

APPENDIX F: FINANCIAL IMPACT OF INTERNATIONAL ACCOUNTING STANDARDS

OVERVIEW

Australia is adopting International Accounting Standards from reporting periods beginning on or after 1 January 2005. In addition, the Australian Accounting Standards Board (AASB) has committed to harmonise Government Finance Statistics reporting (GFS) with Accounting Standards as a priority for the public sector.

The New South Wales public sector will apply the Australian equivalents to International Financial Reporting Standards (AEIFRS) from 2005-06. Although not mandatory for budget reporting, the 2005-06 Budget Papers have been prepared assuming:

- ◆ existing Australian Accounting Standards (AGAAP) for all years up to and including 2004-05; and
- ◆ AEIFRS for 2005-06 and all forward years.

However the Budget Papers have not been adjusted for the impact of the new standard AASB 139 *Financial Instruments* as there are significant unresolved issues currently being addressed by the International Accounting Standards Board. AEIFRS requires initial adjustments be made directly to opening equity at adoption. For Budget 2005-06 the opening equity adjustments are presented effective 1 July 2005 (instead of 1 July 2004 as AEIFRS requires) as the original 2004-05 (and revised projections) are on an AGAAP basis.

AEIFRS does not change the presentation of Government Finance Statistics (GFS) reports prepared for these Budget Papers. It does however slightly modify the presentation of categories in accounting based reports in Budget Paper No.3, and in Appendix A to Budget Paper No.2.

Whilst the format of GFS Reports does not change, AEIFRS requires different measurement treatments from 2005-06 for certain assets and liabilities presented in GFS reports, such that there is a “time series” break between the period up to 2004-05 (prepared on an AGAAP basis), and the 2005-06 and forward years (prepared on the AEIFRS basis).

The primary impact of AEIFRS on the 2005-06 General Government Sector GFS Balance Sheet has been to:

- ◆ increase *defined benefit scheme superannuation liabilities* by \$5,050 million due to a change in the discount rate adopted for measuring the accrued benefits liabilities; and
- ◆ increase *Other Non Equity Assets* by \$3,560 million due to an increase in the Crown's accrual of deferred income tax assets from the PTE sector. The balance sheet line *Other Equity Assets* is reduced by an equivalent amount due to a reduction in the PTE sector's net worth from increasing its deferred tax payable to the Crown.

The above balance sheet changes have a direct impact on general government *net financial liabilities*.

There is a historical difference between the GFS based general government balance sheet (Chapters 1 and 9) and the accounting based balance sheet (Appendix A). The GFS based balance sheet also includes the government's investment in the net assets of the PTE and PFE sectors, whereas the accounting based report excludes this "investment" as the accounting based report does not adopt a holding company model. Whilst the abovementioned AEIFRS adjustment to increase the Crown's deferred tax asset has no impact on general government sector net worth (Chapters 1 and 9), because of a compensating fall in the equity investment in the PTE sector, it directly impacts the accounting based total equity (in Appendix A). However, the impact is eliminated in the Total State Sector Accounts balance sheet.

The 2005-06 and forward year GFS Budget results will deteriorate due to AEIFRS adoption (in 2005-06 by \$354 million). This occurs primarily due to increases in GFS operating expenses for:

- ◆ nominal superannuation interest expense. The expense is calculated from 2005-06 using the higher AEIFRS superannuation liability as a base; and
- ◆ superannuation expense. The lower discount rate results in higher annual expenses.

There is no impact on the Budget result from the treatment of *deferred income tax assets* referred to above.

It can be expected that the implementation of AEIFRS will result in greater volatility in the future operating results of the public trading enterprise (PTE) sector, especially on adoption of the financial instruments standard. This volatility, which cannot be readily budgeted for, could indirectly impact the general government sector outcomes through more volatile dividend and tax revenues from PTEs.

The GFS cash result is not impacted by AEIFRS implementation. For example, the measurement under AEIFRS of a higher superannuation liability due to a change in discount rate has no impact on the future dollar contributions that the Government must make. The superannuation liability is being funded by asset reserves which still have the same long term earnings rate, both prior to and post adoption of AEIFRS.

The Public Trading Enterprises sector has been similarly impacted by higher superannuation liabilities, deferred income tax payable (relating to the unrealised tax gains for assets revalued prior to AEIFRS), as well as adjustments specifically relevant to for-profit entities. Some of these adjustments relate to the measurement and valuation of assets. There is the potential for the PTE sector to be impacted by AASB 139 *Financial Instruments* depending upon future decisions to be made by the International Accounting Standards Board.

This appendix outlines the Government's AEIFRS implementation strategy and provides a summary of the financial impact on the 2005-06 Budget.

AEIFRS IMPLEMENTATION STRATEGY

NSW Treasury's strategy to implement AEIFRS and GFS/GAAP convergences includes the following steps:

- ◆ analyse and comment to the Australian Accounting Standards Board on all exposure drafts of standards;
- ◆ identify and assess the impacts of all significant changes in pending and finalised standards, and make this information available to all agencies;
- ◆ keep the Treasurer, the Government, government agencies and all other stakeholders informed;
- ◆ develop new or amended policies and guidance as necessary;
- ◆ establish and maintain an up-to-date website to keep all stakeholders continuously informed; and

- ◆ facilitate a collaborative approach to managing the change by means of an 'IAS Agency Reference Panel'. The Panel includes representatives from a spectrum of public sector agencies including the Audit Office.

The role of the panel is to assist Treasury in identifying the impacts of the changes, including information and systems changes and to provide Treasury with both input and feedback. The State's electricity authorities are also represented on an industry group that is reviewing specific AEIFRS issues pertaining to the electricity industry;

- ◆ implement AEIFRS for the Total State Sector Accounts. This includes reviewing issues from a whole-of-government perspective to ensure that similar transactions are prepared on a consistent basis. Further some standards will require that transactions (such as Treasury Managed Fund self insurance) be treated differently at the Total State Sector, than at the agency level. The capability of information technology systems is also being reviewed for the preparation of the Total State Sector Accounts;
- ◆ present training and development seminars to all NSW public sector agencies;
- ◆ facilitate agencies, which have primary responsibility for assessing the impacts of AEIFRS on their budgets and financial reports, information needs and required system changes; and
- ◆ encourage all agencies to be actively involved and to provide input and feedback to Treasury. Treasury's analysis of standards focuses on the general impact of significant changes on public sector financial reporting. Each agency must assess any additional impacts that are not addressed in Treasury's analysis.

Public sector agencies are managing the transition to the new standards by allocating internal resources and/or engaging consultants to analyse the pending standards and Urgent Issues Group Interpretations to identify key areas regarding policies, procedures, systems and financial impacts affected by the transition.

The larger agencies have each established a project team to manage the implementation. The team leader generally reports through the Chief Finance Officer to the Audit Committee which monitors AEIFRS implementation.

Implementation of the above strategy has identified a number of significant differences in accounting policies that will arise from adopting AEIFRS. Some differences arise because AEIFRS requirements are different from existing AASB requirements. Other differences could arise from options in AEIFRS. To ensure consistency at the whole-of-government level, NSW Treasury has advised agencies of options it is likely to mandate, and will confirm these during 2005-06. The 2005-06 Budget and forward year estimates reflect these likely mandates.

There is also a project to harmonise accounting standards with Government Finance Statistics. This is likely to require the preparation of a general purpose ex-post financial report for the general government sector. This will mean that ex-ante and ex-post budget reporting are brought closer together. To facilitate this, a number of options have been selected by NSW Treasury consistent with GFS, for adoption by individual agencies and the Budget. In addition, it is likely that when finalised, a new GFS/GAAP converged standard will significantly affect the presentation of the operating statement, by adopting a comprehensive income approach.

IMPACT OF AEIFRS ON 2005-06 AGGREGATES

Table F-1: Reconciliation of opening equity under existing Standards (AGAAP) to equity under AEIFRS

	Notes	General Government 1 July 2005 \$m	Public Trading Enterprise 1 July 2005 \$m
Total accounting based (AGAAP) equity per Appendix A-3		57,525	68,010
Adjustments to accumulated funds			
Defined Benefit superannuation liability adjustment for change in the discount rate	1	(5,050)	(588)
Group adjustment to the Treasury Managed Fund's insurance liability	2	316	...
Write back the asset revaluation reserve for investment properties	3	162	263
Recognition of asset restoration costs	4	19	1
Effect of valuing assets individually rather than by class	5	(16)	(26)
Write back the asset revaluation reserve for assets recognised at deemed cost	6	...	371
Tax effect adjustment	7	190	(190)
Recognition of developer assets	8	...	182
Derecognition of capitalised interest	9	...	(83)
Grant revenue accrued (for profit entities)	10	...	(35)
Recognition of major inspection costs	11	...	9
Other net adjustments		6	(4)
Adjustments to asset revaluation reserves			
Revalue deferred income tax assets receivable by the Crown from PTEs	7	3,101	(3,101)
Write back the asset revaluation reserve for investment properties to accumulated funds	3	(162)	(263)
Derecognition for impaired property, plant and equipment	12	...	(577)
Write back the asset revaluation reserve for assets recognised at deemed cost	6	...	(371)
Derecognition for capitalised interest	9	...	(128)
Recognition of developer assets	8	...	121
Derecognition and reclassification of intangible assets	13	...	(25)
Effect of valuing assets individually rather than by class	5	...	26
Impact of AEIFRS on Opening Equity		(1,434)	(4,418)
Total Accounting Based Equity restated for AEIFRS		56,091	63,592
GFS only adjustments			
June 2005 equity investment in the PTE/PFE sectors		67,769	
AEIFRS adj to <i>Equity investment in the PTE/PFE sectors</i>		(4,418)	
Allowance for Doubtful Debts (excluded from GFS Net Worth)		186	
Total GFS Net Worth restated for AEIFRS at 1 July 2005		119,628	

Table F-2: Reconciliation of General Government Net Financial Liabilities

	Year ending 30 June			
	Budget	Estimate		
	2006	2007	2008	2009
	\$m	\$m	\$m	\$m
Net Financial Liabilities under AEIFRS	27,187	27,834	28,457	28,859
Major AEIFRS Adjustments (included in above)				
Increase in superannuation liabilities from revised discount rate	(5,050)	(5,050)	(5,050)	(5,050)
Recognition of deferred income tax assets on adoption of AASB 112	3,560	3,604	3,614	3,633
Adjusted Net Financial Liabilities under AGAAP	25,697	26,388	27,021	27,442

AEIFRS has primarily impacted the general government balance sheet for superannuation and insurance liabilities, deferred tax assets and the value of some physical assets.

However, net debt has not been affected by AEIFRS, as the cash transactions that affect net debt are still identical between AGAAP and AEIFRS.

Notes:

- AASB 119 Employee Benefits requires the defined benefit superannuation obligation to be discounted using the government bond rate as at each reporting date, rather than the long-term expected rate of return on plan assets. Where the superannuation obligation is not assumed by the Crown, this will increase the defined benefit superannuation liability against the opening accumulated funds and change the quantum of the annual superannuation expense.*
- The Treasury Managed Fund is a self-insurance arrangement for the general government sector and the Total State Sector Accounts, and AASB137 will therefore apply. AASB137 requires the application of a discount rate that reflects the time value of money adjusted for the risks specific to the liability, rather than the expected rate of return on Fund assets under the previous AASB1023. Further, it is likely that the Treasury Managed Fund's prudential margin will not be recognised for the general government sector and for the Total State Sector Accounts. Prudential margins are required to be recognised under AASB 1023 but not AASB 137.*
- Under AASB 140 Investment Property and Treasury's indicative mandates, investment property will be recognised at fair value. In contrast to their current treatment as property, plant and equipment, investment property recognised at fair value will not be depreciated and changes in fair value will be recognised in the income statement, rather than the asset revaluation reserve. This means that any asset revaluation reserve balances relating to such property will be written back to accumulated funds.*
- AASB 116 Property, Plant and Equipment requires the cost and fair value of property, plant and equipment to be increased to include the estimated restoration costs, where restoration provisions are recognised under AASB 137. These restoration costs must be depreciated and the unwinding of the restoration provision must be recognised as a finance expense. This treatment is not required under current AGAAP.*
- AASB 116 Property, Plant and Equipment requires for-profit entities to recognise revaluation increments and decrements on an individual asset basis, rather than a class basis. This change will decrease accumulated funds and increase the asset revaluation reserve.*
- Under AASB 1 Treasury has mandated the deemed cost option for for-profit entities, based on a previous AGAAP revaluation at the date of corporatisation or date of establishment. This means that any asset revaluation reserve prior to the date of established corporatisation is written back to accumulated funds.*

7. *AASB 112 Income Taxes uses a balance sheet approach which requires the differences between the accounting and tax value of assets and liabilities to be identified. Current AGAAP uses an operating statement method that accounts for tax by adjusting accounting profit for temporary and permanent differences to derive taxable income. The AASB 112 approach alters the quantum of tax assets and liabilities recognised. In particular, the balance sheet approach results in the recognition of a deferred tax liability in relation to revalued assets that are not recognised under current AGAAP. This also changes the quantum of the tax expense. However, any such tax liabilities accrued by PTEs would be eliminated against tax assets of the Crown upon consolidation within the NSW Total State Sector Accounts.*
8. *As a result of initial adoption the accounting treatment of some past transactions has been reviewed and amended to be consistent with AEIFRS. This adjustment to retained earnings and asset revaluation reserve mainly relates to a different interpretation under AEIFRS of the treatment of developer assets, than under AGAAP.*
9. *AASB 123 Borrowing Costs provides the option to expense or capitalise borrowing costs. Current AGAAP requires borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset to be capitalised and other borrowing costs to be expensed.*
10. *AASB 120 Accounting for Government Grants and Disclosure of Government Assistance for for-profit entities spreads income recognition over the period necessary to match related costs. This has the effect of delaying revenue recognition and increasing liabilities. Under current AGAAP grants are normally recognised on receipt.*
11. *AASB 116 Property, Plant and Equipment requires major inspection costs to be capitalised, where these were previously expensed. The adoption of AEIFRS will require the fair value and depreciation of the related asset to be re-allocated. The adoption of AASB 138 will also result in certain reclassifications from property, plant and equipment to intangible assets (e.g. computer software and easements).*
12. *AASB 136 Impairment of Assets requires an entity to assess at each reporting period whether there is any indication that an asset (or cash generating unit) is impaired and if such indication exists, the entity must estimate the recoverable amount. The adoption of AEIFRS has resulted in an adjustment to the opening asset revaluation reserve.*
13. *AASB 138 Intangible Assets requires all research costs to be expensed and restricts the capitalisation of development costs. Current AGAAP permits some research and development costs to be capitalised when certain criteria are met. As a result, some previously recognised intangible assets will need to be derecognised. Further, intangibles can only be revalued where there is an active market, which is unlikely to occur. Therefore, revaluation increments and decrements will need to be derecognised and intangible assets recognised at amortised cost.*
14. *AASB 5 Non-Current Assets Held for Sale and Discontinued Operations requires non-current assets classified as 'held for sale' to be reclassified as current and recognised at the lower of the carrying amount and the fair value less costs to sell. Unlike current AGAAP, 'held for sale' assets are not depreciated, thereby reducing the depreciation expense. However, at the date of transition there is no material difference in the carrying value of these assets, as selling costs are considered immaterial. Whilst this standard has not resulted in any adjustments to opening equity, assets held for sale have been reclassified to current assets from property, plant and equipment upon implementation of AEIFRS.*
15. *AASB140 Investment Property requires investment properties to be measured at cost or fair value. NSW Treasury is likely to mandate the adoption of fair value. Investment property classified at fair value is not depreciated, and changes in fair value are recognised in the operating statement. In contrast, the treatment under AGAAP was to classify investment properties within property, plant and equipment.*

The Crown Property Portfolio has investment properties that generate a rental income. Certain properties of the Crown Property Portfolio are tenanted primarily by general government agencies and therefore are considered owner-occupied (and therefore not investment property) for the general government sector and Total State Sector Accounts. Such owner-occupied properties (estimated at \$313 million in June 2006) are accounted for in accordance with AASB116 as property, plant and equipment of the general government sector.