# Is corporate Australia ready for major accounting changes?

December 2017

pwc

www.pwc.com.au

# Overview

Corporate Australia has a tsunami of change coming its way in the form of new revenue, leases and financial instruments accounting standards. With this in mind, we trawled through the ASX 100's most recent financial reports to see if companies are prepared for the most significant changes to accounting practices since the introduction of the IFRS global financial reporting regime in 2005. And the answer is...it's difficult to tell.

Despite encouragement from the regulator to provide meaningful detail on the expected impact of the new standards in financial report disclosures, less than 10% of companies indicated they've completed their impact assessment for each of the three standards. Given that two of the standards (financial instruments and revenue) come into effect on 1 January 2018, investors and other financial report users may find it hard to make informed assessments on whether a company will be affected by the new standards, or what they're doing to implement any changes. This is worrying because changes brought about by the new standards could could significantly affect a company's reported profits, its net assets and its ability to pay dividends.

Our findings on 'expected impact' highlight a lack of clarity or very little information, at least in financial report disclosures, around how corporate Australia is preparing for the new standards. For example, 64 companies indicated they did not expect the new revenue standard to have a material impact on their financial statements, despite only 22 of these companies disclosing that they had actually completed their impact assessments or preliminary impact assessments. We found a similar situation for the new leases standard, in that 23 companies indicated they do not expect the standard to have a material impact on their financial statements despite only 5 disclosing that they'd completed their impact assessments or preliminary impact assessments. Have companies made sufficient progress in their transition projects to confidently make this assessment?

It's likely that many companies are further along with their implementation plans than they've disclosed, but it's also likely that many have underestimated what's required to adopt the revenue, leases and financial instruments standards. Our experience on numerous transition projects is that even companies with straightforward business models have discovered that once they get into the detail, the issues are complex, their reported results will be affected by the new standards' requirements and they'll need to make significant changes to their systems and processes. We've also seen a number of examples where the standards have not had a material impact, but where there has been considerable work required to get comfortable that this is the case.

The next reporting season will provide corporate Australia with a final opportunity to better communicate the impact of the new standards to stakeholders. We did find a number of companies that have made great progress in assessing the impact, so we have shared their disclosures in our report as inspiration. For boards and audit committees, now is the time to be ensuring that management teams have a robust implementation plan in place, that they have the right expertise and resources, and that the timeline is clear about when they will be able to quantify the impact of these new standards on reported results.

Margot Le Bars
Partner, PwC

# Table of Contents


Overview ..... 2

Background ..... 4

Key Findings ..... 5

- Has the company assessed the impact of the new standards? ..... 5
- Has the company disclosed any quantitative and/or qualitative information about the impact of the new accounting standards on future financial statements? ..... 7
- Has the company disclosed if there will be any material impact on specific areas of the future financial statements ..... 9
- Has the company provided information on how it's preparing for the new standards (i.e. plans and activities around transition projects)? ..... 10
- Has the company given any information on what transition method they'll adopt for each new standard? ..... 10

Examples of good disclosures ..... 11

What's next ..... 12

Appendix ..... 13

- AGL ..... 13
- CIMIC ..... 16
- Flight Centre ..... 18
- Rio Tinto ..... 20
- Telstra ..... 22

# Background

## The new standards and why they matter

The three new standards and the dates from which they need to be adopted are:

- AASB 9 *Financial Instruments* - 1 January 2018
- AASB 15 *Revenue from Contracts with Customers* - 1 January 2018
- AASB 16 *Leases* - 1 January 2019

This trinity of standards will affect the financial position and future profits of many Australian companies. They'll affect revenue, which is typically the biggest number in a company's profit and loss statement, as well as a significant number of other key metrics. And it's not just Australian corporates that are grappling with the most significant changes to accounting practices we've seen for over a decade. Their equivalent versions will be applied in the world's largest economies, most of which have adopted the International Financial Reporting Standards (IFRS) reporting regime. Already we've seen a number of companies highlight just how pervasive the impact of these standards can be. For example, UK manufacturer Rolls Royce reported that had they applied the new revenue model to their 2015 aerospace business, reported revenue would have been reduced by nearly 1 billion pounds, while their balance sheet would have been reduced by 3.5 billion pounds. There are other examples closer to home. When the National Australia Bank early adopted the new financial instruments standard, this resulted in an $831 million increase in 'provisions for doubtful debts', due to the changes in the way this number is now required to be calculated.


**We wanted to understand...**

...the impact of the new accounting standards on the ASX Top 100 companies and the level of preparedness of those companies. With looming application dates, we think that companies should be reasonably well progressed by now with their assessments of the impact, particularly for AASB 9 and AASB 15. We would also expect companies to be making disclosures so that the market can assess the effect of the new standards on companies' future financial statements.

**We did this by...**

...studying the most recent financial report disclosures of the ASX Top 100 companies.[1]

**We asked the following questions about each company's disclosures on new standards implementation:**

Has the company:

- assessed the impact of the new standards?
- disclosed any quantitative and/or qualitative information about the impact of the new accounting standard on future financial statements?
- disclosed if there'll be any material impact on specific areas of the future financial statements?
- provided information on how it's preparing for the new standards (i.e. plans and activities around transition projects)?
- given any information on what transition method they'll adopt for each new standard?

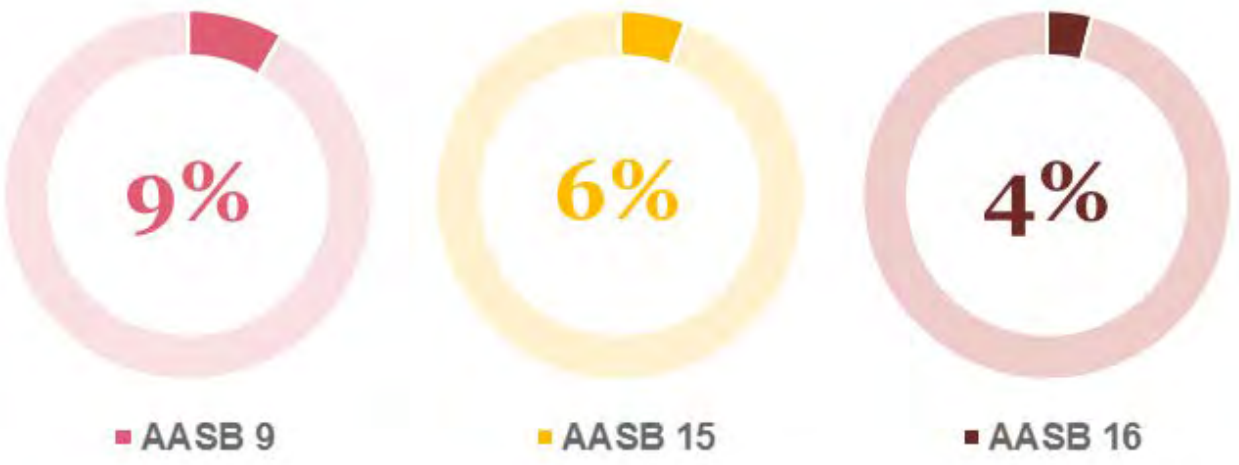
While we were rigorous in ensuring we took a consistent approach to each company's disclosures, judgement was required when interpreting certain disclosures.

1 We studied 97 of the ASX Top 100 companies (as of 29 August 2017).Two companies in the ASX 100 are foreign entities that prepare financial statements under US GAAP (i.e. rather than under IFRS). The remaining entity had just completed a merger in April 2017 and an annual report was not yet available. Of the 97 companies we examined, 60 had a financial year period ending in June 2017.

# Key Findings

## *Has the company assessed the impact of the new standards?*[1]

**FIGURE 1.** Companies that have **completed** assessment of new standards




As we can see from the Figure 1, very few companies indicated they had completed their assessment of the impact of the new standards, with only 8 (9%) having indicated this for AASB 9, 6 (6%) for AASB 15 and 4 (4%) for AASB 16.

**FIGURE 2.** Companies **in the process** of assessing potential impacts of new standards

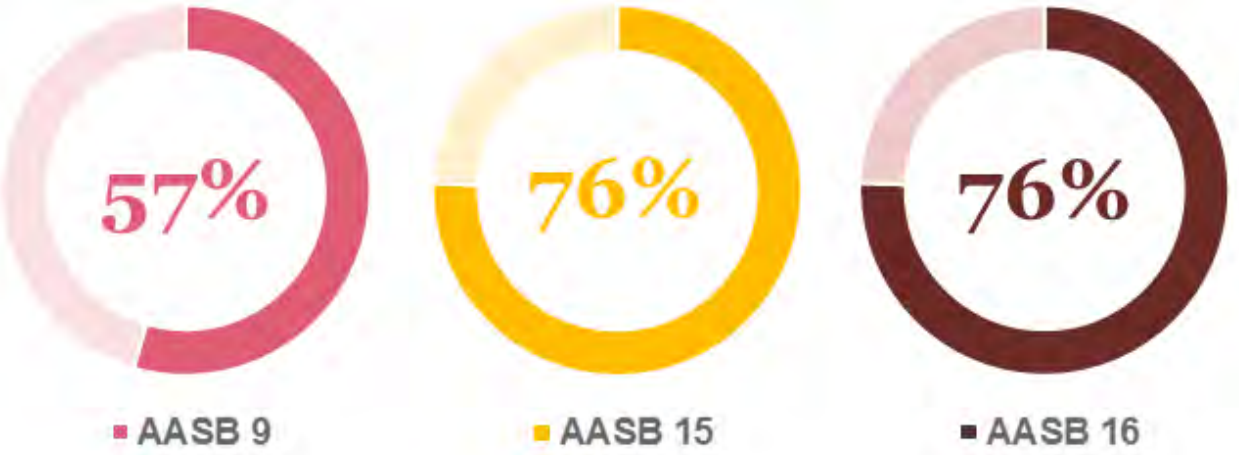



Figure 2 shows that most of the companies indicated they are in the process of assessing potential impacts of the new standards, with 50 (57%) indicating this for AASB 9, 74 (76%) for AASB 15 and 74 (76%) for AASB 16.

1 For AASB 15 and AASB 16, the number of companies studied was 97. For AASB 9, 10 companies had early adopted the standard and were excluded, leaving us with data on 87 companies.

**FIGURE 3.** Companies that **did not indicate** their progress in assessing the impact of new standards or that indicated they had not started the assessment


As shown by Figure 3, 29 companies (33%) did not provide any indication of their progress in assessing the impact of AASB 9, or indicated that they hadn't started their assessment. For AASB 15, this was the case for 17 companies (18%), while for AASB 16 it was the case for 19 companies (20%).

Finally, we looked at whether some industries appeared to be significantly more progressed than others in their assessment. There did not appear to be a trend in particular industries.

### *ASIC's expectations on new standard disclosures*

Accounting standards require that when a new accounting standard is released, companies must, in the period before adoption of the new standard, disclose any "known or reasonably estimable information" that is relevant to how that company assesses the possible impact of the new standard. ASIC also expects companies to disclose their progress on adopting new standards and to disclose sufficient information on the specific impact of the new accounting standards.This is so financial report users can fully understand the impact of the new standards on a company and make informed decisions.

ASIC has been reasonably specific on what it expects financial report disclosures to include regarding AASB 9, 15 and 16.[1] We've summarised the key elements as follows:

- Known or reasonably estimable information relevant to assessing the possible impact that adoption of the new standards will have on the future financial statements
- Quantitative information about the impact on the future financial statements
- How prepared a company is to transition to the new standards
- The possible financial impact
- Future impact in fundraising and other transaction documents

Given the financial instruments and revenue standards come into effect on 1 January 2018, ASIC's view is that companies by now should have made significant progress on the assessment of potential impact of these standards on future financial statements, and have a clear plan for the transition and implementation.

The findings from this research, however, appear to show companies have more work to do. Less than 10% of companies have completed their assessment of new standards, no company provided any quantitative impact of the new revenue standard and over 85% did not reveal their proposed adoption methods for AASB 15 and AASB 16.

ASIC recently re-emphasised that entities need to be prepared for the new standards and ready to disclose their impact on reported results.[2]

1 Source: Companies need to respond to major new accounting standards, ASIC media release 16-442MR, 16/12/16.

2 Source: ASIC calls on preparers to focus on financial report quality and new requirements, ASIC media release 17-423MR, 8/12/17.

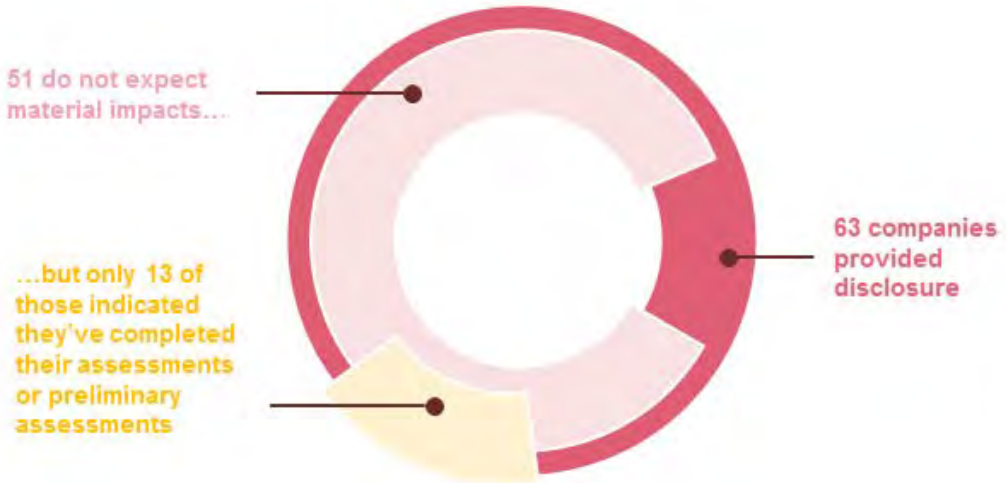
## *Has the company disclosed any quantitative and/or qualitative information about the impact of the new accounting standards on future financial statements?*

We found that:

- For AASB 9, 4 companies provided a quantitative assessment of the potential impact
- For AASB 15, no companies provided a quantitative assessment of the potential impact
- For AASB 16, 32 companies provided quantitative information but 28 of these simply cross referenced to their existing operating lease commitments note.

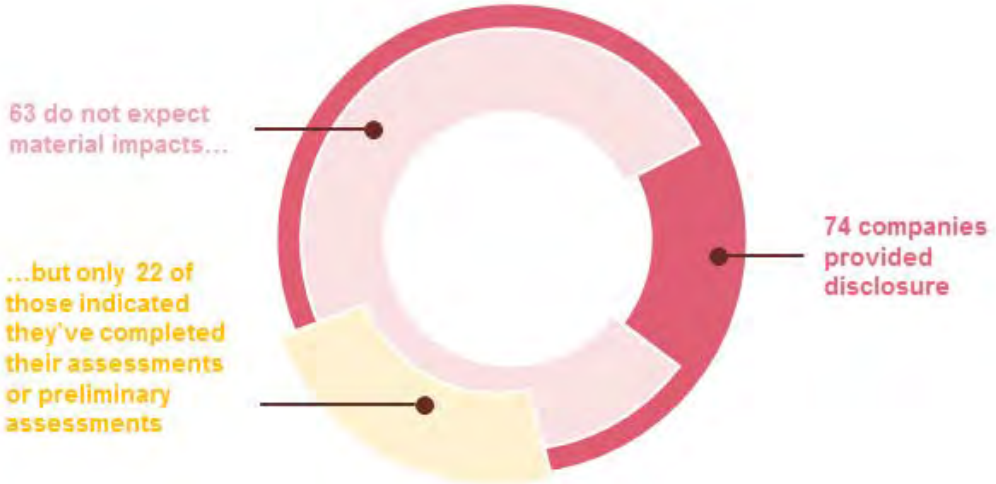
A number of companies provided qualitative information about expected impact including disclosure around whether the company expects the impact to be material. A summary of these results is presented below.

**FIGURE 4.** Companies that provided disclosure on expected impact of AASB 9 on financial statements[1]




We can see from Figure 4 that 63 companies provided disclosure on their expectation of whether there would be an impact of AASB 9. Of those companies, 51 do not expect material impacts, and of those 51, 13 have indicated that they completed their assessments or their preliminary assessments.

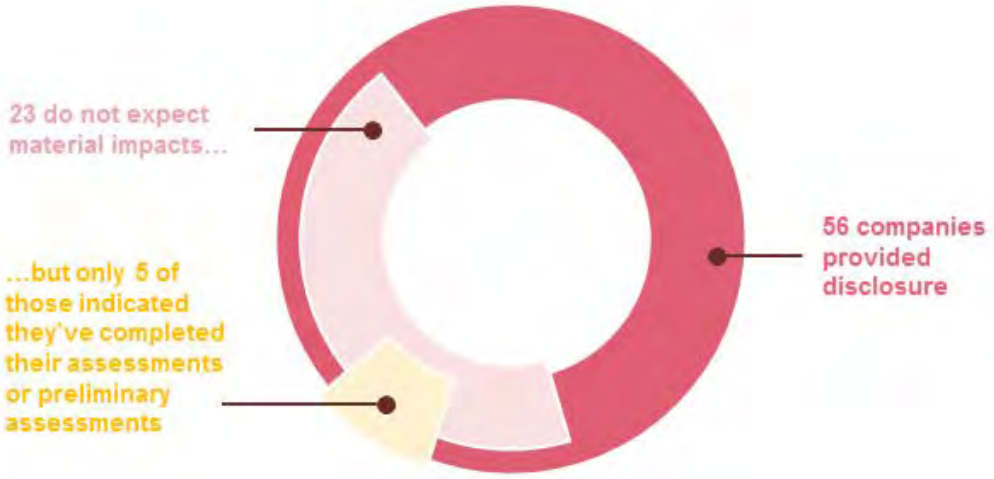
**FIGURE 5.** Companies that provided disclosure on expected impact of AASB 15 on financial statements




What's most interesting to note from Figure 5 is that while 63 companies (of the 74 that provided disclosures) disclosed that they do not expect AASB 15 adoption will have a material impact on their financial statements, only 22 indicated that they had completed their assessments or their preliminary assessments.

1 When compiling information on companies that provided disclosure on the expected impact of AASB 9 on financial statements, we only included data from 87 companies because 10 companies early adopted AASB 9.

**FIGURE 6.** Companies that provided disclosure on expected impact of AASB 16 on financial statements




Similarly, Figure 6 shows that while 23 companies (of the 56 that provided disclosure) disclosed that they do not expect a material impact on the adoption of AASB 16, only 5 indicated that they had completed their assessments or their preliminary assessments.

The question highlighted by Figures 4, 5 and 6 is whether companies have made sufficient progress in their transition projects to confidently make this assessment. It's possible that companies have made more progress than their disclosures reveal, but there is the potential that as they complete their assessments, some unexpected outcomes could take companies and the market by surprise.

## *Has the company disclosed if there will be any material impact on specific areas of the future financial statements*

In the reports we reviewed, companies provided very little tailored information on how the new standards might affect future financial statements. Companies tended to provide generic information about the new accounting standards (in particular AASB 9 and AASB 16) rather than specific detail of how the new requirements would relate to the company's individual facts and circumstances. Again, the lack of specific detail indicates that companies may still have considerable work to do, or at least some improvements to be made, in what they are communicating to the market.

We were, however, able to glean some insights into how AASB 15 could affect future financial statements based on the disclosures of 25 of the 97 companies studied. We found meaningful information about the issues that either would have an impact or require further consideration when transitioning to the new revenue standard. We have grouped these impacts by industry in Figure 7:

**FIGURE 7.** Potential impacts of AASB 15 disclosed by companies

| Industry | Some examples of potential impact disclosed by companies studied |
|---|---|
| Utilities | • The definition of a contract with a customer<br>• Estimates and judgements in the unbilled revenue process<br>• Long-term gas sales agreements<br>• Upfront fees such as connection fees<br>• Customer acquisition costs such as sales commissions |
| Mining | • Construction contract costs incurred during the tender process may give rise to a reduction in net contract debtors since costs can only be capitalised if they are both expected to be recovered and either would not have been incurred if the contract had not been won or if they are intrinsic to the delivery of a project.<br>• Claims and variances from construction revenue may give rise to a reduction in net contract debtors since revenue can only be recognised when it is highly probable that a significant reversal of revenue will not happen.<br>• Different stages in mine development and production could represent separate performance obligations and may give rise to a change in the timing of revenue recognition that may be accelerated or deferred.<br>• Freight revenue is likely to be deferred under given shipping terms. |
| Real estate | • The timing of revenue and costs recognition on property development |
| Health | • The timing of revenue recognition (i.e. recognise revenue at a point in time or over time) may affect:<br>◦ Surgical and non-surgical services<br>◦ Pathology service contracts<br>◦ Hospital management service fee income |
| Packaging | • Trading terms with customers that include bill and hold arrangements<br>• Pricing adjustment structures including volume rebates and discounts and payment of upfront contract incentives<br>• Consignment arrangements with customers and provisioning of other services |
| Oil and gas producers | • Production imbalances and consideration of the entitlements method versus sales method<br>• Take-or-pay contracts<br>• Gas balance arrangements<br>• Provisional pricing |
| Telecommunications | • Long-term contracts that provide bundle services (e.g. a bundle of hardware and services) are commonly provided by telecommunication entities. Entities can no longer combine these services for revenue recognition.<br>• It is common for a customer to receive discounts when purchasing a bundle of goods or services under a contract. Under AASB 15, entities will need to allocate the discounts to all performance obligations proportionally, unless the exception allocation criteria are met.<br>• Contracts with customers may include deferred payment terms (i.e. providing financing to customers). AASB 15 requires at contract inception an entity should separately account for a significant financing component and measure it using a discount rate that would be reflected in a separate financing transaction between the entity and the customer. |

## *Has the company provided information on how it's preparing for the new standards (i.e. plans and activities around transition projects)?*

Less than 30% of companies provided any detail about their transition projects (AASB 9 = 19%, AASB 15 = 26%, AASB 16 = 25%), such as whether a project team had been established or plans on what area the company has focused on and what will be the focus while implementing the new standards. This percentage is low given ASIC has indicated it expects details, and that users of financial statements will likely want to know:

- whether the entity has enough resources to implement the new standards
- whether the entity will be ready in time for implementation of the new standards, and
- the main activities the entity is planning to do to implement the new standards successfully (eg. information systems that might be required to capture details of leases contracts needed to prepare financial statements).[1]

<30%

of companies provided any detail about their transition projects

## *Has the company given any information on what transition method they'll adopt for each new standard?*

By now, companies should also be close to deciding the adoption method for the new standards, in particular for AASB 15, so that they are ready to prepare the comparative figures, if required. There are two options for transition to the revenue and leases standards: the full retrospective approach and the modified retrospective approach. Under the full retrospective approach, an entity is required to adjust figures for all prior periods presented in the year of adoption of the new standards, and thus requires additional work and effort. Under the modified retrospective approach, an entity will not need to restate comparative periods in the financial statements but will need to adjust the opening balance of retained earnings in the year of adoption. Regardless of which approach an entity will select, both approaches require significant effort to get the figures right. For the financial instruments standard, companies can either restate comparatives or not restate comparatives.

We found over 85% of companies (AASB 9 = 94%, AASB 15 = 93%, AASB 16 = 96%) did not give any indication of which adoption method they would use for AASB 9, AASB 15 and AASB 16. We've provided a breakdown for each of the standards below:

>85%

of companies did not give any indication of which adoption method they would use for AASB 9, AASB 15 and AASB 16.

**AASB 9**

4 companies indicated an adoption method for AASB 9. One company indicated it will restate comparatives and 3 companies will choose not to restate.

**AASB 15**

11 companies indicated an adoption method for AASB 15. Eight of these expect to use the modified retrospective method and three companies indicated they are taking a fully-retrospective approach for AASB 15.

**AASB 16**

7 companies indicated an adoption method for AASB 16, with 5 expecting to use the modified retrospective approach and 2 expecting to use the fully retrospective approach.

1 ASIC media release 16-442MR, Companies need to respond to major new accounting standards, 16 December 2016.

# Examples of good disclosures

## What makes a good disclosure?


To give companies an idea of what a good disclosure looks like, we've included examples from AGL, CIMIC, Flight Centre, Rio Tinto and Telstra's financial reports in an Appendix, along with a brief explanation of what they're doing right. The disclosures include information such as:

- progress of the impact assessment
- plans for implementing the new accounting standards such as transition project and focus area
- key areas that may be affected by the new accounting standards
- expected material or immaterial impact on the future financial statements
- transition method chosen and its impact on the financial report, and
- any other tailored information that is meaningful for users.

# What's next?

The biggest change to accounting standards in more than a decade is about to get very real for Australian companies. But this is more than a compliance exercise. Its an opportunity for companies to gain a deeper understanding of some of the most important elements of their business: their revenue and customer engagement process; the impact of financial risks and the volatility this creates in their earnings profile; and the levers involved in capital investment decisions. The question is whether Australian companies are ready for this change, and whether they will use this opportunity to enhance communication and transparency, and create shareholder value.

If you'd like to have a conversation about how to get your transition plan back on track, please contact your usual PwC representative or one of the experts below.

**Margot Le Bars**
Partner
+61 (3) 8603 5371
margot.le.bars@pwc.com

**Regina Fikkers**
Partner
+61 (2) 8266 8350
regina.fikkers@pwc.com

AGL Energy Limited and controlled entities
Notes to the Consolidated Financial Statements
For the year ended 30 June 2017

## Note 1 - Summary of significant accounting policies (cont'd)

**(ad) Income tax (cont'd)**

***Tax consolidation (cont'd)***

The members of the tax-consolidated group have entered into a tax sharing and tax funding agreement. The tax funding agreement requires payments to/from the head entity equal to the current tax liability (asset) assumed by the head entity and any tax-loss deferred tax asset assumed by the head entity. The payments are recorded as intercompany receivables/payables.

**(ae) Standards and Interpretations in issue not yet adopted**

A number of Australian Accounting Standards have been issued by the AASB but are not effective for the year ended 30 June 2017. AGL's assessment of the expected impact of these Standards is set out below.

**AASB 9 *Financial Instruments*** and the related subsequent amendments replaces AASB 139 *Financial Instruments: Recognition and Measurement* and applies to the classification, measurement and derecognition of financial instruments. The standard includes a single approach for the classification and measurement of financial assets, based on cash flow characteristics and the business model used for the management of the financial instruments. It introduces the expected credit loss model for impairment of financial assets which replaces the incurred loss model used in AASB 139. Lastly, the standard amends the rules on hedge accounting to more closely align the accounting treatment with the risk management practices of the business.

AASB 9 is effective for annual reporting periods commencing on or after 1 January 2018, which means it will be effective for AGL's 30 June 2019 financial statements.

AASB 9

***Overview of assessment activities***

In FY16, AGL established a project team which comprises appropriate financial instrument subject matter specialists working with individual business units. Work to date has focused on AGL's energy risk management operations and debtors, including unbilled revenue. A review of treasury operations and the various debt facilities has also been completed during FY17.

***Potential impact on AGL's financial report***

AASB 9

To date, some of the key issues for consideration which have been identified include: development and application of an impairment model for debtors (including unbilled debtors) to reflect the expected loss (as opposed to the current standard requirements of incurred loss); identification of components that may be able to be hedged within treasury and energy financial instruments; the application of the new hedge accounting rules; the interaction of AASB 9 and AASB 15 and 16; and specific quantitative and qualitative disclosures that may be required under AABS 9.

The project team has provided periodic updates to management, the audit committee and the auditors.

While a considerable portion of FY16 and FY17 has been spent progressing AGL's assessment of the potential impact of AASB 9, at this stage, management cannot reasonably estimate and quantify the impact.

***Application date***

AGL plans to adopt the new standard on the required effective date.

**AASB 15 *Revenue from Contracts with Customers*** and the related subsequent amendments replaces all existing revenue requirements (AASB 111 *Construction Contracts*, AASB 118 *Revenue* and related Interpretations) and applies to all revenue from contracts with customers.

The new requirements provide a single, contract-based revenue recognition model. AASB 15 establishes principles for reporting the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. The core principle of AASB 15 is that an entity recognises revenue when a customer obtains control of promised goods or services and is recognised in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

The requirements include a five-step framework to determine the timing and amount of revenue to recognise relating to contracts with customers. In addition, the standard requires new and expanded disclosures related to the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers and the key judgements made. AASB 15's increased focuses on contracts with customers will require a greater understanding of customer contracts at a level of detail not previously required.

AASB 15 is effective for annual reporting periods commencing on or after 1 January 2018, which means it will be effective for AGL's 30 June 2019 financial statements. The standard permits two methods of adoption: full retrospective – by retrospectively adjusting each prior reporting period presented and recognising the cumulative effect of initially applying the new requirements at the start of the earliest period presented, which would be 1 July 2017 for AGL; or modified retrospective – by recognising the cumulative effect of initially applying the new requirements at the date of initial application, which would be 1 July 2018 for AGL.

AGL Financial Report 2017
16

**Information about transition project plan**

**Information about key focus area**

Source: AGL Energy Limited, Annual Report 2017 (for 30/6/17 year end), pages 16-18. Accessed 7/12/17.

AGL Energy Limited and controlled entities
Notes to the Consolidated Financial Statements
For the year ended 30 June 2017

## Note 1 - Summary of significant accounting policies (cont'd)

**(ae) Standards and Interpretations in issue not yet adopted (cont'd)**

AASB 15

**AASB 15 *Revenue from Contracts with Customers* (cont'd)**

***Overview of assessment activities***

In the first half of FY17, AGL established a project team comprising appropriate revenue subject matter specialists working with individual business units. Work to date has focused on segregating AGL's revenue streams into major components to further understand the nature of the contractual arrangements with each of these customer groups. While AGL has more than 25 revenue streams, approximately 87% of its annual revenue comes from four main customer groups including:

- Consumer market - electricity and gas;
- Electricity generation sales to pool;
- Business customers - electricity and gas, and
- Wholesale markets electricity and gas.

AASB 15

The project team has initially focused on the larger revenue streams and has undertaken a range of activities to identify those streams that have the highest potential risk of impact and/or will require a greater level of work effort to assess and/or quantify the financial impact of AASB 15.

Subsequent to this, further activities have been undertaken, including reviewing an initial representative sample of contracts, to gain a more detailed understanding of the contractual arrangements with customers. The team is now analysing the impact of the new standard by assessing these contracts in light of the requirements of AASB 15, comparing to AGL's current accounting policies and practices, and identifying potential differences. Further contract reviews, as required, will be completed throughout FY18. This will be followed by consideration of broader business impacts.

***Potential impact on AGL's financial report***

To date, some of the key issues for consideration that have been identified include: identifying AGL's customer for some types of contracts (e.g., generation); identifying what represents the enforceable contract for the purposes of applying AASB 15; impact on the estimates and judgements involved in the unbilled revenue process; impact on long-term gas sales agreements; treatment of upfront fees such as connection fees; treatment of customer acquisition costs such as sales commissions; and specific quantitative and qualitative disclosures that may be required under AASB 15.

AASB 15

The project team has provided periodic updates to management, the audit committee and our auditors.

While a considerable portion of FY17 has been spent progressing AGL's assessment of the potential impact of AASB 15, at this stage, management cannot reasonably estimate and quantify the potential impact.

***Application date and transition approach***

AGL plans to adopt the new standard on the required effective date. AGL is still in the process of assessing which transition method it will adopt. This decision will depend in part upon the completion of, and impact arising from, the evaluation of our revenue arrangements.

**AASB 16 *Leases*** replaces all existing leases requirements (AASB 117 *Leases*, Interpretation 4 *Determining whether an Arrangement contains a Lease* and related Interpretations). For lessees, the distinction between operating and finance leases will no longer exist. Instead, AASB 16 will require lessees to account for practically all leases under a single on-balance sheet model in a similar way to finance leases under AASB 117.

The standard includes two recognition exemptions for lessees – leases of 'low-value' assets (e.g., personal computers) and short-term leases (i.e., leases with a lease term of 12 months or less). At the commencement date of a lease, a lessee will recognise a liability representing its obligation to make future lease payments (i.e., the lease liability) and an asset representing its right to use the underlying asset for the lease term (i.e., the right-of-use ("ROU") asset). Lessees will be required to separately recognise interest expense on the lease liability and depreciation expense on the ROU asset rather than operating lease expense.

The lease expense recognition pattern for lessees will generally be accelerated as compared to today. Key balance sheet metrics such as gearing and finance ratios, debt covenants and income statement of profit or loss metrics, such as earnings before interest, taxes, depreciation and amortisation ("EBITDA"), will be impacted. Also, statement of cash flows for lessees will be affected as payments for the principal portion of the lease liability will be presented within financing activities.

Lessor accounting is substantially unchanged from today's accounting under AASB 117. Lessors will continue to classify all leases using the same classification principle as in AASB 117 and distinguish between two types of leases: operating and finance leases.

The standard will require lessees and lessors to make more extensive disclosures than under AASB 117. Given the significant accounting implications, lessees will have to carefully consider the contracts they enter into to identify any that are, or contain, leases. This evaluation will also be important for lessors to determine which contracts (or portions of contracts) are subject to the new revenue recognition standard.

AGL F

**Information about transition project plan**

**Information about what the project team has done to date**

**Information about key focus area**

AGL Energy Limited and controlled entities
Notes to the Consolidated Financial Statements
For the year ended 30 June 2017

## Note 1 - Summary of significant accounting policies (cont'd)

**(ae) Standards and Interpretations in issue not yet adopted (cont'd)**

**AASB 16 *Leases* (cont'd)**

AASB 16 is effective for annual reporting periods commencing on or after 1 January 2019, which means it will be effective for AGL's 30 June 2020 financial statements. The standard permits two methods of adoption: full retrospective – by retrospectively adjusting each prior reporting period presented and recognising the cumulative effect of initially applying the new requirements at the start of the earliest period presented, which would be 1 July 2018 for AGL; or modified retrospective – by recognising the cumulative effect of initially applying the new requirements at the date of initial application, which would be 1 July 2019 for AGL.

AASB 16

***Overview of assessment activities***

In the first half of FY17, AGL established a project team comprising appropriate leases subject matter specialists working with individual business units. Work to date has focused on identifying the current operating leases that will be in the scope of AASB 16 at transition and reviewing and analysing the terms of these contracts. While note 25 contains the population of existing operating leases as at 30 June 2017, a number of these leases will expire or will have a remaining lease term of less than 12 months at the date of initial application and therefore will not be impacted by AASB 16. The majority of the existing operating leases relate to property and equipment leases.

The project team worked with management to assess AGL's ability to apply the grandfathering provision available under AASB 16, which is a practical expedient available to help manage the cost of implementation the new standard. The application of this provision will mean AGL will not be required to reassess whether a contract is, or contains, a lease under the requirements of AASB 16 at the date of initial application, i.e., 1 July 2019. Instead, the current AASB 117 and Interpretation 4 lease/non-lease assessments would remain. That is, for existing arrangements that have been identified as a lease under AASB 117 at the date of initial application, will continue to be accounted for as a lease under AASB 16 with operating leases coming on balance sheet. Those not identified as leases under AASB 117 at the date of initial application will not be subject to AASB 16. AASB 16 will only apply to new arrangements entered into, or modified, after the date of initial application.

AASB 16

Subsequent to this, the team commenced its review of the in scope operating lease contracts, to identify the key terms required to calculate the lease liabilities and related ROU assets, and to identify key decisions made under the existing lease arrangements which may affect the lease calculation. The team is currently in the process of analysing the impact of the new standard by assessing the terms of these contracts in light of the requirements of AASB 16. Further contract reviews, as required, and computation of the likely lease liability and ROU assets to be recognised on transition (including modelling the impact of the various transition methods), will be completed throughout FY18. This will be followed by consideration of broader business impacts.

***Potential impact on AGL's financial report***

To date, some of the key issues identified include: application of the grandfathering provision; determination of what constitutes a low-value asset; determination of the incremental borrowing rates; and assessment of what constitutes "reasonably certain" for the purposes of assessing whether an option to extend, or to terminate, a lease contract, will be exercised.

AASB 16

AGL has concluded that it intends to apply the grandfathering provision under AASB 16 at the date of initial application. This therefore means the focus of the project team has been, and will continue to be, on analysing the current operating lease contracts that will be impacted by AASB 16 and identifying and assessing the key terms which will impact the calculation of the lease-related balances.

As at 30 June 2017, AGL had $165 million of non-cancellable operating lease commitments as disclosed in note 25. Operating leases included in this note, which will still be effective and will have a lease term of more than 12 months from the date of initial application, will be subject to AASB 16 and will therefore be recognised on balance sheet. Any new leases entered into subsequent to 30 June 2017 will also be subject to a scoping assessment.

AGL's existing finance leases (in note 19) are not expected to be materially impacted by the new standard. The relevant finance lease assets will be presented as ROU asset under the new standard.

The project team has provided periodic updates to management, the audit committee and our auditors.

While a considerable portion of FY17 has been spent progressing AGL's assessment of the potential impact of AASB 16, at this stage, management cannot reasonably estimate and quantify the impact.

***Application date and transition approach***

AGL is still in the process of assessing the appropriate adoption date of AASB 16 and which transition method it will adopt. This decision will depend in part upon our completion of, and impact arising from, the evaluation of the lease arrangements.

In addition to the above Standards, which are applicable in future years, other issued amendments and new Standards are not expected to materially impact AGL's financial statements upon adoption.

**Information about transition project plan**

**Information about what the project team has done to date**

**Information about decisions made while transitioning**

# Notes continued

for the 12 months to 31 December 2016

## 39. NEW ACCOUNTING STANDARDS

The following standards, amendments to standards and interpretations have been identified as those which may impact the Group in the period of initial application. They are available for early adoption at 31 December 2016, unless noted otherwise below, but have not been applied in preparing this financial report. The Group's assessment of these new standards and interpretations is set out below:

- AASB 9 *Financial Instruments (revised December 2014)* and AASB 2014-7 *Amendments to Australian Accounting Standards arising from AASB 9 (December 2014)*

  This standard replaces AASB 139 *Financial Instruments: Recognition and Measurement*. AASB 9 includes revised guidance on the classification and measurement of financial instruments, including a new expected credit loss model for calculation of impairment on financial assets, and new general hedge accounting requirements. It also carries forward guidance on recognition and derecognition of financial instruments from AASB 139. The standard will become mandatory for reporting periods beginning on or after 1 January 2018. The Group does not intend to early adopt the standard. Retrospective application is required with some exceptions.

  While the Group has yet to undertake a detailed assessment of the classification and measurement impacts of the new standard the Group expects the following impacts:

  - the Group does not expect the new guidance to have a significant impact on the classification and measurement of its financial assets;
  - the Group does not hold any financial liabilities at fair value through profit and loss and as such there is no impact of the new standard on financial liabilities;
  - as a general rule more hedge relationships may be eligible for hedge accounting. Existing hedge relationships would appear to qualify as continuing hedge relationships upon adoption of the new standard; and
  - the new impairment model requires the recognition of impairment provisions based on expected credit losses rather than only incurred credit losses. Whilst the Group has not yet finalised its detailed assessment of the impact of AASB 9 and its interaction with AASB 15 *Revenue from Contracts with Customers* it may result in earlier recognition of credit loss provisions.

- AASB 15 *Revenue from Contracts with Customers* and AASB 2014-5 *Amendments to Australian Accounting Standards arising from AASB 15*

  AASB 15 establishes a comprehensive framework for determining the timing and quantum of revenue recognised. It replaces existing guidance, including AASB 118 *Revenue* and AASB 111 *Construction Contracts*. The core principle of AASB 15 is that an entity shall recognise revenue when control of a good or service transfers to a customer. This standard will become mandatory for reporting periods beginning on or after 1 January 2018. The standard permits either a full retrospective or a modified retrospective approach for the adoption.

  The Group is assessing the impact on its consolidated financial statements resulting from the application of the new standard. Broadly there is an increased threshold to recognising revenue and related assets in the new standard. Given the number of projects operated by the Group, revenue in any particular year is not expected to vary significantly in percentage terms however there is expected to be a reduction in assets recognised on the balance sheet. The following areas have been identified that are likely to be significantly affected.

  - Currently under AASB 111 *Construction Contracts* costs incurred during the tender process are capitalised within net contract debtors when it is deemed probable the contract will be won. Under the new standard costs can only be capitalised if they are both expected to be recovered and either would not have been incurred if the contract had not been won or if they are intrinsic to the delivery of a project. As such a reduction in net contract debtors is expected.
  - Construction revenue is predominantly derived on projects with one performance obligation. Contracted revenue will continue to be recognised over time on a percentage completion basis however the new standard imparts a higher threshold of probability for recognition of claims and variances. Revenue is currently recognised when it is probable that work performed will result in revenue whereas under the new standard revenue is recognised when it is highly probable that a significant reversal of revenue will not happen. As such a reduction in net contract debtors may be seen under the new standard.
  - Mining projects typically involve payment on the delivery of ore to a client. There are several stages in mine development and production that, dependent on the contract terms, could represent separate performance obligations. Revenue is required to be allocated to each performance obligation and recognised on transfer of control. The appropriate allocation of revenue may result in a change in the timing of revenue recognition that may be accelerated or deferred compared to the current method.
  - The new standard requires significant increases in disclosures in relation to revenue derived from contracts, key judgments and future revenue expected to be generated.

AASB 9

AASB 15

AASB 15

**Expected impact**

**Key area affected by the standard**

**Progress of impact assessment**

Source: CIMIC Group Limited, 2016 Annual Report (for 31/12/16 year end), pages 178-179. Accessed 7/12/17.

# Notes continued

for the 12 months to 31 December 2016

## 39. NEW ACCOUNTING STANDARDS CONTINUED

- *AASB 16 – Leases*

AASB 16 *Leases* specifies how to recognise, measure and disclose leases. The standard provides a single lessee accounting model, requiring lessees to recognise assets and liabilities for almost all leases. AASB 16 applies to annual reporting periods beginning on or after 1 January 2019.

As at the reporting date, the Group has non-cancellable operating lease commitments of $969.4 million, refer to Note 32: *Commitments*. The Group manages its owned and leased assets to ensure there is an appropriate level of equipment to meet its current obligations and to tender for new work. The decision as to whether to lease or purchase an asset is dependent on the finance available at the time and the residual risk of ownership following the anticipated completion of a project.

Many of the operating leases currently held expire prior to the implementation of the standard and decisions on future leases will be made as projects are tendered for. As such the Group has not quantified the effect of the new standard, however the following impacts are expected:

AASB 16

- the total assets and liabilities on the balance sheet will increase with a decrease in net total assets, due to the reduction of the capitalised asset being on a straight line basis whilst the liability reduces by the principal amount of repayments. Net current assets will show a decrease due to an element of the liability being disclosed as a current liability;
- interest expenses will increase due to the unwinding of the effective interest rate implicit in the lease. Interest expense will be greater earlier in a leases life due to the higher principal value causing profit variability over the course of a lease life. This effect may be partially mitigated due to number of leases held in the Group at different stages of their terms; and
- operating cash flows will be higher as repayment of the principle portion of all lease liabilities will be classified as financing activities.

The following new or amended standards are not expected to have a significant impact on the Group's consolidated financial statements:

- AASB 2016-1 *Amendments to Australian Accounting Standards – Recognition of Deferred Tax Assets for Unrealised Losses;*
- AASB 2016-2 *Amendments to Australian Accounting Standards – Disclosure Initiative: Amendments to* AASB 107;
- AASB 2016-5*Amendments to Australian Accounting Standards – Classification and Measurement of Share-based Payment Transactions;*
- AASB 2014-10 *Amendments to Australian Accounting Standards: Sale or Contribution of Assets Between an Investor and its Associate or Joint Venture; and*
- AASB 2015-10 *Amendments to Australian Accounting Standards – Effective Date of Amendments to* AASB 10 and AASB 128

## 40. EVENTS SUBSEQUENT TO REPORTING DATE

Subsequent to reporting date:

- The Group determined a 100% franked dividend of 62 cents per share to be paid on 4 July 2016
- On 24 January 2017, CIMIC announced its intention to acquire the remaining shares of Macmahon that it did not already own, at a price of $0.145 per share, made through an unconditional off market takeover offer.
- On 25 January 2017, CIMIC, through the UGL-CH2M JV-GE Consortium, which includes UGL and its joint venture partner CH2M, terminated its contract with JKC Australia LNG for the design, construct and commissioning of the Ichthys Combined Cycle Power Plant. The termination is adequately covered by provisions held at 31 December 2016.
- The Directors approved the financial report on 8 February 2017.



**Tailored discussion to the entity**

## I SUMMARY OF ACCOUNTING POLICIES (CONTINUED)

### (X) NEW ACCOUNTING STANDARDS AND INTERPRETATIONS ISSUED BUT NOT YET EFFECTIVE

Certain new accounting standards and interpretations have been published that are not mandatory for the 30 June 2017 reporting period. FLT is in the process of determining the impact of these new standards and interpretations.

#### AASB 15 REVENUE FROM CONTRACTS WITH CUSTOMERS

AASB 15 was issued by the AASB in December 2014 and replaces virtually all revenue recognition requirements, including those as set out in AASB 118 *Revenue*. The core principal of AASB 15 is that an entity recognises revenue in accordance with the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

AASB 15

The standard comes into effect 1 January 2018. This means it will be applied to the reporting period ending 30 June 2019, with the comparative period ending 30 June 2018. FLT does not intend to adopt the standard before its operative date.

#### IMPLEMENTATION

AASB 15

Management are progressing through the project plan established in 2016, with updates regularly shared with the board and external auditors.

A sample of current contracts for FLTs material revenue in core geographies have been assessed against AASB 15 requirements with external consultants providing assistance in the review of some of these contracts. Based on these reviews FLT are developing accounting policies for the material revenue streams.

FLT are only just entering the transition period for the comparative period (1 July 2017 – 30 June 2018) and therefore are not yet operating under many of the contracts which will be in place under the new standard. As such it is not yet prudent to finalise the accounting policies nor draw conclusions as to the potential impact of the standard. As the plan progresses, FLT will finalise the contract reviews and accounting policies and engage with the external auditors to review these. At that time FLT expect to disclose information in relation to the adoption of AASB 15 including, if relevant, any significant issues that will impact FLT on transition.

The outcome of the assessment activities and the resultant impact on revenue (if any) will impact whether the full retrospective or modified retrospective transition method is adopted. As such, a decision on which method will be adopted has not yet been made.

As part of the project plan, management will continue to engage with the wider business in the AASB 15 discussions and consider IT requirements as part of the new IT system development. The plan also includes consideration to develop and test systems, internal controls and procedures necessary to collect and disclose the required information.

#### DISCLOSURE

AASB 15 provides presentation and disclosure requirements, which are more detailed than under current AASB 118.

The presentation and disclosure requirements represent a change from current practice and may increase the volume of disclosures required in FLT financial statements.

The disclosure requirements are currently being assessed for the material revenue streams where accounting policies are under development.

**Information about transition project plan**

**Information about what the project team has done to date**

**Progress of impact assessment**

Source: Flight Centre Travel Group, Annual Report 2017 (for 30/6/17 year end), pages 111-112. Accessed 7/12/17.

# NOTES TO THE FINANCIAL STATEMENTS CONTINUED

## I SUMMARY OF ACCOUNTING POLICIES (CONTINUED)

### AASB 16 LEASES

AASB 16 was issued by the AASB in February 2016. Due to the large number of operating leases held by FLT for its global shop network, this standard will have a significant impact on the group.

The key features of the new standard are:

- elimination of classification of leases as either operating leases or finance leases for a lessee
- the recognition of lease assets and liabilities on the balance sheet, initially measured at present value of unavoidable future lease payments
- recognise depreciation of lease assets and interest on lease liabilities on the income statement over the lease term
- separation of the total amount of cash paid into a principal portion and interest in the cash flow statement
- short-term leases (less than 12 months) and leases of low-value assets are exempt from the requirements

The new standard will be effective for annual reporting periods beginning on or after 1 January 2019, which means that it will be applied in the reporting period ending 30 June 2020. FLT does not intend to adopt the standard before its operative date.

AASB 15

Management had previously conducted reviews of the impact of the proposed standard. The gross-up of the balance sheet and the impact to EBIT and EBITDA under the proposed standard had been considered during negotiations of major contracts. Now the standard has been issued in full, management are developing a project plan, which includes an in-depth review of the requirements and steps for implementation.

The outcome of these assessments will determine the impact of the changes.

There are no other standards that have been issued but are not yet effective and that are expected to have a material financial impact on the entity in the current or future reporting periods and on foreseeable future transactions.



**Progress of impact assessment**

# Notes to the 2016 financial statements

## 1 Principal accounting policies

**Corporate information**

Rio Tinto's business is finding, mining and processing mineral resources. Major products are aluminium, copper, diamonds, gold, industrial minerals (borates, titanium dioxide and salt), iron ore, thermal and metallurgical coal and uranium. Activities span the world and are strongly represented in Australia and North America, with significant businesses in Asia, Europe, Africa and South America.

Rio Tinto plc is incorporated in the UK and listed on the London and New York Stock Exchanges and Rio Tinto Limited is incorporated in Australia and listed on the Australian Stock Exchange. Rio Tinto plc's registered office is at 6 St James's Square, London SW1Y 4AD, UK. Rio Tinto Limited's registered office is at 120 Collins Street, Melbourne, Australia, 3000.

These financial statements consolidate the accounts of Rio Tinto plc and Rio Tinto Limited (together "the Companies") and their respective subsidiaries (together "the Group") and include the Group's share of joint arrangements and associates as explained in note 1(b) below. The Group's financial statements for the year ended 31 December 2016 were authorised for issue in accordance with a directors' resolution on 1 March 2017.

Notes 33 to 36 provide more information on the Group's subsidiaries, joint arrangements and associates and note 40 provides information on the Group's transactions with other related parties.

**Basis of preparation of the financial statements**

The basis of preparation and the accounting policies used in preparing the Group's 2016 financial statements are set out below.

The financial statements have been prepared on a going concern basis in accordance with the Companies Act 2006 applicable to companies reporting under International Financial Reporting Standards and in accordance with applicable UK law, applicable Australian law as amended by the Australian Securities and Investments Commission Order dated 14 December 2015, Article 4 of the European Union IAS regulation and also with:

- International Financial Reporting Standards as issued by the International Accounting Standards Board (IASB) and interpretations issued from time to time by the IFRS Interpretations Committee (IFRS IC) both as adopted by the European Union (EU) and which are mandatory for EU reporting as at 31 December 2016; and
- International Financial Reporting Standards as issued by the IASB and interpretations issued from time to time by the IFRS IC which are mandatory as at 31 December 2016.

The above accounting standards and interpretations are collectively referred to as "IFRS" in this report. The Group has not early adopted any amendments, standards or interpretations that have been issued but are not yet mandatory.

The Group's financial statements have been prepared on the basis of accounting policies consistent with those applied in the financial statements for the year ended 31 December 2015 except for the implementation of a number of minor amendments issued by the IASB and endorsed by the EU which have been applied for the first time in 2016. These new pronouncements do not have a significant impact on the Group's financial statements and therefore prior-period financial statements have not been restated for these pronouncements.

Mandatory for 2017 – not yet endorsed by the EU

Amendments to IAS 12: Recognition of Deferred Tax Assets for Unrealised Losses. These amendments on the recognition of deferred tax assets for unrealised losses clarify how to account for deferred tax assets related to debt instruments measured at fair value.

IAS 7 – Statement of cash flows, Narrow-scope amendments. The amendments introduce an additional disclosure that will enable users of financial statements to evaluate chan[illegible]sing fro[illegible] financing activities. The Group wi[illegible]rmation on movements in gross liabilities arising from financing activities in addition to the net debt reconciliation currently provided.

The Group does not expect these pronouncements to have a significant impact on the Group's financial statements.

Mandatory beyond 2017

IFRS 9 "Financial Instruments", IFRS 15 "Revenue from Contracts with Customers" and IFRIC 22 "Foreign Currency Transactions and Advance Consideration" are mandatory in 2018 and IFRS 16 "Leases" is mandatory in 2019.

The Group's process of implementation of new pronouncements is in four stages:

- Diagnostic – the high-level identification of accounting issues in the new pronouncement that will impact the Group.
- Confirmation of understanding – the detailed review of contracts or other relevant data and training for finance, commercial, procurement and other teams.
- Solution development – identifying and progressing system and data changes.
- Implementation.

The Group is currently evaluating the impact of these pronouncements. This work is ongoing and additional impacts may be identified later in the implementation process.

IFRS 9 "Financial Instruments" – endorsed by the EU

The standard includes a single approach for the classification and measurement of financial assets, based on cash flow characteristics and the business model used for the management of the financial instruments. It introduces the expected credit loss model for impairment of financial assets which replaces the incurred loss model used in IAS 39. Lastly, the standard amends the rules on hedge accounting to align the accounting treatment with the risk management practices of the business.

Work to date has primarily focused on the Group's Treasury operations, which hold the majority of the Group's financial instruments, with a high level review of the rest of the Group. In 2017, a more detailed review will be completed including analysis at a business unit level. Potential differences identified to date relate to the alternative under IFRS 9 to amortise the cost of hedging over the life of the hedging instrument (this is currently taken directly to the income statement under IAS 39), and changes to the calculation of impairment losses as well as the possibility of increased application of hedge accounting. The Group does not currently expect the impact of these changes to be material.

IFRS 15 "Revenue from Contracts with Customers" – endorsed by the EU

The core principle of IFRS 15 is that an entity recognises revenue related to the transfer of promised goods or services when control of the goods or services passes to customers. The amount of revenue recognised should reflect the consideration to which the entity expects to be entitled in exchange for those goods or services.

Work to date has focused primarily on the Iron Ore and Aluminium product groups, as these together account for over 70 per cent of the Group's sales revenue, with a limited review of contracts at other product groups. In 2017, further review of contracts will be undertaken at all businesses. To date, no material measurement differences have been identified between IAS 18, the current revenue recognition standard, and IFRS 15.

The Group sells a significant proportion of its products on CFR or CIF Incoterms. This means that the Group is responsible for providing shipping services after the date at which control of the goods passes to the customer at the loading port. Under IAS 18, the Group recognises such shipping and other freight revenue and accrues the associated costs in full on loading. The impact of treating freight, where applicable, as a separate performance obligation and therefore recognising revenue over time would not have materially impacted revenue, costs or earnings as at 31 December 2016.



AASB 9

AASB 15

AASB 9

AASB 15

**Progress of impact assessment**

**Information about whether impact will be material or immaterial**

Source: Rio Tinto, 2016 Annual Report (for 31/12/16 year end), pages 116-117, Accessed 7/12/17.

IFRS 15 as well as IFRS 9 requires certain additional disclosures, in particular in relation to the impact of provisional pricing and, where applicable, changes to systems are being made to capture this data.

AASB 15

The Group expects to adopt the modified transitional approach to implementation where any transitional adjustment is recognised in retained earnings at the date of implementation of the standard without adjustment of comparatives. The new standard will only be applied to contracts that remain in force at the transition date.

IFRIC 22 "Foreign Currency Transactions and Advance Consideration" – not yet endorsed by the EU

The Interpretation, which was issued on 8 December 2016, addresses how to determine the date of a transaction for the purpose of determining the exchange rate to use on initial recognition of an asset, expense or income (or part of it) when a related non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration in a foreign currency is derecognised.

The Group is currently evaluating the impact of this pronouncement.

IFRS 16 "Leases" – not yet endorsed by the EU

Under the new standard, a lessee is in essence required to:

(a) recognise all right of use assets and lease liabilities, with the exception of short term (under 12 months) and low value leases, on the balance sheet. The liability is initially measured at the present value of future lease payments for the lease term. This includes variable lease payments that depend on an index or rate but excludes other variable lease payments. The right of use asset reflects the lease liability, initial direct costs, any lease payments made before the commencement date of the lease, less any lease incentives and, where applicable, provision for dismantling and restoration.

(b) recognise depreciation of right of use assets and interest on lease liabilities in the income statement over the lease term.

(c) separate the total amount of cash paid into a principal portion (presented within financing activities) and interest portion (which the Group presents in operating activities) in the cash flow statement.

This standard will have an impact on the Group's earnings and shareholders' funds at transition and in future years. It must be implemented retrospectively, either with the restatement of comparatives or with the cumulative impact of application recognised as at 1 January 2019 under the modified retrospective approach.

IFRS 16 contains a number of practical expedients, one of which permits the classification of existing contracts as leases under current accounting standards to be carried over to IFRS 16.

Under the modified retrospective approach, on a lease-by-lease basis, the right of use of an asset may be deemed to be equivalent to the liability at transition or calculated retrospectively as at inception of the lease.

Under IFRS 16 the present value of the Group's operating lease commitments as defined under the new standard, excluding low value leases and short term leases, will be shown as right of use assets and as lease liabilities on the balance sheet. Information on the undiscounted amount of the Group's operating lease commitments under IAS 17, the current leasing standard, is disclosed in note 31. The Group is considering the available options for transition.

To date, work has focused on the identification of the provisions of the standard which will most impact the Group. In 2017, work on these issues and their resolution will continue and work on the detailed review of contracts and financial reporting impacts will commence as well as assessment of likely changes to systems.

**Judgments in applying accounting policies and key sources of estimation uncertainty**

The preparation of the financial statements requires management to make assumptions, judgments and estimates and to use judgment in applying accounting policies and in making critical accounting estimates.

These assumptions, judgments and estimates are based on management's best knowledge of the relevant facts and circumstances, having regard to previous experience, but actual results may differ materially from the amounts included in the financial statements. Key areas of judgment and estimation uncertainty are highlighted below and further information is contained in the accounting policies and/or the notes to the financial statements.

Areas of judgment that have the most significant effect on the amounts recognised in the financial statements are:

- Dual listed companies reporting (see Dual listed companies structure on page 115);
- Determination of Cash Generating Units (CGUs), review of asset carrying values, impairment charges and reversals and the recoverability of goodwill – note 1(e) and (i), note 6, note 12 and note 13;
- Estimation of asset lives – note 1(e) and (i);
- Determination of ore reserve and mineral resource estimates – note 1(j);
- Provision for onerous contracts – note 1(i);
- Close-down, restoration and environmental obligations – note 1(k);
- Deferral of stripping costs – note 1(h);
- Recognition of deferred tax on mining rights recognised in acquisitions – note 1(m);
- Uncertain tax positions – note 1(m), note 9 and note 31;
- Recoverability of potential deferred tax assets – note 17(c), (e) and (f);
- Capitalisation of exploration and evaluation costs and development costs prior to the decision to mine/construct – note 1(f);
- Identification of functional currencies – note 1(d);
- Estimation of obligations for post-employment costs– note 1(n) and note 45;
- Basis of consolidation – note 1(b) and note 42;
- Contingencies – note 31.

Key sources of estimation uncertainty that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are:

- Review of asset carrying values, impairment charges and reversals and the recoverability of goodwill – note1(e) and (i), note 6, note 12 and note 13;
- Estimation of asset lives – note 1(e) and (i);
- Determination of ore reserve and mineral resource estimates – note 1(j);
- Provision for onerous contracts – note 1(i);
- Estimation of close-down, restoration and environmental costs and the timing of expenditure – note 1(k) and note 26;
- Uncertain tax positions – note 1(m), note 9 and note 31;
- Recoverability of potential deferred tax assets – note 17 (c), (e) and (f);
- Capitalisation of exploration and evaluation costs and development costs prior to the decision to mine/construct – note 1(f);
- Estimation of obligations for post-employment costs – note 1(n) and note 45;
- Contingencies – note 31.

AASB 16

These areas of judgment and estimation are discussed further in critical accounting policies and estimates on pages 125 to 127.

**(a) Accounting convention**

The financial information included in the financial statements for the year ended 31 December 2016, and for the related comparative periods, has been prepared under the historical cost convention, as modified by the revaluation of certain derivative contracts and financial assets, the impact of fair value hedge accounting on the hedged item and the accounting for post-employment assets and obligations. The Group's policy in respect of these items is set out in the notes below.



Transitional approach

Progress of impact assessment

## Section 7. Other information (continued)

### 7.1 Other accounting policies (continued)

**7.1.3 New accounting standards to be applied in future reporting periods (continued)**

***(a) Financial instruments - impairment of financial assets (continued)***

AASB 9 requires us to record expected credit losses on our financial assets measured at amortised cost or at fair value through other comprehensive income, except for investments in equity instruments, and to contract assets arising under AASB 15: 'Revenue from Contracts with Customers', on either of the following bases:

- 12-month expected credit losses which result from all possible default events within the 12 months after the reporting date
- lifetime expected credit losses which result from all possible default events over the expected life of a financial instrument.

Lifetime expected credit losses measurement applies if the credit risk of a financial asset at the reporting date has increased significantly since initial recognition. Otherwise 12-month expected credit losses measurement applies. An entity may determine that a financial asset's credit risk has not increased significantly if the asset has low credit risk at the reporting date. However, lifetime expected credit losses measurement always applies for trade receivables and contract assets without a significant financing component. This policy choice is also available for trade receivables and contract assets with a significant financing component.

AASB 9

While we are in the process of completing our detailed assessment to determine the extent of the impact, we expect a reduction in our opening retained earnings for the first time adoption of the standard due to higher loss allowance resulting from earlier recognition of credit losses.

***(b) Revenue from contracts with customers***

In December 2014, the AASB issued AASB 15: 'Revenue from Contracts with Customers' and AASB 2014-5: 'Amendments to Australian Accounting Standards arising from AASB 15'. In October 2015 the AASB issued AASB 2015-8: 'Amendments to Australian Accounting Standards – Effective Date of AASB 15' which deferred the effective date of the new revenue standard from 1 January 2017 to 1 January 2018. In May 2016, the AASB issued AASB 2016-3: 'Amendments to Australian Accounting Standards - Clarifications to AASB 15.'

AASB 15 establishes principles for reporting the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers and requires application of a five-step process to identify the contract with the customer, identify performance obligations in the contract, determine transaction price, allocate the transaction price to the performance obligations and recognise revenue when performance obligations are satisfied. AASB 15, AASB 2014-5, AASB 2015-8 and AASB 2016-3 apply to Telstra from 1 July 2018, with early application permitted.

AASB 15

We are continuing our analysis and assessment of the impact of the new revenue standard on our financial results. This includes identifying changes to our accounting policies, internal and external reporting requirements, IT systems, business processes and associated internal controls with the objective of quantifying the expected first time adoption impacts as well as supporting ongoing compliance with the new accounting requirements. The outcome of these analysis will ultimately determine our adoption approach and application of the transition provisions of the new standard; however, we expect that we will apply the standard retrospectively to prior reporting periods, subject to permitted and elected practical expedients.

We generate revenue from customer contracts, which vary in their form (standard or bespoke), legal term (casual, short-term or long-term) and customer segment (consumer, small to medium business and government and large enterprise). AASB 15 impacts will differ depending on the type of customer contract, with the main ones being:

- Homogeneous retail consumer contracts (mass market prepaid and postpaid mobile, fixed and media offerings)
- Retail small to medium business contracts (mass market and off-the shelf technology solutions)
- Retail enterprise and government contracts (carriage, standardised and bespoke technology solutions and their management)
- Network capacity contracts (mainly Indefeasible Right of Use (IRU))
- Wholesale contracts for telecommunication services
- nbn Definitive Agreements
- Network design, build and maintenance contracts (mainly with nbn co)
- Other contracts (including software and health products sold by our subsidiaries).

Based on the work done to date, and like many other telecommunications companies, we expect to be materially affected by the application of the new standard, primarily in respect of the timing of revenue recognition, the classification of revenue, the capitalisation of costs of obtaining a contract with a customer and possibly the capitalisation of the costs to fulfil certain contracts while expensing those costs which are currently deferred for other contracts.

AASB 15

Our initial impact assessment focused on homogeneous retail consumer contracts, with a large number of low value contracts, for which we expect some accounting changes on the adoption of AASB 15.

Our mobile long-term contracts often offer a bundle of hardware and services, where the customer pays a monthly fee and receives a discount, which is allocated between the hardware and services based on their relative standalone selling prices. Under the legal terms of these contracts the allocated hardware amount is not contingent on delivery of future services and we recognise the hardware revenue on delivery of the handset. Therefore, on adoption of AASB 15 and unlike many other telecommunication companies, we do not expect an acceleration of hardware revenue in our mobiles business due to the removal of the contingent consideration rules.

AASB 15

However, when determining the customer contract AASB 15 requires us to assess the combination of two or more contracts entered into at or near the same time with the same customer. As a result and based on our current practice, we expect changes in the accounting treatment of customer contracts sold via our dealer channel where the substance over form principle will be overridden by these new contract combination rules, as we can no longer combine these separate legal contracts. Consequently no discounts will be allocated to hardware sold via dealer channel, bringing forward timing of our hardware revenue recognition for the dealer channel.



**Progress of impact assessment**

**Information about whether impact will be material or immaterial**

**Example of expectation on specific area**

Source: Telstra, Telstra Annual Report 2017 (for 30/6/17 year end), pages 143-144. Accessed 7/12/17.

Notes to the financial statements (continued)

## Section 7. Other information (continued)

### 7.1 Other accounting policies (continued)

**7.1.3 New accounting standards to be applied in future reporting periods (continued)**

***(b) Revenue from contracts with customers (continued)***

AASB 15 gives far greater detail on how to account for contract modifications than current revenue accounting principles. Changes must be accounted for either as a retrospective cumulative change to revenue (creating either a catch up or deferral of past revenues for all performance obligations in the original contract), a prospective change to revenue with a reallocation of revenues amongst remaining performance obligations in the original contract, as a separate contract which will not require any reallocation to performance obligations in the original contract, or both a cumulative change and prospective change to revenue in the original contract. Currently we account for any changes in our consumer retail contracts prospectively as there is no clear guidance for contract modification accounting.

AASB 15 defines a material right which constitutes a separate performance obligation in a customer contract and gives customer an option to acquire additional goods or services at a discount or for free i.e. it is beneficial. In principle this concept is largely consistent with our current accounting policy for non-cash sales incentives which are treated as separate deliverables. However, determination and measurement of material rights (including accounting for their breakage) will differ from our current practice. As a result revenue will be allocated to some of the goods and services we currently offer for free in our mass market plans.

AASB 15

If a customer receives any discounts when purchasing a bundle of goods or services under one accounting contract, AASB 15 requires a proportional allocation of the discounts to all performance obligations, unless the exception allocation criteria are met, in which case the discounts can be allocated to only one or some but not all performance obligations. This differs from our current accounting policy which allocates cash sales incentives to goods or services contributing towards the earning of the incentives. Meeting the allocation exemption criteria is expected to be rare; therefore adoption of AASB 15 will result in changes to both timing of revenue recognition and revenue allocation between the products in a bundle.

Some of our contracts with customers include deferred payment terms and under AASB 15 Telstra is considered to provide financing to the customer. AASB 15 requires us to separately account for a significant financing component and measure it using a discount rate that would be reflected in a separate financing transaction between Telstra and the customer at contract inception. The rate would reflect the credit characteristics of the party receiving financing in the contract, i.e. the customer. For our mass market customers this rate is likely to differ from our current practice of using Telstra's incremental borrowing rate, which will result in reduction of revenue and a higher interest income being recognised over the contract term.

The magnitude of the financial impacts on transition and on the comparative financial year is yet to be determined, with some impacts expected to be immaterial or offsetting each other.

Our operations and associated systems are complex and the new standard requires analysis and assessment of millions of multi-year contracts with our customers. This includes incremental compilation of historical data for the millions of already existing multi-year contracts with our customers that are expected to be in-scope for purposes of transitioning to the new standard in order to determine the accounting estimates of opening retained earnings adjustments as at 1 July 2017 i.e. the first comparative period presented in our 30 June 2019 financial statements. Our current estimate of the time and effort necessary to develop and implement the accounting policies, estimates, judgments and processes (including critical incremental requirements of our information technology systems) we will need to have in place in order to comply with the new standard extends into mid/late financial year 2018.

Once we have developed and implemented the necessary accounting policies, estimates, judgments and processes, we will commence the incremental compilation of historical data, as well as the accounting for that data, which is necessary to transition to, and to make reasonable quantitative estimates of the effects of the new standard. As a result, at this time, it is not possible to make reasonable quantitative estimates of the effects of the new standard, and we may not be able to do so prior to completing our 31 December 2018 half-year consolidated financial statements. Should reliable estimates become available earlier we will provide an estimate of opening retained earnings adjustment and the expected impacts on the comparative period in our consolidated financial statements for the financial year 2018.

***(c) New leasing standard***

In February 2016, AASB issued AASB 16 'Leases', which replaces the current guidance in AASB 117 'Leases', Interpretation 4 'Determining whether an Arrangement contains a Lease', Interpretation 115 'Operating Leases - Incentives' and Interpretation 127 'Evaluating the Substance of Transactions Involving the Legal Form of a Lease'. The new standard will apply to us from 1 July 2019. Early adoption is permitted, but only in conjunction with AASB 15: 'Revenue from Contracts with Customers'.

The new standard requires the lessee to recognise its leases in the statement of financial position as an asset (the right to use the leased item) and a liability reflecting future lease payments. Depreciation of the leased asset and interest on lease liability will be recognised over the lease term. The lessee can utilise the exceptions related to short-term and low-value leases, however, assets subject to subleases do not qualify for the low-value exception.

AASB 16

AASB 16 substantially carries forward the lessor accounting requirements of AASB 117. Accordingly, a lessor continues to classify its leases and account for them as operating or finance leases.

We have a significant number of long-term non-cancellable property leases for our office buildings and network sites, which are expected to have a material impact when recognised in the statement of financial position. We are currently assessing the impact of the new leasing standard on our financial results. This includes identifying changes to our accounting policies, internal and external reporting requirements, IT systems, business processes and controls. Our adoption approach and application of the transition provisions under the new standard will depend on the outcome of this assessment, which is yet to be finalised.

AASB 16



**Tailored information**

**Progress of impact assessment**