Three Accounting Standards that will shake up the Australian Technology, Media and Telecom (TMT) sector

In the coming years companies in the Australian Technology, Media and Telecom (TMT) sector may find themselves having to account for certain transactions in a very different way compared to previous years.

The upcoming changes in accounting standards are unique in that they potentially have a pervasive impact on organisations, including on systems, data, controls, key performance measures and remuneration schemes, whilst they all become effective around the same time.

The three standards we are talking about: AASB 15 (IFRS 15), Revenue from Contracts with Customers, AASB 16 (IFRS 16), Leases, and AASB 9 (IFRS 9), Financial Instruments.

We set out below some of the key issues that may impact TMT entities:

1 AASB 15, Revenue from Contracts with Customers

In a nutshell

The core principle is simple: 'An entity will recognise revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration (payment) to which the entity expects to be entitled in exchange for those goods or services.'

This concept is supported by a model that includes five steps, one of which requires entities to identify the various 'performance obligations' in a contract, each of which may then be accounted for separately. This requirement is where some telecom operators are likely to be impacted, as they may not have separately accounted for each of those 'bundled' elements in the past. Software companies on the other hand, might need to 'bundle up' the delivery of, for example, software and implementation services, if neither of the two 'performance obligations' provide value to a customer on its own.

This standard also requires judgment in nearly every one of its five steps. The identification of 'performance obligations' under bundled scenarios is not always straight forward and establishing a transaction price (another step of the model), taking into consideration elements such as the time value of money and price variations, can cause practical challenges. Further complexity may also arise in the accounting for multiple and frequent contract modifications that might occur during the contract life.

Impact on data / systems

The availability and validity of contract data necessary to recognise revenues under the new standard can be problematic as data elements are often stored in many different systems. Applications need to be able to cope with the complexity of the new revenue recognition standard and provide sufficient information in order to meet the more onerous financial statement disclosure requirements.

Impact on performance indicators / key metrics

The impact on performance indicators will vary between companies but AASB 15 potentially changes the revenue line item, EBIT, EBITDA and certain industry specific key metrics such as Average Revenue Per User (ARPU – telecoms).

Effective date

AASB 15 is effective for annual reporting periods beginning on or after 1 January 2018 with earlier adoption permitted.

2 AASB 16, Leases

In a nutshell

The main changes relate to the expansion of guidance on identifying a lease whilst, for lessees, the distinction between operating and finance leases has been removed. A (right-of-use) asset and a lease liability will now be recognised on the balance sheet in respect of all leases (subject to the limited exceptions explained below), thereby increasing reported assets and liabilities.

Implementation issues for various TMT entities can be expected around the definition of a lease. Under the new standard a contract is (or contains a lease) only if it relates to an identified asset and if the lessee has the ability to 'control' the use of the identified asset.

Capacity arrangements entered into by many telecoms (e.g. indefeasible rights of use or network tower space arrangements) need to be assessed as well. Capacity portions of assets are only a lease if an identified asset is physically distinct (e.g. specified wavelength), or if it represents substantially all of the capacity of an asset.

Exceptions exist for leases with a maximum duration of twelve months and of underlying assets which have a low value when new (e.g. laptops). In such cases lessees can elect to continue to apply existing operating lease accounting.

The standard will impact technology companies with significant operating lease contracts. Examples are data centres that have entered into multiple year (operating) lease contracts of buildings, software or hardware, and also telecom operators (e.g. leasing of mobile base stations).

Impact on data / systems

The elimination of nearly all 'off balance sheet' accounting for leases requires the capture of more lease data which might require more advanced systems to track leases, as well as more robust controls in order to maintain integrity of lease information.

Impact on performance indicators / key metrics

The recognition of a right-of-use asset and a lease liability for lessees will lead to depreciation and interest expense (which will be front loaded), rather than the current (straight-lined) operating lease expenses. This will result in an increase in EBIT and EBITDA. Capitalisation of a right-of-use asset and a lease liability potentially impacts debt covenants and gearing ratios.

Effective date

AASB 16 is effective for annual reporting periods beginning on or after 1 January 2019, with earlier adoption permitted only if AASB 15, Revenue from Contracts with Customers, has also been applied.

3 AASB 9, Financial Instruments

In a nutshell

AASB 9 changes the accounting for impairment of financial assets, classification and measurement of all financial assets and liabilities, and hedge accounting.

- Impairment of financial assets (including trade receivables)

The new impairment model uses a forward looking (expected loss model) such that companies are now required to recognise expected credit losses (rather than losses incurred). This will likely bring forward impairments of financial assets such as trading receivables and long term loans.

In order to reduce the cost of implementation, certain practical expedients have been included in the new standard. For example, expected credit losses on trade receivables may be calculated using a provision matrix where a fixed rate provision applies depending on the number of days that a trade receivable is outstanding.

- Classification and measurement

A company's business model and the nature of contractual cash flows now drive the classification of financial assets. All financial assets are now measured at fair value unless they are intended to be held, and cash flows solely represent principal and interest. When financial assets are measured at fair value, changes in fair value are recognised through either profit or loss or other comprehensive income depending on the specific classification.

- Hedge accounting

The new standard simplifies the hedge accounting rules including the elimination of the 80%–125% quantitative threshold for qualifying for hedge accounting.

TMT entities are now able to reduce profit or loss volatility by deferring the changes in time value of options in other comprehensive income (subject to meeting the hedge accounting requirements) and to hedge an aggregated exposure that includes a derivative. This provides them with more opportunity to apply hedge accounting.

Impact on data / systems

For most TMT entities (depending on the level of hedge accounting), the new standard is not expected to have a significant impact on data and systems.

Impact on performance indicators / key metrics

The new hedge accounting requirements might lead to less volatility in profit or loss due to the potential to widen the application of hedge accounting. The impairment rules might impact TMT entities with large receivables balances and bring forward losses.

Effective date

AASB 15 is effective for annual reporting periods beginning on or after 1 January 2018 with earlier adoption permitted.

Why early preparation is critical

Considering that the combined impact of these three new standards could be significant, we recommend Technology, Media and Telecom companies use the intervening period to analyse the new requirements, consider any wider implications and make any required changes to their systems, controls and processes. In addition, companies should develop a plan to communicate any significant impacts of these new standards to their key stakeholders such as board members, investors and banks.

Where can I go for more information?

If you would like to discuss any aspects of this report, please contact one of the below at Deloitte Australia:

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