

# **NSW TREASURY**

## **AIFRS / IAS ACCOUNTING STANDARDS UPDATE**

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# OVERVIEW

	<b>Page</b>
◆ State of Play	3
▪ Background	4
▪ State of Play	5
◆ Treasury and Agency AIFRS implementation strategies	6
▪ Treasury's strategy	7
▪ Agency's AIFRS strategy	9
◆ AASB 1047 & Revised Timetable for implementation	10
▪ Revised Timetable	11
▪ Treasury's Strategy – Agency's to submit to Treasury	12
▪ Implementation Strategy as at 1 July 2004	12
▪ Timetable	12
◆ Summary of major impacts of AIFRSs on Agency financial reporting	13
▪ Summary of major impacts of AIFRSs on all entities	14
▪ Additional major impacts of AIFRSs on <i>for-profit entities</i>	14
▪ Additional major impacts of AIFRSs on <i>not-for-profit entities</i>	14
▪ Major impacts avoided or deferred	14
▪ Comprehensive income is the Wild Card	15
▪ GFS/GAAP unresolved issues	16
◆ Implications of specific Standards	17
▪ AASB 1047 Disclosure of AIFRS Impacts (see above)	10
▪ AASB 1 First Time Adoption	19
▪ AASB 108 Accounting Policies	21
▪ AASB 120, AASB 141 & AASB 1004 Grants	21
▪ AASB 119 Employee Benefits	23
▪ AASB 137 Provisions & AASB 110 Events after Balance Sheet Date	24
▪ AASB 138 Intangible Assets	24
▪ AASB 132 & AASB 139 Financial Instruments	25
▪ AASB 140 Investment Property	28
▪ AASB 116 PP&E	29
▪ AASB 136 Impairment	32

## **STATE OF PLAY**

## **BACKGROUND**

### ***Two Simultaneous Projects for Australian Public Sector***

- ◆ AIFRS adoption
  - from 2005-06 financial year
- ◆ GFS/GAAP harmonisation
  - was expected to apply from 2005-06
- ◆ Both AIFRS & GFS/GAAP are strategic directives by the Financial Reporting Council (FRC) to the AASB
- ◆ The AASB will mandate both as accounting standards
- ◆ Both only affect ex-post general purpose reporting
- ◆ Yet it is desirable that Budget & Outcomes be on the same basis

### ***Why Converge with IAS?***

- ◆ Decision of FRC
- ◆ Globalisation of business & financial markets
- ◆ Long term benefits of:
  - high quality, comparable financial reporting that is globally accepted
  - reduced cost of equity
- ◆ But IASs focus on publicly listed entities

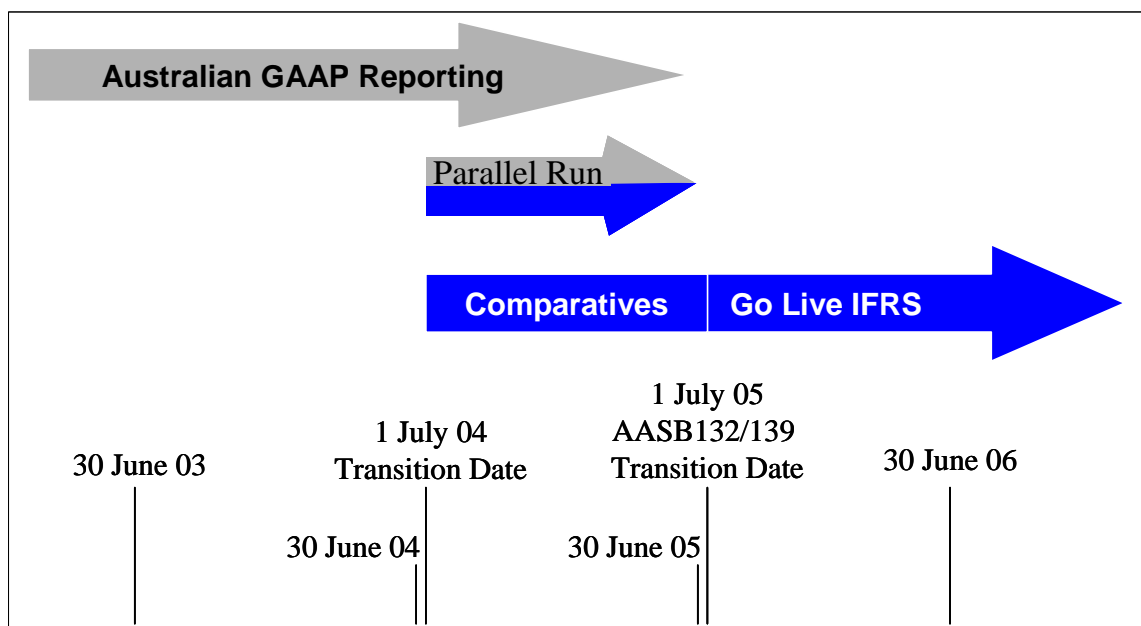
### ***Why should GFS & GAAP be harmonised?***

- ◆ Decision of Financial Reporting Council for 2003-03
  - “.. The objective is an Australian accounting standard for a single set of Government reports in which the Outcomes Statements are directly comparable to the relevant Budget Statements.”

## STATE OF PLAY

- ◆ IFRS *stable platform* was issued 31 March 04
- ◆ FRC confirmed 2005-06 deadline in April
- ◆ AASB *confirmed* in April it will issue *Australian Equivalents of IFRS (AIFRS)* by 30 June 04
- ◆ ED on GAAP/GFS:
  - ED is running behind schedule (of August 04)
  - needs to incorporate changes to AAS29 *Accounting by Government Departments*
  - *2005-06 adoption is now uncertain*
- ◆ IAS stable platform is already being amended:
  - Apply for 2006-07 but may be early-adopted
- ◆ AASB 1047 issued reducing 30 June 04 disclosures

### ***The Transition to IFRS***



# **TREASURY AND AGENCY AIFRS IMPLEMENTATION STRATEGIES**

## TREASURY'S STRATEGY

- ◆ Assess implications of adopting AIFRS & GFS/GAAP:
  - Dollar impacts on *Budget Result & Net Financial Liabilities*
  - Data collection, systems impacts, training needs and resource impacts
- ◆ Communicate implications to stakeholders continuously, especially CEOs, Ministers
- ◆ Make high level policy decisions as early as possible
- ◆ Develop agencies understanding by:
  - Web site including *Treasury Analyses*
  - Seminar presentations
  - Developing policies & guidance
- ◆ Implement AIFRS and GFS concurrently, *if possible*, so that change only occurs once

### ***What we have done to date***

- ◆ Seminar to all agencies May 2003
- ◆ Submission on all EDs (circulated to all CFOs for input)
- ◆ Letter to all CEOs re needed leadership, strategy & action
- ◆ Agencies Reference Panel & Electricity Industry sub-group
- ◆ Treasury Web Site including:
  - Treasury and Agency strategies
  - *Treasury Analysis* of impacts of each AIFRS
- ◆ Seminars scheduled for 2004

### ***Treasury's Mandates***

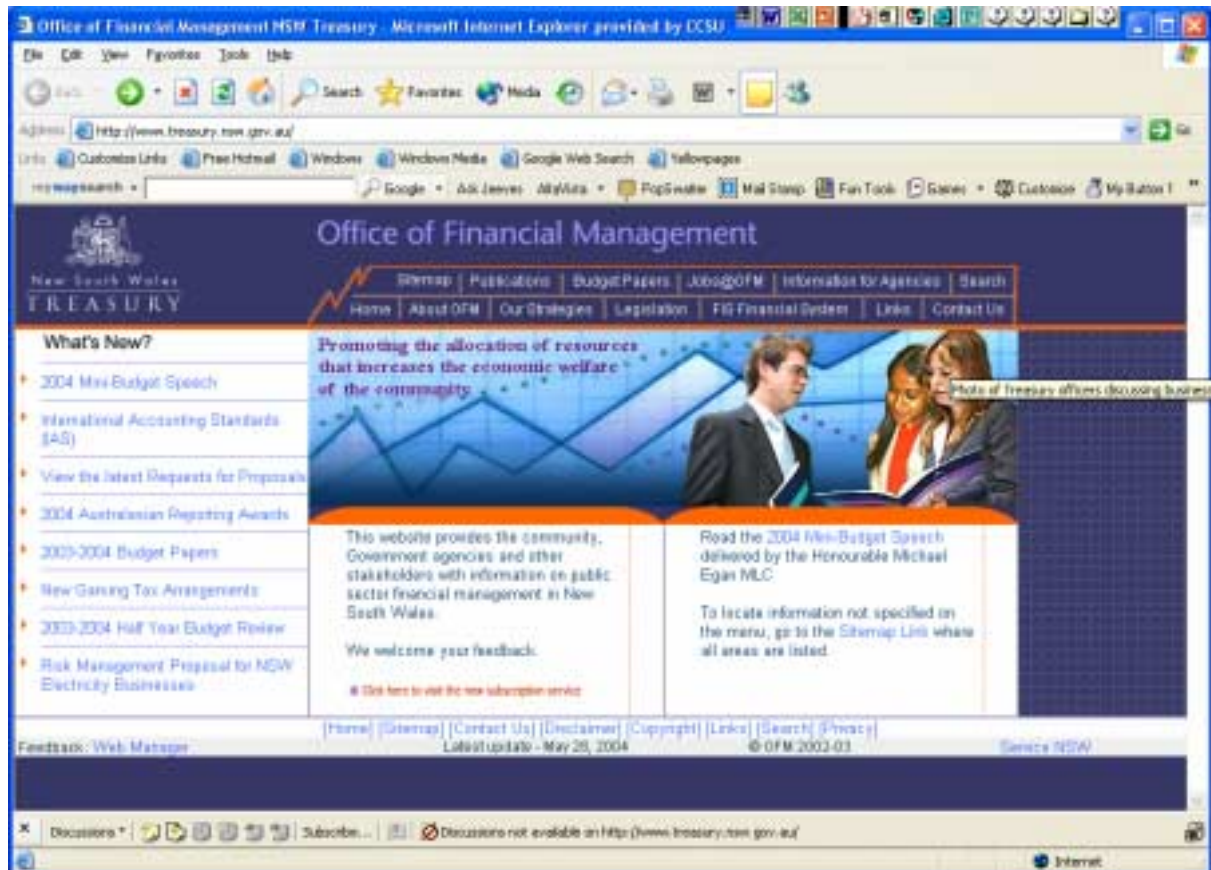
Treasury will mandate to the extent possible:

- ◆ Options in AIFRS for 2 reasons:
  - Consistency at GG & WOG level
  - GFS/GAAP harmony
- ◆ First Time Implementation optional exemptions eg
  - AASB 132/139 optional transition date of 1 July 05
- ◆ Whether to early adopt post stable platform amendments to standards
  - AASB will make applicable for 1 July 06, but permit early adoption
  - eg AASB 141 Grants; revised AAS29
- ◆ AIFRS & GFS/GAAP will not be used in 2005-06 Budget

## Treasury Analyses & This Seminar

Treasury's Analyses & this seminar *focus on:*

- ◆ High level summary of major impacts of changes
- ◆ Key features of standards
- ◆ Main differences to current AASB requirements
- ◆ Impacts on the public sector
- ◆ Policy and implementation issues:
  - Policy and Guidance
  - Mandating options
  - Implementation issues



## **AGENCY'S AIFRS STRATEGY**

- ◆ Assess implications of adopting AIFRSs & harmonising GFS/GAAP:
  - Dollar impacts on Income Result/ Balance Sheet
  - Data collection, systems impacts, training needs and resource impacts
- ◆ Strategy to communicate implications to stakeholders continuously especially CEOs, Ministers & Boards
- ◆ Feedback to Treasury on significant impacts not identified by Treasury
- ◆ Raise awareness and develop understanding within agency

## **AASB 1047 & REVISED TIMETABLE FOR IMPLEMENTATION**

## REVISED TIMETABLE –

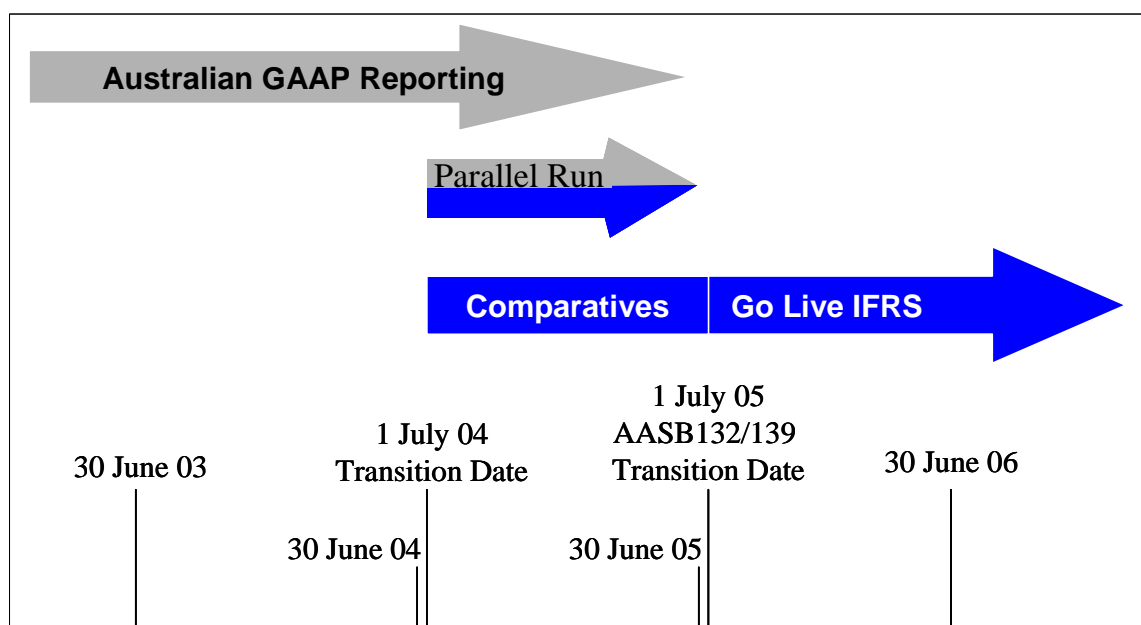
### **AASB 1047: Disclosure of AIFRS Impact – 30 June 2004**

- ◆ Disclosures of impact of adopting AIFRS have been substantially reduced for 30 June 2004
- ◆ Two key disclosures are required at 30 June 2004:
  - Explanation of how the transition to AIFRSs is being managed; and
  - Narrative explanation of the key differences in accounting policies that are expected to arise
- ◆ Treasury will provide a suggested note disclosure by 30 June 2004:
  - Agencies can modify; but nature should be the same
- ◆ Impact - we have been given more time to change

### **AASB 1047: Disclosure of AIFRS Impact- 30 June 2005**

- ◆ Two key disclosures are required at 30 June 2005:
  - Any known or estimable reliable information about the impacts; and
  - If impacts are not known/reliable, a statement to that effect
- ◆ The manner of presentation is not prescribed. However, an entity should consider disclosing a reconciliation of affected line items in the financial statements and key aggregates

### **The Transition to IFRS**



## TREASURY'S STRATEGY - AGENCIES TO SUBMIT TO TREASURY

- ◆ Agency Strategy for adoption of AIFRS
  - deadline 30 June 04 (to assess readiness of agencies)
- ◆ Draft opening Balance Sheet for 1 July 04
  - deadline 15 December 04
- ◆ Final opening Balance Sheet for 1 July 04
  - deadline 31 March 05 (to permit audit of opening trial balance before 30 June 05)

## IMPLEMENTATION STRATEGY AS AT 1 JULY 04

- ◆ At 30 June 04:
  - Financial statements under current AASB standards
- ◆ *As at* 1 July 04:
  - Determine opening AIFRS balance sheet in accordance with AIFRSs including AASB 1. This means:
    - Recognise or derecognise assets & liabilities under AIFRS
    - Remeasure assets & liabilities under AIFRSs

## TIMETABLE

<b>Step</b>	<b>Milestone</b>
Agency - Submit agency strategy for AIFRS adoption	30 June 04
Treasury - Issue suggested AASB 1047 note disclosure	30 June 04
Treasury - Make all decisions	30 Sept 04
Treasury develops policies & guidance to extent possible. But this depends on progress of GFS/GAAP	30 Sept 04
Treasury and Agencies - determine data needs and system requirements	30 Sept 04
Agencies - Disclose likely impacts of moving to AIFRSs in 2004 financial statements	Aug 04
Agencies - Submit draft opening Balance Sheet as at 1/7/04	15 Dec 04
Agencies - Submit final opening Balance Sheet as at 1/7/04	31 Mar 05

**SUMMARY OF MAJOR IMPACTS OF AIFRSs**

**ON AGENCY FINANCIAL REPORTING**

## **SUMMARY OF MAJOR IMPACTS OF AIFRSs ON ALL ENTITIES**

- ◆ Increase superannuation liability/income volatility (by using borrowing discount rate not asset earnings rate), where liability is not assumed by the Crown
- ◆ PP&E impacts for:
  - constructive obligations to rectify environmental impacts
  - major inspections
- ◆ *Impairment testing* and annual check for *indicators of impairment*
- ◆ De-recognition of certain internally generated intangibles (eg research costs) & revaluation of intangibles

## **ADDITIONAL MAJOR IMPACTS OF AIFRSs ON FOR-PROFIT ENTITIES**

- ◆ Higher income volatility & liabilities due to:
  - recognising derivatives on balance sheet
  - impact depends on effectiveness of cash-flow hedges
- ◆ ARR re PP&E adjusted by asset not class
- ◆ Impairment loss may increase if cash flows had not previously been discounted
- ◆ Grants to be accounted for under IAS20 (after removing 2 options) but maybe early adopt IAS41

## **ADDITIONAL MAJOR IMPACTS OF AIFRSs ON NOT-FOR-PROFIT ENTITIES**

- ◆ Comprehensive Income Statement if GFS/GAAP in force
- ◆ Current treatment of grants has to be examined because of *expected change* in definition to distinguish in AAS29 between those that are ‘in substance agreements for the purchase of goods/services’ versus those that are not
- ◆ AAS29 to apply to all General Government Sector agencies
- ◆ But uncertain re timing of GFS/GAAP & AAS29

## **MAJOR IMPACTS AVOIDED OR DEFERRED**

- ◆ The 2004-05 figures need not comply with AASB132 & AASB139 (ie deferred transition date)
- ◆ Year end dividends can still be accrued
- ◆ Not-for-Profit entities continue to be exempted from some impacts, including:
  - PP&E impairment because value-in-use is WDRC
  - ARR by class (not by asset)
- ◆ GFS/GAAP will eliminate most fluctuations at the transaction level.

## COMPREHENSIVE INCOME (GFS/GAAP) IS THE WILD CARD

- ◆ AASB is currently developing this standard *for all entities*, but:
  - Uncertain re timing
  - Initial phase excludes PTE entities
- ◆ This standard splits income into 2 categories (analogous to GFS):
  - Transactions &
  - Re-measurements
- ◆ ‘GFS/GAAP harmonisation’ project is creating a Government equivalent standard but in advance of the IAS standard
- ◆ But the rules have not been fully developed

### **Comprehensive Income Matrix**

	Total	Income before re-measurements	Re-measurements
Business	XX	X	X
Financing	XX	X	X
Tax	XX		
Comprehensive income	XX		

### **Impact of AIFRS Adoption on Results will be Minimised by GFS/ GAAP harmonisation**

- ◆ *Comprehensive Income* discloses ‘transactions’ separately from ‘re-measurements’, consistent with GFS, eg
  - Superannuation actuarial adjustments
  - All valuation adjustments re financial assets & liabilities
- ◆ Can adopt options in IFRS that harmonise with GFS, eg:
  - Expense borrowing costs
  - Valuation of financial instruments at fair value

## **GFS/GAAP UNRESOLVED ISSUES**

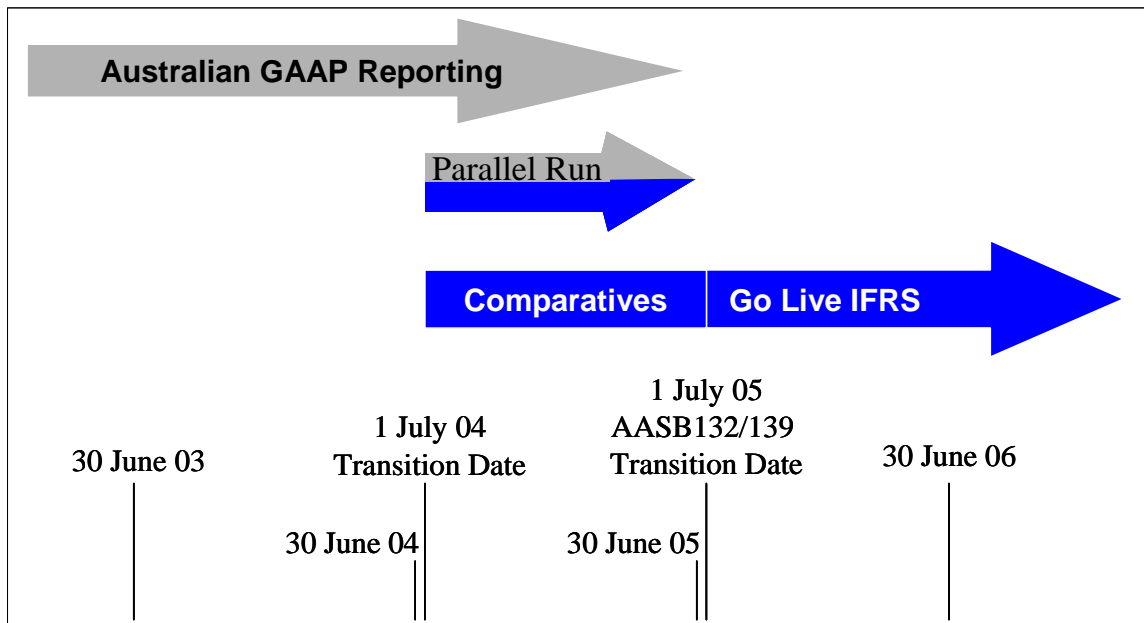
- ◆ Whether the GG Sector is a separate reporting entity or a segment
- ◆ Whether or not harmonised policies are mandated at WOG level or not

## **IMPLICATIONS OF SPECIFIC STANDARDS**

## IMPLICATIONS OF SPECIFIC STANDARDS

- ◆ AASB 1047 Disclosure of AIFRS Impacts (see above)
- ◆ AASB 1 First Time Adoption
- ◆ AASB 108 Accounting Policies
- ◆ AASB 120, AASB 141 & AASB 1004 Grants
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- ◆ AASB 140 Investment Property
- ◆ AASB 116 PP&E
- ◆ AASB 136 Impairment

### ***The Transition to IFRS***



## **AASB 1 FIRST TIME ADOPTION**

- ◆ Requires full retrospective application
  - Date of transition – 1 July 2004 (except AASB 132 & AASB 139 – 1 July 2005)
  - Opening balance sheet at 1 July 2004 – to be submitted to Treasury
  - Restate comparative information (except AASB 132 & AASB 139)
  - Therefore, same accounting policies throughout all periods presented from 1/7/04, as if always applied
  - Overrides transitional provisions of individual Standards
- ◆ Must make explicit and unreserved statement of compliance with AIFRS

### ***Adjustments required at date of transition***

- ◆ De-recognise A&L if AIFRS do not permit e.g. research costs
- ◆ Recognise new A&L where not recognised under previous GAAP e.g. restoration provisions
- ◆ Reclassify previous GAAP opening balance sheet e.g. investment property
- ◆ Measure A&L based on AIFRS where this differs from previous GAAP e.g. unfunded superannuation
- ◆ Adjustments to retained earnings at date of transition (or other appropriate category of equity) – i.e. at 1 July 2004 or 1 July 2005 (for financial instruments)

### ***Exemptions from retrospective application***

- ◆ 9 Optional elections – elect to use one or more – Treasury likely to mandate
- ◆ 3 Mandatory exemptions i.e. requires prospective application

### ***Optional exemptions – Treasury to mandate***

- ◆ Comparative information – financial instruments and insurance contracts – defers date of transition to 1 July 2005
- ◆ Designation of previously recognised financial instruments – at date of transition rather than date of initial recognition
- ◆ Business combinations
- ◆ Fair value or deemed cost – PP&E
- ◆ Assets and liabilities of subsidiaries, associates and joint ventures, with different year end dates

### **Mandatory exemptions i.e. prospective application**

- ◆ Hedge Accounting
- ◆ De-recognition of financial assets and liabilities
- ◆ Estimates

### **Example – Estimates - Facts**

- ◆ Previous GAAP – No provision in 2003/04 financial report for court case arising from events occurred in March 2004
- ◆ Court case concluded in Nov 2004 (after completion of 2003/04 financial report under previous GAAP), entity required to pay \$5m
- ◆ Assume – Previous GAAP was consistent with AASB 137
- ◆ Estimates at date of transition must be consistent for same date under previous GAAP (after adjustments for any differences in accounting policies), unless evidence of an error.
- ◆ Conclusion – Provision not recognised at date of transition (i.e. 1/7/04), consistent with previous GAAP.

### **Disclosures**

- ◆ Reconciliations of:
  - Equity under previous GAAP to equity under AIFRS at:
    - 1/7/04; and
    - 30/6/05
  - Profit or loss under previous GAAP for 2004/05 to profit and loss under AIFRS for same period
  - Sufficient detail to understand material adjustments to balance sheet, income statement and cash flow statement
- ◆ Other disclosures e.g. recognition or reversals of impairment losses, use of fair value as deemed cost

	30/6/06	30/6/05	1/7/04
◆ Balance Sheet	X	X	
◆ Income Statement	X	X	
◆ Statement of Changes in Equity	X	X	
◆ Cash Flow Statement	X	X	
◆ Reconciliation of Equity		X	X
◆ Reconciliation of P&L		X	

## **Key Actions**

- ◆ Opening AIFRS balance sheet – must submit to Treasury
- ◆ Treasury to mandate:
  - Options within AASB 1
  - Options within other AIFRS
  - Whether or not early adoption of new AIFRS that are not yet mandatory (i.e. post 31/3/2004 amendments to “stable platform”) is permitted

## **AASB 108 ACCOUNTING POLICIES, CHANGES IN ESTIMATES AND ERRORS**

- ◆ Retrospective application of voluntary changes in accounting policy and correction of errors by,
  - restating comparatives; and
  - opening retained earnings for earliest period
- ◆ Eliminates concept of fundamental errors
- ◆ Disclosure of expected impact of a new Standard that is not yet effective
- ◆ First time adoption and initial impacts– refer AASB 1 & AASB 1047

## **GRANTS**

- ◆ Effect at 2005 is unclear; depends on timing of a number of projects
- ◆ Not-for-profit entities – 2 scenarios
  - Status quo – based on AASB 1004 & AAS 29
  - Revised AAS 29 – based on ED 125
- ◆ For-profit entities – 2 scenarios
  - Existing IAS 20 Government Grants
  - Revised IAS 20 – based on IAS 41 Agriculture

### ***NFP entities AAS 29 NOT revised by 2005***

- ◆ No change for treatment of grants
- ◆ AASB 1004 regarding “contributions” is retained for NFPs
- ◆ Retains distinction between reciprocal and non-reciprocal transfers
- ◆ 3 key features of reciprocal transfers
  - Value given in exchange for transfer
  - Value given directly to parties to transfer
  - Approximately equal value in exchange

### ***NFP entities AAS29 IS revised by 2005***

- ◆ Based on ED 125 on Local Government
- ◆ Removes reciprocal / non-reciprocal distinction
- ◆ Distinction between:
  - voluntary transfers - in-substance agreements for the provision of g&s
  - voluntary transfers – NOT in-substance agreements for the provision of g&s
  - involuntary transfers e.g. taxes, fines etc
- ◆ Agreements for provision of g&s - criteria:
  - Specify quantities
  - Reliable acquittal process
  - Right to refuse payment or demand repayment, if less than agreed quantity, quality etc
  - BUT substance is important e.g. does acquittal process operate in practice?
  - Accounting treatment – revenue/expense when control of goods passes or service provided
- ◆ Agreements NOT for provision of g&s
  - Restrictions on purpose or use (including time) – does not give rise to a liability / asset
  - Conditions – gives right of compensation or return – may give rise to liability / asset

### ***For-profit entities - If current IAS 20 applies***

- ◆ Grants must not be recognised until reasonable assurance the entity will comply with conditions and grant will be received
- ◆ Grants must be recognised as income over period necessary to match with related costs
- ◆ Non-monetary grants recognised at fair value
- ◆ Grants related to assets presented as deferred income

### ***For-profit entities - If IAS 20 is replaced by IAS 41***

- ◆ Unconditional grants are revenue when become a receivable
- ◆ Conditional grants are revenue only when conditions are met
- ◆ Time is a condition and grant can be recognised on a time basis

### ***Summary Possible Key Impacts***

- ◆ Deferral of revenue recognition
- ◆ Action now – review Grant agreements for “substance” rather than “form”

## **AASB 119 EMPLOYEE BENEFITS UNFUNDED SUPERANNUATION**

### ***Unfunded Superannuation***

- ◆ Requires full recognition of unfunded superannuation liability
- ◆ Main impact – Unfunded superannuation, where NOT assumed by Crown
- ◆ NSW public sector already recognises BUT different discount rate
- ◆ Different discount rate to calculate unfunded superannuation liability in balance sheet
  - Either high quality corporate bond rate or government bond rate (i.e liability rate)
  - Previously expected rate of return on plan assets
- ◆ Effect will be to increase the unfunded superannuation liability
  - i.e. Liability discount rate lower than expected return on assets
- ◆ Greater volatility in earnings and in balance sheet
  - i.e. discount rate *as at* each reporting date
- ◆ Disclose unfunded liability (or surplus) on *two* bases:
  - Balance sheet – liability discount rate
  - Notes – surplus or deficit on a funding basis i.e. using expected rate of return on plan assets discount rate
- ◆ For consistency, Treasury will determine which discount rate is to be used for balance sheet recognition i.e.
  - High quality corporate bond rate; or
  - Government bond rate
- ◆ For financial reporting purposes, actuarial information to be provided centrally

### ***Unfunded Superannuation - Disclosures***

- ◆ Components of superannuation expense i.e. current service cost; interest cost; expected return on assets; actuarial gains and losses
- ◆ Actuarial assumptions
- ◆ Reconciliation of movements of net liability
- ◆ Amounts included in fair value of scheme assets for each category of entity's own financial instruments

### ***LSL and other long term benefits***

- ◆ More detailed methodology – as for defined benefit obligations
- ◆ Interest cost (i.e. unwinding of discount rate) – must be separately calculated and identified as interest (previously not required)

## **AASB 137 PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS**

- ◆ Changed treatment for contingent assets and recoveries receivable
  - Recognition of assets based on *virtual certainty*
  - Disclosure of contingent assets when *probable*
- ◆ Treatment of contingent assets inconsistent with contingent liabilities i.e. -
  - Recognition of liabilities based on *probability*
  - Disclosure of contingent liabilities when *higher than remote but less than probable*
- ◆ Restoration provisions – refer PP&E

## **AASB 110 EVENTS AFTER BALANCE SHEET DATE - DIVIDENDS**

- ◆ No change likely
- ◆ Only dividends “*declared*” before the reporting date can be recognised.
- ◆ “*Declared*” means appropriately authorised and no longer at discretion of entity
- ◆ Signed SCI/SBI = “*Declared*”

## **AASB 138 INTANGIBLE ASSETS**

- ◆ Previously no one comprehensive Australian Standard on Intangibles
- ◆ Definition – an “*identifiable*” non-monetary asset without physical substance
- ◆ “*Identifiable*” -
  - Separable; or
  - Arises from contractual or other legal rights
- ◆ E.g. computer software, patents, copyrights, customer lists and licenses
- ◆ Internally generated intangibles – more restrictive recognition criteria
- ◆ Internally generated brands, mastheads, publishing titles, customer lists etc – expense
- ◆ Research costs – expense
- ◆ Development costs – expense, unless satisfy criteria for recognition e.g. technically feasible
- ◆ Revaluations – not permitted unless “*active market*”
- ◆ Finite life
  - Amortise
  - Assess annually for indicators of impairment
  - Residual value assumed to be zero, unless active market
- ◆ Indefinite life
  - No amortisation
  - Annual impairment test

## **AASB 139 FINANCIAL INSTRUMENTS: RECOGNITION AND MEASUREMENT**

- ◆ Key changes
- ◆ Recognition and measurement
- ◆ Impairment & de-recognition
- ◆ Hedge accounting
- ◆ Embedded derivatives
- ◆ Fair value measurement
- ◆ First-time adoption
- ◆ Main impacts

### ***Key changes***

- ◆ New Standard – no equivalent Standard on recognition
- ◆ Broad scope:
  - Definition includes loans and receivables
  - Applies to ‘for profit’ and ‘not-for-profit’ entities
- ◆ Mixed measurement model
- ◆ Main impacts
  - Recognition of financial instruments previously “off-balance sheet”
  - Potential increased volatility
  - System issues

### ***Recognition and Measurement***

- ◆ Initial recognition – at cost
- ◆ Recognition – 5 categories
  - Fair value through P&L – includes ‘held for trading’ and derivatives (eg options and swaps)
  - Held to maturity investments (eg debt securities)
  - Loans and receivables
  - Available for sale financial instruments - residual category of non-derivative financial assets (eg equity)
  - Non trading financial liabilities - residual category of liabilities

<b>Financial Instrument</b>	<b>Fair Value</b>	<b>Amortised Cost</b>	<b>Impairment</b>
FV through P&L (‘held for trading’ & derivatives)	✓ (Income Statement)		
Held to maturity		✓	✓
Loans and receivables		✓	✓
Available for sale	✓ (Equity)		✓
Non-trading financial liabilities		✓	

### ***Impairment***

- ◆ Impairment test *only* for assets at amortised cost and available for sale (ie not for financial instruments measured at Fair Value)
- ◆ Assess at each reporting date whether any objective evidence of impairment
- ◆ General provisions for doubtful debts will no longer be permitted - i.e. specific impairment calculation required

### ***De-recognition***

- ◆ Financial assets
  - Risks and rewards test
  - Control test (secondary test)
- ◆ Financial liabilities
  - Obligation discharged, cancelled or expires
  - In-substance defeasance – prohibits offsetting of financial asset and liability (IAS32)

### ***Hedge Accounting***

- ◆ 3 categories of hedges with different treatments:
  - Fair value hedge – movements to P&L
    - Eg commodity purchase commitment
  - Cash flow hedge – equity unless ineffective; ineffective portion to P&L
    - Eg floating rate debt
  - Hedge of a net investment in foreign entity as defined in AASB 121 – same treatment as for cash flow hedge
- ◆ Hedge relationship qualifies for hedge accounting *only* if certain conditions are met e.g.
  - Identification, designation and documentation
  - Effectiveness test (80-125% range of effectiveness)
  - Forecast transaction highly probable
  - Effectiveness and valuation reliably measured
- ◆ Hence, detailed trading, risk management and contract management systems are required

### ***Embedded derivatives***

- ◆ Part of an instrument that includes both a derivative and host contract e.g. part of a lease; debt instrument or supply contract
- ◆ Causes cash flows of host contract to be modified based on a variable such as an interest rate
- ◆ E.g. lease agreement with an option to extend the lease
- ◆ Must be separated from host contract & recorded at fair value if but only if:
  - hybrid (combined) contract not recorded at fair value;
  - satisfies definition of a derivative; and
  - the economic characteristics and risks are not “closely related”.
- ◆ NOT closely related – therefore must be recognised:
  - E.g. Option to extend term of a debt instrument, based on original rate
- ◆ Closely related – therefore not recognised:
  - E.g. Option to extend term of lease, where rental reset to market rate at time of extension

### ***Fair Value measurement***

- ◆ Incorporates observable market data and factors
- ◆ Where there is no active market, valuation methodologies to determine fair value:
  - Generally accepted by the market:
    - recent comparable transactions;
    - discounted cash flow analysis; and
    - option pricing models.
  - Theoretically robust
  - Empirically validated

### ***First-time adoption***

- ◆ Date of transition delayed by 1 year to 1 July 2005 – ADDITIONAL TIME available!
- ◆ Hedge accounting – prospectively
- ◆ De-recognition – prospectively
- ◆ Designation of previously recognised financial instruments

### ***Main impacts***

- ◆ GFS/GAAP convergence – Treasury to consider whether designation of all financial assets and liabilities at **fair value** through **P&L**
- ◆ BUT - IASB Exposure Draft proposes to limit use of the fair value option to where it is 'verifiable' - stricter test than 'reliably measured' requirement
  - Not mandatory for 05/06, but available for early adoption
- ◆ Identification and recognition of all financial instruments, including derivatives
- ◆ Potential increased volatility in operating profit
- ◆ Possible capital structure issues
- ◆ Potential challenge where there is no liquid market
- ◆ Changes to the contracts management, risk management, accounting system and valuation methodologies
- ◆ Impairment testing
- ◆ Restrictions on de-recognition

## **AASB 140 INVESTMENT PROPERTY**

- ◆ Key changes
- ◆ Measurement
- ◆ Operating leases of land or property
- ◆ Impacts

### ***Key changes***

- ◆ New standard for Australia – previously treated as for PP&E
- ◆ Investment property is property held to earn rentals and/or for capital appreciation, but excludes properties:
  - used in the production of goods/services;
  - held for administrative purposes (eg head office building);
  - held for sale; or
  - held by a not-for-profit entity solely to meet service delivery objectives - accounted for under AASB 116 as PP&E (eg Department of Housing)

## **Measurement**

- ◆ Fair value OR Cost model (as per AASB 116 PP&E)
- ◆ But Treasury will mandate Fair Value:
  - Changes in fair value to P&L (previously to Asset Revaluation Reserve)
  - Depreciation not recognised
  - Fair value as at the reporting date –implies annual revaluations (but not necessary to be independent)

## **Operating leases of land or property**

- ◆ A lessee can treat an operating lease as investment property:
  - From the lessors' viewpoint, long term leases of land are in-substance sales or finance leases (see Treasury Circular NSWTC 00/19 Accounting for Long Term Leases of Land and Other Property)
  - AASB 140 comes to a similar conclusion from the lessees' perspective

## **Impacts**

- ◆ May need to reallocate from PP&E
  - Also, review treatment of operating leases related to property
- ◆ Derecognise ARR and Accumulated depreciation for any “investment property”
- ◆ Assess fair value at each reporting date

## **AASB 116 PP&E & AASB 136 IMPAIRMENT (RE PP&E)**

- ◆ These two new standards substantially replace AASB 1041 Revaluation of Non-Current Asset & AASB 1010, AASB 1021 Depreciation & AASB 1015 Acquisition of Asset
- ◆ However, most of the changes in AASB 136 re PP&E were already incorporated into Treasury's Policy *Valuation of Physical Non-Current Assets at Fair Value*
- ◆ Further, Treasury's policy continues to provide extensive additional guidance not in AASB 116 eg
  - valuing assets at existing use based on feasible alternative use
  - measuring replacement cost based on incremental optimisation
- ◆ However, AASB 116 has introduced other changes

## **AASB 116 PP&E**

### ***Major changes***

- ◆ Cost of an asset includes
  - restoration provisions
  - Inspection cost
- ◆ Borrowing costs may be expensed or capitalised
- ◆ Revaluations may use gross or net restatement
- ◆ For-Profit entities must account for Asset Revaluation changes on an *asset basis*; but
- ◆ Not-For-Profit entities continue to use the *class of asset* basis.
- ◆ AASB 1 allows *Deemed Cost option* on transition to AIFRS
- ◆ Additional disclosures for assets measured at a revalued amount
- ◆ Let's look at each of these changes .....

### ***Restoration Costs***

- ◆ Cost of PP&E *includes* the initial estimate for dismantling, removing or restoring an asset
- ◆ Obligations arise from *past events* that exist independently of an entity's future actions, ie
  - as a consequence of installation or
  - as a consequence of using the item
- ◆ Obligations include legal or constructive obligations per AASB 137 *Provisions*
- ◆ In contrast, an intention to operate differently in future is not a present obligation eg install smoke stacks in the future

### ***Major Inspection Costs***

- ◆ Cost of PP&E *includes* the cost of major inspections, as a replacement, whether originally identified when acquired
- ◆ This means that the major inspection cost is part of the original cost (and must be *allocated from the total cost*)
- ◆ This is *different to restoration costs* that are added onto the original cost, based on the liability recognised
- ◆ The inspection cost is distinct from the cost of physical parts replaced at an inspection
- ◆ This was previously Treasury's policy (but rejected by the UIG)

### ***Accounting for Asset Revaluation changes by For-Profit Entities***

- ◆ *For-Profit entities* must account for changes in ARR on an *individual asset basis* (not a class basis as in AASB1041)
- ◆ But AASB116 does not prescribe the unit of measure for recognising an item of PP&E. The standard says this requires judgement

- ◆ But parts of an asset are not an asset
- ◆ The standard merely requires parts to be depreciated separately
- ◆ Previously, AASB 1021 required *components* to be accounted for as *separate assets* and depreciated
- ◆ This changed approach minimises the negative impact that accounting for ARR on the basis of parts could have on unappropriated profits
- ◆ But this is no different in concept to AASB1021. It required:
  - components to be recognised as separate assets
  - but allowed that changes in the ARR be accounted for on a class of asset basis
 AASB116 is simply more restrictive

### ***Treasury to Mandate Options***

Treasury will likely *mandate options* in AASB 116:

- ◆ Borrowing Costs
  - AASB 116 allows borrowing costs to be expensed or capitalised
  - Treasury is likely to mandate that borrowing costs be expensed to harmonise with GFS
- ◆ Gross restatement or net revaluation method
  - AASB 116 allows either the gross or net method to be used
  - Where assets are valued by reference to assets newer than those being revalued, Treasury will continue to mandate use of the *gross restatement* method
  - This is relevant information for entities in the public sector which must continue to provide the services

### ***AASB 1 Deemed Cost Option***

- ◆ AASB 1 allows an exemption from retrospection application at date of transition for PP&E
- ◆ It allows an entity to elect to measure PP&E at fair value and:
  - use that fair value as its deemed cost, or
  - use a previous GAAP revaluation as deemed cost, if the revaluation was broadly comparable to fair value
- ◆ For a *For-Profit entity*, using a previous revaluation:
  - retains the ARR
  - but requires movements in the ARR to transition to be adjusted (ie based on the asset basis not class of asset basis). This may require considerable work
- ◆ For a *For-Profit entity*, using fair value at transition date as deemed cost:
  - resets the ARR to zero (avoiding the work above)
  - But any future decrements would hit the operating statement because there is no ARR to offset against

- ◆ For a Not-For-Profit entity, there is no benefit of the deemed cost option because they will continue to be permitted to offset increments and decrements on a class of asset basis
- ◆ Because of the impact on For-Profit entities, *Treasury is considering whether it should mandate one of the 2 deemed cost options*
- ◆ Treasury's current view is that it is preferable to retain the ARR by using a previous revaluation (such as at date of corporatisation) as deemed cost

## **AASB 136 IMPAIRMENT RE PP&E**

- ◆ A new standard. With AASB 116, it creates a two step process in valuing PP&E
- ◆ But, in practice, it replicates the Recoverable Amount Test in AASB 1010 & AASB 1041
- ◆ Little difference for NSW Public Sector entities because the concepts were already included in NSW Treasury's policy *Valuation of Physical Non-Current Assets at Fair Value*
- ◆ Requires an annual assessment of whether there are *indicators of impairment*
- ◆ Previously no such explicit requirement, but revaluation was required if carrying amount and fair value were materially different
- ◆ If, but only if, such indicators of impairment exist, the *recoverable amount* must be estimated. This replicates the existing RAT including Treasury's *Valuation* policy

### ***Indicators of Impairment***

- ◆ External indicators of significant impairment:
  - unexpected market value decline
  - Adverse environmental change eg technological
  - Interest rate increases
  - Equity exceeds market capitalisation
- ◆ Internal indicators of significant impairment:
  - Obsolescence/damage of asset
  - Reduced expected use of asset
  - Reduced expected asset performance

### ***Recoverable Amount***

- ◆ *Impairment loss* is the amount by which the carrying amount exceeds the recoverable amount
- ◆ *Recoverable amount* is the higher of an asset's (or cash generating unit's (CGU)) fair value (less costs to sell) and value in use.

- ◆ *Value in Use is:*
  - Present value of future cash flows from use of the asset
    - Cash flows must be discounted eg by WACC (consistent with Treasury's policy *Valuation of Physical Non-current Assets*)
  - **OR** depreciated replacement cost for assets of not-for-profit entities that are not part of a CGU

### ***Wider Scope***

- ◆ Applies to all assets
  - current, non-current, at cost or revalued
  - except if covered by another standard eg financial instruments
- ◆ Requires an annual assessment for indicators of impairment
- ◆ In addition, must make an annual impairment test of:
  - Intangible assets with an indefinite useful life
  - Goodwill on a business combination
- ◆ Requires additional disclosures of impairment losses compared to previously.

### ***Extensive Guidance is provided***

- ◆ Indicators of impairment
- ◆ Elements in calculating value in use
- ◆ Identifying cash generating units
- ◆ How to measure value in use based on cash-flow projections