently preparing general purpose financial statements ("GPFS") will be classified according to a two-tier framework (tier 1 & 2).

- ❖ *Tier 1* applies to entities which have 'public accountability', and the Australian state, territory and local governments. These entities are required to comply with all requirements of Australian Accounting Standards.
- ❖ *Tier 2* applies to entities that do not have 'public accountability', including not-for-profit private sector entities and public sector entities other than the Australian state, territory and local governments. These entities are still required to comply with all recognition and measurement requirements of Australian Accounting Standards but with substantially reduced disclosures. However, entities may elect, or may be required by regulation or statute, to apply Tier 1 reporting.

The adoption of Australian Accounting Standards – RDR may significantly reduce the disclosure burden of preparing and auditing GPFS for most Schools.

Under the RDR, examples of disclosures that can be removed are as follows:

- ❖ Financial instruments/financial risk management
- ❖ Cash flow reconciliation
- ❖ Key management personnel compensation component
- ❖ New accounting standards and interpretations for application in future periods
- ❖ Auditor's remuneration

If you would like further information on the Reduced Disclosure Requirements, or other accounting standards issues, please contact our accounting standards experts on 03 9018 4666 or email info@mcleandelmo.com.au

About McLean Delmo

McLean Delmo is a dynamic professional services organisation offering advice to all types of businesses and individuals. Our team consists of progressive accountants, auditors, financial planners, mortgage brokers as well as tax and other specialists.

Our focus is to help create, maximise and protect wealth for all our clients - be they small, medium or large.

Our purpose built offices are located in Hawthorn, on the fringe of Melbourne's CBD. While the majority of our clients are from in and around Melbourne, we are increasingly involved in interstate and international work.

Our membership of Kreston International, a worldwide network of experienced, independent accounting and business advisory firms means we can look after our clients throughout Australian and in all parts of the world.

Specialist services

Audit and assurance	Franchising	Corporate secretarial
Business and financial advice	Financial planning	Bookkeeping
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Taxation	Estate and succession planning	Information technology



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Important: This is not advice. Clients should not act solely on the basis of the material contained in this newsletter. Items herein are general comments only and do not constitute or convey advice per se. Also changes in legislation may occur quickly. We therefore recommend that our formal advice be sought before acting in any of the areas.

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