Confusion in reporting

Confusion about some accounting requirements made the preparation of financial statements for the 30 June 2003 financial year a greater challenge for Australian companies, their advisers and external auditors.

PricewaterhouseCoopers partner Jan McCahey says there were areas of accounting where companies were genuinely unsure of the requirements with which they were meant to comply as they prepared their numbers for the annual financial statements.

She says there were at least four areas that caused some difficulty for companies during the last reporting season: first-time application of a standard on provisions and contingencies, lack of clarity on accounting for defined benefit superannuation plans, accounting for revenue and complications in accounting for tax.

The introduction of any new accounting requirements is inevitably accompanied by a period of uncertainty as companies grapple with the wording in a standard and how it should apply to their circumstances.

Ms McCahey says some companies thought guidance on accounting for onerous contracts, which is contained in the provisions and contingencies standard, applied in a different way to that contemplated by the standard.

‘There were two sorts of issues. I think some companies had misunderstood the standard. They were tending to come to the view that if they had entered into a contract and they could have done a better deal today compared with the one they are currently locked into then that contract is in a sense onerous,’ Ms McCahey explains.

‘Colloquially, it is onerous if you could have got a better contract with a supplier of some kind of product. But the standard does say the key point is whether you are going to make a loss as a result of entering into that contract and not whether you could have done better.’

Some entities were also stumped when thinking about whether contracts they had entered into actually met the ‘onerous contract’ criteria set down in the standard. Ms McCahey says companies are required to consider any contracts in the much broader context of their business and not just the terms of the contracts themselves.

‘Sometimes you enter into a contract – it might relate to something like sponsorship – and the benefits you derive from that contract are a bit hard to measure,’ says Ms McCahey.

‘You could put a view that there are costs being incurred but there’s no revenue stream flowing from that. Does that make the contract onerous? You’ve really got to say no, it doesn’t because you’ve entered into the contract for good reasons.’

One of those areas that brought about concern from companies, Ms McCahey notes, was the increased focus by the corporate regulator, the Australian Securities and Investments Commission, on accounting for defined benefit superanuation funds.

She says there was confusion among companies about whether they were required to book a liability on balance sheet for deficits in defined benefit plans because of the attention given to the issue by the regulator.

The present accounting standards do not mandate the booking of a liability or asset in all circumstances where a defined benefit plan has a deficit or surplus

‘There was literature issued by the ASIC seeming to infer something that didn’t seem to be supported by a release by the Australian Accounting Standards Board. Those sorts of issues have, I think, made companies feel somewhat uncomfortable about the accounts preparation process.’

Companies were looking for the accounting authorities to be more definitive about the approach they needed to take in this area, Ms McCahey says.

Accounting for taxes caused some degree of confusion because of the new tax consolidation regime, Ms McCahey says, and there were cases where companies did not realise they had to use principles embedded in a newer accounting standard on accounting for tax in order to satisfy the requirements of an interpretation issued by the Urgent Issues Group.

A lack of detailed literature in Australia in the area of how companies should account for revenue has continued to pose problems during the preparation of financial statements.

While Australia does have an accounting standard on revenue and general guidance in the form of accounting concepts the lack of flesh on those bones made it tough for some companies to determine how they should account for revenue.

This has been complicated further by the corporate regulator’s scrutiny of companies and whether the total revenue is reported as a gross or net total.

‘We have a concepts statement that deals with revenue, but that many people would not really understand the implications of the revenue concept as it is written in the statements of accounting concepts,’ says Ms McCahey.

‘They are still working with their own intuitive sense of what they think revenue is. I think that’s why we have problems in practice trying to sort out whether revenue should be reported gross or net.’