

TREASURY ANALYSIS – INTERNATIONAL ACCOUNTING STANDARDS

AASB 1 “First Time Adoption of Australian Equivalents to International Financial Reporting Standards”

Major impact

- Requires retrospective application of the new Australian equivalents to International Financial Reporting Standards (AIFRS) from the beginning of the first comparative period in the first AIFRS financial report, except in limited circumstances.
- AASB includes some options or exemptions from the principle of retrospective application (e.g. use of deemed cost for PP&E). Treasury will need to mandate whether agencies use these options, as well as options in other AIFRSs.

Key features

Application

- AASB 1 and all other AIFRSs will apply in Australia to annual reporting periods beginning on or after 1 January 2005 (para Aus 1.2).
- Specifically, AASB 1 applies to the first AIFRS annual financial report in which the entity adopts AIFRSs, by an explicit and unreserved statement of compliance with AIFRSs (para 3). This requirement is satisfied where there is a statement that the financial report complies with Australian Accounting Standards (also refer para Aus13.2 of AASB 101 “Presentation of Financial Statements”).

Recognition and measurement

- The first AIFRS financial report must comply with the AIFRSs effective as at the reporting date (i.e. 30 June 2006 for entities with 30 June year ends) and use the same accounting policies throughout all periods presented in the first AIFRS financial report (para 7). An entity may apply a new Standard that is not yet mandatory if it permits early application (para 8).
- AIFRSs applicable at the reporting date must be applied retrospectively from the date of transition (i.e. 1 July 2004 for 30 June year ends), except in limited circumstances (see exemptions below) (para 7 and 11).
- This means that an entity must prepare an opening AIFRS balance sheet at the date of transition to AIFRS (i.e. 1 July 2004), but need not present it in its first AIFRS financial report (para 6).
- In the opening AIFRS balance sheet, an entity will need to adjust the amounts that it reported previously for the same date using its previous GAAP by adjusting retained earnings (or, if appropriate, another category of equity) at the date of transition (para 11).
- Adjustments required to change from previous GAAP to AIFRSs include (para 10):
 - De-recognise assets and liabilities if AIFRSs do not permit such recognition;
 - Recognise new assets and liabilities required to be recognised by AIFRSs where they were never recognised under previous GAAP;
 - Reclassify previous GAAP opening balance sheet items into the appropriate AIFRS classification;
 - Measure all recognised assets and liabilities based on AIFRS where this differs from previous GAAP, with some exceptions (see exemptions below).

Optional exemptions from retrospective application (i.e. may elect to use one or more)

- *Comparative information* (para 36A and para 36B) - The comparative information in the first AIFRS report need not comply with AASB 132 and AASB 139 on financial instruments and AASB 4, AASB 1023 and AASB 1038 on insurance contracts. For these Standards, this in effect defers the date of transition by one year to 1 July 2005. Further, an entity need not present the disclosures required by AASB 6 *Exploration for and Evaluation of Mineral Resources* for comparative periods. However, AASB 6 should not be relevant to the NSW public sector.
- *Business combinations* (para 15 and Appendix B) – Need not apply AASB 122 “Business Combinations” retrospectively to past business combinations.
- *Fair value or revaluation as deemed cost* (paras 16-19)– Permitted to measure an item of property, plant and equipment at the date of transition to AIFRSs at its fair value and use that fair value as its deemed cost at that date (addressed in detail in Treasury Analysis on AASB 116 “Property, Plant and Equipment”). This exemption is also available to intangible assets and investment properties in limited circumstances (para 18).
- *Cumulative translation differences* (para 21 and 22)– Need not comply with AASB 121 “The Effects of Changes in Foreign Exchange Rates” for cumulative translation differences that existed at the date of transition.
- *Compound financial instruments* (para 23) – Need not separate the two equity components (i.e. retained earnings and cumulative interest), where the liability component is no longer outstanding at the date of transition.
- *Assets and liabilities of subsidiaries, associates and joint ventures* (paras 24-25)– Exemption applies if subsidiaries, associates or joint ventures etc become first time adopters at different dates to the parent. However, this should not be an issue for the NSW public sector, as controlled entities are subject to the same reporting requirements as parent entities and will not be able to choose to adopt AIFRS at different dates.
- *Designation of previously recognised financial instruments* (para 25A) – Permitted to designate a financial asset or liability at fair value through profit or loss or as available for sale at the date of transition rather than on initial recognition.
- *Share based payment transactions* (paras 25B-25C)– Encouraged but not required to apply AASB 2 “Share-based Payment” to equity instruments that were granted on or before 7 November 2002; and not required to apply AASB 2 to liabilities arising from share-based payment transactions that were settled before the date of transition. This should not impact on public sector entities.
- *Insurance contracts* (para 25D)– A first-time adopter may apply the transitional provisions in AASB 4, AASB 1023 and AASB 1038. AASB 4 restricts changes in accounting policies for insurance contracts, including changes made by a first-time adopter.
- *Decommissioning liabilities* (para 25E) – Allowed to include in the depreciated cost of the asset at the date of transition an amount calculated by discounting the liability at that date back to, and depreciating it from, when it was first incurred.
- *Fair value measurement of financial assets or financial liabilities at initial recognition* (para 25G) – Provides relief from retrospective application of ‘day 1’ gain or loss recognition requirements.

Mandatory prohibition from retrospective application (i.e. mandatory prospective application)

- *De-recognition of financial assets and liabilities* (para 27) – An entity must apply the de-recognition requirements in AASB 139 prospectively for transactions occurring on or after 1 January 2004, except for derivatives or other interests retained after de-recognition and special purpose entities.
- *Hedge accounting* (para 28-30) - An entity must apply the AASB 139 hedging requirements prospectively.
- *Estimates* (para 31-34) – An entity’s estimates at the date of transition must be consistent with estimates made for the same date under previous GAAP (after adjustments to reflect any differences in accounting policies), unless there is objective evidence that those estimates were in error.

Presentation and Disclosure

- This Standard does not provide exemptions from the presentation and disclosure requirements in other AIFRSs (para 35).
- *Comparatives* - An entity's first AIFRS financial report must include at least one year of comparative information under AIFRSs (para 36). This is consistent with AASB 101.
- *Reconciliations* - An entity must explain how the transition from previous GAAP to AIFRSs affected its reported financial position, financial performance and cash flows (para 38). This requires disclosure of reconciliations of (para 39-43):
 - Equity under previous GAAP to equity at date of transition to AIFRSs and the end of the latest period in the entity's most recent financial report presented under previous GAAP.
 - Profit or loss under previous GAAP for latest period in most recent financial report to profit or loss under AIFRSs for the same period.
- *Use of fair value as deemed cost* - If an entity uses fair value as deemed cost in the opening AIFRS balance sheet for an item of property, plant and equipment, an investment property or an intangible asset, it must disclose for each line item in the opening AIFRS balance sheet, the aggregate of those fair values and the aggregate adjustment to the carrying amounts reported under previous GAAP (para 44).
- *Designation of financial instruments* - An entity must disclose the fair value of any financial assets or financial liabilities designated as a financial asset or liability at fair value through profit or loss or as available for sale (para 25A) and the classification and carrying amount in the previous financial statements (para 43A).

Main differences compared to previous Australian requirements

- AASB 1 requires prior period information presented as comparative information to be restated as if the requirements of the Standards had always applied. Previously, under Australian requirements, the preceding periods' primary financial statements were not restated for changes in accounting policies.

Impact on the public sector

- Some AIFRSs contain Australian added paragraphs for not-for-profit entities (NFPs). Some of these paragraphs may contain requirements inconsistent with the corresponding IASB Standard. When an NFP entity is required to comply with a requirement that conflicts with the IASB counterpart, it will comply with AIFRSs but it will not be able to make an explicit and unreserved statement of compliance with IFRSs as required by AASB 101 (AASB 101, para 14 and AASB 1 Preface).
- However, a NFP should still be able to make an explicit and unreserved statement of compliance with Australian Accounting Standards (para 3 and Aus3.1) and therefore be able to utilise the first time adoption exemptions in AASB 1.

Policy and Implementation issues (see attached)

Mandating options

- To ensure consistency of accounting policies across the public sector, NSW Treasury will need to consider mandating accounting policies where AIFRSs provide for options.
- This will include mandating whether or not the AASB 1 optional exemptions should be exercised.
- The exemptions on first time adoption are addressed separately in the Treasury Analysis on each topic area.
- Treasury may also mandate whether agencies can early adopt a new Standard that is not yet mandatory.

Other implementation issues

- An entity must prepare an opening AIFRS balance sheet at the date of transition. As a result, for general purpose financial reporting, Treasury (FIS) and agencies will need to maintain parallel systems with potential system and audit issues. Further, Treasury will need to collect parallel data from agencies for whole of government reporting. A different approach will be applied for Budget Reporting (see below).

Budget reporting

- The Budget timing for adopting AIFRS is inconsistent with general purpose financial reporting, as follows:
 - For Budget purposes *only*, the AIFRS is applied retrospectively by adjusting opening equity at **1 July 2005**. In contrast, for ex-post general purpose financial reporting, agencies are required to apply AIFRS retrospectively by adjusting opening equity on **1 July 2004**. This means that for Budget Reporting *only*, the 1 July 2005 AIFRS opening equity adjustment comprises the 1 July 2004 AIFRS equity adjustment plus any AIFRS adjustments that would have arisen during 2004/05 had AIFRS been applied to these transactions and events.
 - The 2004/05 Budget projections must be prepared on an existing AAS basis consistent with the original 2004/05 Budget. In contrast, in the 2005/06 ex-post general purpose financial report, the 2004/05 comparatives need to be restated to comply with AIFRS.
 - For 2005/06 Budget estimates only, AASB 139 is not to be applied for 2005/06. This is because there is significant uncertainty regarding the final form of AASB 139. However, AASB 139 will need to be applied from 1 July 2005 in the 2005/06 (ex-post) general purpose financial report. Refer to the *Treasury Analysis* of AASB 139.
- The above is further discussed in the “Instructions for the Preparation of ‘TOES’ Data for Budget 2005/06” which will be issued to agencies.

This summary has been written in general terms and is intended for general reference only. Agencies should review the contents of the AASB Standard to determine its application in particular circumstances.

**SUMMARY OF POLICY, IMPLEMENTATION & SYSTEM ISSUES
AASB 1 “FIRST-TIME ADOPTION OF AUSTRALIAN EQUIVALENTS TO
INTERNATIONAL FINANCIAL REPORTING STANDARDS”
TREASURY & AGENCIES**

	Issue	Treasury Policy & Guidance		System/ Implementation Issue	Mandate Options for GFS Harmonisation	Budget / Total State Sector Issue
		Mandate Option	Additional guidance			
1	Identification of accounting policy options within AIFRSs	✓		✓		✓
2	Optional exemptions in AASB 1	✓		✓		✓
3	Early adoption of new Standards that are not yet mandatory	✓		✓		✓
4	Opening AIFRS balance sheet		✓	✓		✓