THE BOTTOM LINE

Issue 11

HLB MANN JUDD
ADVISORY AND ACCOUNTING

Welcome to the latest edition of our financial reporting publication that aims to keep you in the loop with all the latest accounting and financial reporting developments, and the potential impact they may have on your business.

The last few months have been fairly quiet in terms of financial reporting developments. We've taken the opportunity to focus on the revised Research & Development Tax Incentive that kicked in on 1 July 2021 and remind entities how to account for these. We also remind NFP readers of recent changes to reporting thresholds and disclosures that registered charities need to be aware of. Listed entities have new Jobkeeper disclosure requirements to adhere to which we've summarised. We end this issue with a look at two recent agenda decisions issued by the IFRS Interpretations Committee.

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FEATURE ARTICLE

Accounting for the R&D Tax Incentive

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The Research and Development Tax Incentive (R&DTI) has been modified with effect from 1 July 2021. Entities will need to familiarise themselves with the new tax rules to ensure they have the best chance of qualifying for the incentive. At the same time, the accounting consequences should not be overlooked to ensure that the R&DTI has been appropriately dealt with in the financial statements.

Many businesses undertake some form of research and development (R&D) at a point in their lifecycle to build a competitive advantage over their competitors or to develop new or innovative products or services. R&D can be risky business as there is no guarantee that the product can be engineered or designed, or that fickle consumers will want the product.

The R&DTI is designed to encourage businesses to take the risk and try to engineer or develop new products, devices, processes, materials and the like.

While the R&DTI has been in effect since 1 July 2011, the federal government announced enhanced reforms to the scheme as part of the 2020-21 budget, acknowledging that investment in R&D is essential to help stimulate Australia's economy. These enhanced reforms apply to income years commencing on or after 1 July 2021.

In this article, we cover a few of the key elements of the revised R&DTI regime before considering the accounting consequences.

Tax summary

One of the criteria to qualify for the R&DTI is that eligible R&D expenditure must be at least $20,000 for the income year concerned (if R&D expenditure is less than $20,000 entities can still claim the tax offset by using a registered Research Service Providor, or RSP, to conduct R&D). Under the mechanics of the scheme, relief is provided to eligible entities via a tax offset against the basic income tax liability, rather than via a tax deduction at the prevailing corporate tax rate.

For income years beginning on or after 1 July 2021, the tax offset is determined based on the amount incurred on eligible R&D activities undertaken during the income year as follows:

- For R&D entities with aggregated turnover of less than $20 million ('small R&D entities'), a **refundable** R&D tax offset is pegged at a premium of 18.5% over the prevailing corporate tax rate. Therefore, a small R&D entity (which will also be a base rate entity), will be subject to a corporate tax rate of 25% for the 30 June 2022 tax year meaning the R&D tax offset will be 43.5%.
- For R&D entities with aggregated turnover of more than $20 million ('large R&D entities'), a **non-refundable** R&D tax offset is the corporate tax rate plus a premium that increments based on the entity's R&D 'intensity'. The R&D intensity is broadly measured as the entity's eligible R&D expenditure as a proportion of total expenditure for the year. There are two premium increments as follows:

R&D intensity (i.e. eligible R&D expenditure as a % of total expenditure)	R&D tax offset
Up to 2%	8.5% over the corporate tax rate
Over 2%	16.5% over the corporate tax rate

With effect from 1 July 2021, a maximum threshold of $150 million per year applies to eligible R&D expenditure (this was increased from $100 million). This means that the R&D premiums over and above the corporate tax rate as detailed above can only be applied to eligible expenditure up to a maximum of $150 million. Any amounts above this cap are subject to an R&D tax offset equal to the entity's corporate tax rate.

The **refundable** R&D tax incentive is refundable in cash to the extent that it exceeds the current income tax liability. The **non-refundable** R&D tax incentive, on the other hand, is applied against the tax liability with any excess carried forward to future years.

Small R&D entities	Large R&D entities
Aggregated turnover **< $20 million**	Aggregated turnover **> $20 million**
Refundable tax offset rate is: corporate tax rate + R&D premium fixed at **18.5%**	Non-refundable tax offset rate is: corporate tax rate + R&D premium that depends on R&D intensity* **8.5%** On eligible R&D expenditure **up to 2%** of total expenditure; **16.5%** On eligible R&D expenditure **over 2%** of total expenditure

* R&D intensity refers to eligible R&D expenditure as a proportion of total company expenditure

Accounting considerations

Which accounting standard applies?

The R&D tax offset is widely considered to be an 'investment tax credit' (ITC) as it relates to tax credits generated by eligible expenditure on R&D activities. The accounting for ITCs is, however, not specifically addressed in Australian Accounting Standards. This is because:

- AASB 112 *Income Taxes* specifically excludes from its scope the accounting treatment of ITCs (although the treatment of temporary differences arising from ITCs are within the scope of this standard); and
- AASB 120 *Accounting for Government Grants and Disclosure of Government Assistance* scopes out government assistance that is provided in the form of benefits that are available in determining profit or loss or are determined or limited based on the income tax liability, which includes ITCs.

In the absence of an Australian Accounting Standard that specifically applies to ITCs, it is a matter of judgement under AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* to develop and apply, on a consistent basis, the most appropriate accounting policy for the accounting treatment of ITCs.

AASB 108 provides guidance on the sources an entity must consider when developing an accounting policy, citing the first and most relevant source as being the requirements of Australian Accounting Standards dealing with similar and related issues. Despite ITCs being specifically scoped out of both AASB 112 and AASB 120, it is our view that these two standards are the most relevant standards to consider when developing an accounting policy for R&DTIs.

Refundable R&D tax offset

As mentioned above, the refundable R&D tax offset is first used to reduce the amount of any income tax payable by the entity. Any excess is then refunded in cash to the claiming entity.

A refundable R&D tax offset is analogous to a government grant as its purpose is to incentivise entities to invest in eligible R&D activities. That is, the R&DTI received by an entity is effectively a transfer of resources to an entity from the government in return for the entity engaging in and spending money on eligible R&D activities.

A government grant is defined in AASB 120 *as assistance by government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity*.

On this basis, it is appropriate to draw guidance from AASB 120 to account for refundable R&DTIs. Consequently, where the R&D expenditure is not capitalised, the R&DTI is recognised as a credit in profit or loss (as part of earnings before interest and tax, or EBIT) rather than as part of income tax expense.

The corresponding debit will ultimately:

- reduce tax payable to the extent the entity has a tax liability sufficient to absorb the R&DTI; and/or
- increase cash (for any refund) to the extent the tax liability is insufficient to utilise the R&DTI.

In terms of presentation, R&D tax offsets that relate to R&D expenses that have been expensed (and not capitalised) are recognised in profit or loss, either as income or as a deduction from the related expense.

In the case where the related R&D expenditure is capitalised, the R&D tax offset is deferred (as deferred income) and amortised to profit or loss as the associated R&D asset is depreciated. Alternatively, the R&DTI can be offset against the carrying amount of the related R&D asset, thereby directly reducing the depreciation charge recognised in profit or loss.

When eligible R&D expenditure is capitalised under AASB 138 *Intangible Assets*, no deferred tax liability is recognised on initial recognition of the asset. The R&D asset has no tax base since the capitalised R&D expenditure is not deductible for tax purposes either at initial recognition or as it is depreciated. Also, the R&D tax offset is treated as a government grant, so no amount is recognised in determining taxable income nor is any amount recognised in profit or loss on initial recognition of the R&D asset. Consequently, the initial recognition exemption in AASB 112 applies and no deferred tax is recognised.

Non-refundable R&D tax offset

AASB 112 approach

The non-refundable R&DTI is available to entities with annual turnover exceeding $20 million. Where a non-refundable R&D tax offset exceeds the income tax liability, the excess is not refunded to the entity. Rather, the excess is carried forward and can be used in subsequent years.

As the non-refundable R&DTI is only available as a reduction in an entity's current or future tax liability, many entities view this as being more akin to an income tax and therefore apply AASB 112 by analogy.

Under this approach, a credit is recognised in current tax expense to reflect the benefit of the R&D tax offset for each income year, with a corresponding reduction (debit) to the current tax liability.

For eligible R&D expenditure that is capitalised as an R&D asset for accounting purposes, the entity will recognise a deferred tax liability in respect of the capitalised amount. This will give rise to a deferred tax expense, offsetting the current tax benefit arising in the year the expenditure is incurred for tax purposes. The deferred tax liability will then reverse through deferred tax expense as the R&D asset is depreciated for accounting purposes.

The R&D tax offset is carried forward separately from carried forward tax losses and represents a tax offset to be used in future periods. As a result, the carried forward R&D tax offset behaves in the same way as an unused tax credit under AASB 112. Where an entity has carried forward R&D tax offsets, a deferred tax asset will be recognised which will be subject to the normal recognition criteria for deferred tax assets arising from unused tax losses and unused tax credits under AASB 112. This means a deferred tax asset can only be recognised to the extent that future taxable profits will be available against which the unused tax losses and unused tax credits can be utilised.

Other approaches

While the income tax approach discussed above is widely used to account for non-refundable R&DTIs, it is worth mentioning that there is diversity in practice due to the absence of specific accounting guidance.

Some entities treat the non-refundable R&D tax offset as a government grant, applying the principles of AASB 120, as discussed above.

Another less common approach is to use a combination of the income tax approach and government grant approach. Under this 'split accounting' approach, the portion of the non-refundable R&D tax offset that is equal to the entity's corporate tax rate (e.g. 30%) is accounted for by applying AASB 112 by analogy. The incremental portion (i.e. 8.5% or 16.5%, depending on the entity's R&D intensity) is accounted for using the principles of AASB 120.

Proponents of the hybrid approach view the portion of the R&DTI that equates to the corporate tax rate as more akin to a tax deduction as, should the entity choose not to claim the R&DTI, the entity will still be entitled to a tax deduction for the eligible R&D spend at the relevant corporate tax rate. The benefit over and above this is considered to be akin to a government grant, being the benefit that would otherwise not be received had the entity not claimed the R&D offset under the scheme.

Conclusion

The changes to the R&D tax offset rules are not expected to change the way they are dealt with from an accounting perspective. However, this is a good time for entities that undertake R&D activities to review their R&D policies and processes to ensure they have every chance of qualifying for the new and improved R&DTI. At the same time, entities should pay attention to the accounting implications which, quite often, are not considered properly and can be material. It is important that R&D tax offsets are appropriately and transparently dealt with in the financial statements.

*This article was co-authored by **Mariana von Lucken**, Tax Consulting Partner, Sydney.*

Simplifying financial reporting for charities

On 30 June 2021, the federal government announced changes to the financial reporting thresholds for charities registered with the Australian Charities and Not-for-profits Commission (ACNC). The lifting of the thresholds will hopefully reduce the financial reporting obligations of registered charities so they can direct more of their resources, which are often limited, to their charitable purpose.

Reporting requirements for registered charities

Generally, all charities must lodge an Annual Information Statement (AIS) with the ACNC within six months of the end of their financial reporting period (i.e. by 31 December for charities with a 30 June balance date).

Small charities do not have to submit annual financial reports (unless so required by their governing documents), nor are they required to have their financial reports audited or reviewed.

Medium and large charities must lodge annual financial reports. The former can choose whether to have their financial reports reviewed or audited, whereas the latter must have their financial reports audited.

Changes to the reporting thresholds

The increase in reporting thresholds will take effect from 1 July 2022 (reporting against the 2021-22 financial year). The changes are summarised below:

Charity size	Existing annual revenue thresholds	Revised annual revenue thresholds	Reporting requirements
Small	Less than $250,000	Less than $500,000	Annual Information Statement
Medium	$250,000 or more and less than $1 million	$500,000 or more and less than $3 million	Annual Information Statement and audited or reviewed financial report
Large	$1 million or more	$3 million or more	Annual Information Statement and audited financial report

KMP and related party transactions disclosures

As part of the announcement made on 30 June 2021 relating to the increased financial reporting thresholds discussed in the previous segment, there are also new disclosure obligations for remuneration to key management personnel (KMP) as well as for related party transactions. These new reporting requirements are aimed at providing greater accountability and transparency to donors, beneficiaries and the general public.

Reporting remuneration to responsible persons

For the 2021-22 financial year onwards, large charities with two or more KMP will need to report remuneration paid to responsible persons and senior executives on an aggregated basis.

Charities should take care to ensure that payments to responsible persons and senior executives are in the best interest of the charity, are allowed under the charity's rules and are appropriately authorised.

Reporting related party transactions

For the 2022-23 financial year onwards, all registered charities will be required to disclose related party transactions in their annual reporting.

These disclosures are of interest to the ACNC as they may affect a responsible person's ability to act in the best interests of the charity. The aim is to provide increased transparency of transactions with related people or organisations that pose a higher risk of conflicts of interest.

The ACNC will work with the charity sector to develop appropriate guidance and education resources to help the sector understand and meet the new reporting obligations.

Post-implementation review of AASB 1058 *Income of Not-for-profit Entities*

Since 1 January 2019, not-for-profit (NFP) entities have had to grapple with two revenue accounting standards, namely AASB 15 *Revenue from Contracts with Customers*, and AASB 1058 *Income of Not-for-profit Entities*. NFP entities are having to analyse contracts in significant detail, often concluding that it is not clear which standard applies. Ultimately, NFP entities are having to expend much time and effort, and exercise a lot of judgement, in landing on a position.

NFP stakeholders have raised several implementation issues regarding AASB 15 and AASB 1058 since the issue of these standards. In response to this feedback, the Australian Accounting Standards Board (AASB) has conducted targeted outreach to understand the pervasiveness of the issues raised in practice.

The key issues identified from initial stakeholder feedback include:

- Application of the 'sufficiently specific' concept in practice
- Peppercorn cost exemption
- Upfront payments
- Capital grants
- Grants received in arrears
- Enforceability of contracts
- Documentation that should be considered in assessing which standard applies
- Principal versus agent
- Termination for convenience clauses

While the AASB has decided to add a short-term, narrow-scope project to its work program to consider some of the above implementation issues, it is expected that the above matters will be considered during the post-implementation review of AASB 1058 that is scheduled to commence early next year.

We will keep our NFP readers informed on any developments that come out of the short-term project as well as the post-implementation review.

Changes relating to deferred tax assets and liabilities arising from a single transaction

The Australian Accounting Standards Board (AASB) has issued amending standard AASB 2021-5 *Amendments to Australian Accounting Standards – Deferred Tax Related to Assets and Liabilities arising from a Single Transaction* that makes changes to AASB 112 *Income Taxes*.

The amendments clarify the accounting for deferred tax on transactions that give rise to equal taxable and deductible temporary differences at the time of the transactions. This would arise in transactions that involve the recognition of an asset and a liability with a single tax treatment related to both. Examples of such transactions are leases, decommissioning, restoration and similar obligations.

In specific instances, entities are not required to recognise deferred tax when they recognise assets or liabilities for the first time (referred to as the 'initial recognition exemption'). The amendments introduced by AASB 2021-5 essentially limit the application of this initial recognition exemption as it can no longer be applied to transactions that give rise, on initial recognition, to both an asset and a liability with equal taxable and deductible temporary differences.

The amendments apply to annual reporting periods beginning on or after 1 January 2023, however earlier application is permitted.

For a detailed analysis of the amendments as well as the practical implications thereof, refer to the article we published in a previous edition of The Bottom Line which had a specific focus on leases.

"The amendments introduced by AASB 2021-5 essentially limit the application of this initial recognition exemption..."

ASIC issues guidance regarding mandatory Jobkeeper reporting for listed entities

The Corporations Act has recently been amended to include new disclosure requirements relating to Jobkeeper. Specifically, section 323DB of the Corporations Act sets out the required disclosure obligations. These new reporting obligations are only imposed on listed entities.

The new Jobkeeper reporting obligations commenced on 14 September 2021 and require listed entities that received Jobkeeper payments to provide notice to the relevant market operator. Such notice must include:

- the listed entity's name and ABN
- the number of individuals for whom the entity or its subsidiaries received Jobkeeper payments each fortnight that ended in the financial year
- the total amount of Jobkeeper payments the entity and its subsidiaries received in a Jobkeeper fortnight that ended in the financial year
- whether or not the entity or its subsidiaries made voluntary repayments of Jobkeeper payments, and the total amount of those repayments if they did.

To assist listed entities, the Australian Securities and Investments Commission (ASIC) has created a Jobkeeper notice (called the Jobkeeper Payments Notification form) which is available on the ASX and NSX websites. While it is not mandatory for a listed entity to use this form, listed entities are encouraged to do so as it will ensure that a Jobkeeper notice contains all the mandatory information required under section 323DB(2). In addition to the notice, ASIC has also issued guidance in the form of FAQs to help listed entities complete the notice correctly.

In terms of timing of the notices, listed entities that have lodged their annual financial reports for the applicable financial year with ASIC on or prior to 14 September 2021 have until 13 November 2021 to notify the market as required by the amendments. Listed entities that lodge their annual financial reports after 14 September 2021 will have 60 days from the date their annual financial report is lodged with ASIC to notify the market.

ASIC will publish the reported Jobkeeper information in a consolidated report and stresses that listed entities must ensure that the Jobkeeper information they disclose is accurate and up to date.

The features of audit committees that support audit quality

ASIC Information Sheet 196 *Audit quality – The role of directors and audit committees* (INFO 196) is a useful guide that provides information to assist directors in supporting the quality of an external audit. High-quality audits are important as they give credibility to financial statements which are key to keeping markets and investors informed.

INFO 196 has recently been updated to include a new section headed 'What features of audit committees support audit quality?' It includes a host of good practices that may help audit committees to be more effective in promoting and supporting audit quality.

Directors and audit committees are encouraged to refer to INFO 196.

ASIC urges Australian CEOs to review whistleblower policies

Reforms to Australia's whistleblowing laws came into effect in 2019. The changes introduced a requirement for the following entities to have an internal whistleblower policy:

- Public companies
- Large proprietary companies
- Trustees of registrable superannuation entities.

In an effort to understand how affected entities have since responded to the new requirements, ASIC reviewed a sample of 102 whistleblower policies during 2020.

ASIC's findings were that the majority of the whistleblower policies reviewed fell short of the legislative requirements. This prompted ASIC to write a letter to Australian CEOs, reminding them of their obligations under the Corporations Act and encouraging them to assess their whistleblower policies.

ASIC has stated that it will continue to monitor compliance with the whistleblower legislation and the handling of whistleblower disclosures. Non-compliance could mean enforcement action for entities in the future.

For further information, refer to a previous article we published in issue 5 of The Bottom Line, as well as ASIC's Regulatory Guide 270 *Whistleblower Policies*.

Recent agenda decisions by the IFRS Interpretations Committee

The IFRS Interpretations Committee interprets the application of International Financial Reporting Standards (IFRS) and provides timely guidance on financial reporting issues not specifically addressed in IFRS.

A question submitted to the Interpretations Committee on the application of a specific accounting standard may result in either standard-setting where needed, or an agenda decision. Agenda decisions are those issues that the Interpretations Committee decides not to add to its agenda. Instead, the Committee will publish a summary of the submission and explain how the relevant principles and requirements of IFRS apply to the specific question.

While not authoritative guidance, the agenda decisions provide useful insight into the interpretation of IFRS.

Two of the more relevant agenda decisions published in recent months by the Interpretations Committee are summarised below.

Costs necessary to sell inventories

The issue

The question posed was what costs an entity includes when determining the 'estimated costs necessary to make the sale' when determining net realisable value (NRV) of inventories. More specifically, the request asked whether an entity includes all costs necessary to make the sale or only those that are incremental to the sale.

Relevant guidance

NRV is defined in AASB 102 *Inventories* as 'the estimated selling price in the ordinary course of business less the estimated cost of completion and the **estimated costs necessary to make the sale**.'

While guidance is given about how NRV of inventories is estimated, the standard does not identify specifically which costs are necessary to make the sale. AASB 102 does, however, state that the objective of writing inventories down to their NRV is to avoid inventories being carried in excess of amounts expected to be realised from their sale.

AASB 102 requires an entity to estimate the costs necessary to make the sale. To only include costs that are incremental to the sale (and exclude those non-incremental costs that the entity must incur) would not achieve the objective stated above.

Conclusion

When determining the NRV of inventories, an entity must estimate all costs necessary to make the sale in the ordinary course of business. Judgement may be needed to determine which costs are necessary to make the sale, taking into account the specific facts and circumstances, including the nature of the inventories.

Preparation of financial statements when an entity is no longer a going concern

The issue

In the fact pattern presented in this request, an entity assesses that it is no longer a going concern and therefore the current year's financial statements will not be prepared on a going concern basis.

The specific questions posed are whether such an entity:

1. can prepare financial statements for prior periods on a going concern basis if it was a going concern in those prior periods and had not previously prepared financial statements for those periods; and

2. restates comparative information to reflect the basis of accounting used in preparing the current period's financial statements if it had previously issued financial statements for the comparative period on a going concern basis.

Question 1

AASB 110 *Events after the Reporting Period* states that an entity shall not prepare its financial statements on a going concern basis if management determines after the reporting period either that it intends to liquidate the entity or to cease trading, or that it has no realistic alternative but to do so.

On this basis, an entity that is no longer a going concern cannot prepare financial statements (including those for prior periods that have not yet been authorised for issue) on a going concern basis.

Question 2

The Interpretations Committee has not observed diversity in practice and has not seen evidence to suggest that this particular matter has widespread effect (i.e. entities generally do not restate their comparative information to reflect a non-going concern basis of accounting).

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