New South Wales
TREASURY

International Accounting Standards Board
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Our Reference:
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Exposure Draft of Proposed Improvements to International Accounting Standards

I refer to the IASB's Exposure Draft "Improvements to International Accounting Standards" and the related Australian Accounting Standard Boards Invitation to Comment. New South Wales Treasury's comments are attached.

Given the number of changes proposed, the comments provided in the attached table are brief and restricted to areas where the differences between the proposed International Accounting Standards and the Australian Accounting Standards are considered significant. In regard to the proposals that are not included in the table, Treasury either supports the amendments or has no comments.

From the proposals listed in the attached table, the most significant issues from Treasury's viewpoint (which are shaded for ease of reference) include:

- Voluntary changes in accounting policies (IAS 8, para 20);
- Correction of errors – recognition (IAS 8, para 32);
- Dividends (IAS 10, para 12);
- Classification of leases (IAS 17, para 11A);
- Exclusion from consolidation (IAS 27, para 8);
- Amendments to IAS 16 "Property, plant and equipment".

As a general principle, Treasury is of the view that exclusions from accounting principles and exceptions to requirements in Accounting Standards should be minimised.

For example, IAS 27 proposes to exclude a parent from preparing consolidated financial statements in certain circumstances. This is not supported, as it is contrary to the general principle regarding control and the requirement that consolidated financial statements must be prepared by each parent of an economic entity that is a reporting entity.

In addition, Treasury does not support proposals that may be seen to extend the circumstances where items are capitalised rather than expensed. This is particularly important given the recent corporate collapses in the United States of America and Australia. For these reasons, Treasury does not support the following proposals regarding IAS 16 “Property, Plant and Equipment”:

- Definition and review of residual value (paras 6 & 46);
- Dismantling, removal and restoration costs (paras 20A & 20B);
- Component approach to inspection costs (paras 22C & 22D);
- Originally assessed standard of performance (para 23).

Further, it is noted that the recent decision to converge with the International Accounting Standards by 2005 means that there has not been sufficient time for Australian respondents to more fully appreciate the issues involved and the potential impact of the Improvements Project on Australian Standards.

Underlying many of the improvements proposed are other differences between the Australian and International Accounting Standards that are not directly addressed in the Exposure Draft. This makes it difficult to comment on the improvements, without discussing the wider issues of difference.

The attached comments have also been sent to the Australian Accounting Standards Board.

If you have any queries regarding these comments, please do not hesitate to contact me on 61 2 9228 3019 or Dianne McHugh on 61 2 9228 5340.

Yours faithfully

Robert Williams
for Secretary

PROPOSED IMPROVEMENTS TO INTERNATIONAL ACCOUNTING STANDARDS AND THEIR IMPACTS ON AUSTRALIAN STANDARDS

Presentation of Financial Statements		
Proposed changes to IAS 1	**Existing Australian Accounting Standard requirements**	**Comments**
Fair presentation override where departure from accounting standards prohibited – para 15 Include in a requirement that in the extremely rare circumstances in which compliance with a requirement in an IFRS or an Interpretation would be so misleading that it would conflict with the objective of financial statements and the relevant regulatory framework prohibits departure from that requirement, the entity reduces to the maximum extent possible the perceived misleading aspects of compliance by making specified disclosures.	**Fair presentation override where departure from accounting standards prohibited** Not discussed in the Accounting Standards. Australian Corporations Act, s 295, requires additional disclosures in the notes in the financial report where compliance with Australian Standards would not provide a true and fair view.	Supported. This represents a move closer towards the Australian Corporations Act position. However it is noted that IAS1 still allows departure from Accounting Standards on true and fair grounds if regulatory framework requires or does not prohibit such a departure.

Presentation of Financial Statements		
Proposed changes to IAS 1	**Existing Australian Accounting Standard requirements**	**Comments**
Extraordinary items – paragraphs 78 and 79 Remove the definition of extraordinary items and the requirement to disclose extraordinary items as a line item on the face of the income statement, and specify that disclosure of extraordinary items is prohibited.	**Extraordinary items** – AASB 1018, paragraph 5.5 AASB 1018 requires the disclosure of extraordinary items on the face of the statement of financial performance.	Supported. The definition of "extraordinary items" is already restricted therefore removal will not have a great effect.
Changes in equity – paragraph 91 Require disclosure of a separate component of the financial statements showing the profit or loss for the period (profit before minority interest) together with each item of revenue or expense recognised directly in equity. The existing paragraph 86 requires disclosure showing net profit or loss for the period (profit after minority interest) together with each item of revenue or expense recognised directly in equity as a separate component of the financial statements.	**Changes in equity** – AASB 1018, paragraph 4.3 AASB 1018 is consistent with the existing IAS 1 and requires disclosure of profit after minority interest together with each item of revenue or expense recognised directly in equity.	Not supported. This would result in inconsistency in the presentation of the Statement of Financial Performance, in Australia. That is, prior to the "non-owner" section, the last line item is net profit attributable to member of the parent entity (ie after minority interest). This same issue will also exist in any revised IAS 1. The IASB concedes at A18 ("Basis for Conclusions") that it has not considered the implications of this amendment for treatment elsewhere in the financial statements, including the income statement. Suggest IASB defers until it is able to consider all these issues at the same time.

Inventories		
Proposed changes to IAS 2	**Existing Australian Accounting Standard requirements**	**Comments**
Scope – paragraph 1 The scope exception relating to agricultural and forest products, mineral ores and agricultural produce to the extent that they are measured at net realisable value in accordance with well established practices would be extended to non-producers such as brokers and dealers.	**Scope** – paragraph 2.1 This existing scope exclusion is an incompatibility between IAS 2 and AASB 1019. AASB 1019 treats such assets as inventories subject to the lower of cost or NRV.	Not supported. Scope exclusions should be avoided wherever possible. Practices to measure at net realisable value may not be "well established" across all jurisdictions. This does not appear to be a good reason to amend the Standard. Also, the proposed change to IAS 2 extends the incompatibility between IAS 2 and AASB 1019.
Write-down disclosures – paragraph 34(c) The requirement to disclose the carrying amount of inventories carried at NRV would be deleted in favour of a requirement to disclose the amount of write downs as expenses.	**Write-downs** – paragraph 10.1(e) and 10.1(f) Disclosure of the amount of write-downs recognised as expenses is already required. Disclosure of the carrying amount of written down inventories is also required, classified as current and non-current and further sub classified in a manner appropriate to the entity's operations.	Not supported. Reduces disclosure / transparency (compared to AASB1019).

Accounting policies, changes in accounting estimates and errors		
Proposed changes to IAS 8	**Existing Australian Accounting Standard requirements**	**Comments**
Fundamental errors Remove distinction between fundamental errors and other material errors and consequently delete the definition of fundamental errors. All material errors disclosed in same manner as previous requirements for fundamental error.	**Fundamental errors** – AASB1018, para 8.1 and AASB1040, para 9.1 AASB1018 and AASB1040 define fundamental errors and require specific disclosures.	In principle supported, as the difference between fundamental error and material error is unclear. However, requires review of AASB1018 disclosures, as they differ from IAS8.
Future implementation of a new standard – paragraph 19 Require, rather than encourage, disclosure when an entity chooses not to early adopt a new Standard of the nature of a future change in accounting policy, the planned date of adoption and an estimate of the effect of the change on the entity's financial position, unless such an estimate cannot be made without undue cost or effort.	**Future implementation of a new standard** – AASB1001, para 6.2.1 AASB encourages disclosure, when an entity chooses not to early adopt, of the nature of the future change in accounting policy and an estimate of the effect of the change on the entity's financial performance and financial position.	Not supported. One of the reasons entities may not early adopt is that it has not had the opportunity to fully evaluate a new Standards impact. If an entity is able to estimate the financial effect, it may then be difficult to justify not early adopting. Application dates are set to allow sufficient time for implementation.

Accounting policies, changes in accounting estimates and errors		
Proposed changes to IAS 8	**Existing Australian Accounting Standard requirements**	**Comments**
Voluntary changes in accounting policies – para 20 Remove the allowed alternative treatment for voluntary changes in accounting policies (old paras 54-57). A voluntary change in an accounting policy would be accounted for retrospectively by adjusting the opening balance of retained earnings for the earliest period presented and restating comparative information.	**Voluntary changes in accounting policies** – AASB 1001, para 6.3. AASB1001 requires the effect of a voluntary change in an accounting policy to be recognised as revenues or expenses in the reporting period in which the change is made, and requires the retrospective effect to be disclosed in the notes in the financial report.	Not supported, from an accounting perspective. If approved the amendment could encourage manipulation by changing accounting policies; as the change would not impact on the "bottom line" that analysts look at (ie the effect of the change is "hidden" as an equity adjustment). Restatement of comparatives also has the effect of changing the past. However, if such changes were part of a "comprehensive income" concept (ie not a change to unappropriated profits) this would reduce the concern. The arguments for the "alternative treatment" (ie adjustment through equity) discussed in A9 of the "Basis for Conclusions", are supported.

Accounting policies, changes in accounting estimates and errors		
Proposed changes to IAS 8	**Existing Australian Accounting Standard requirements**	**Comments**
		However, the IAS proposal is consistent with Government Finance Statistics (GFS) basis used by Australian Governments for Budget Reporting. Therefore the proposed amendments may be favoured from AAS31 / GFS – Accounting Standard harmonisation perspective. Separate comments will be made on this issue as part of the AASB's project to revise AAS 29/AAS 31.
Correction of errors – recognition – para 32 Remove the allowed alternative treatment for the corrections of errors (old paras 38-40). The correction of an error would be accounted for retrospectively, by either restating the comparative amounts for the prior periods in which the error occurred or, when the error occurred before the earliest prior period presented, adjusting the opening balance of retained earnings for that period with restatement of comparative information.	**Correction of errors – recognition** – AASB1018, para 7.3 AASB1018 requires the effect of the correction of errors to be recognised as revenues or expenses in the reporting period in which the error is discovered, and contains additional disclosures in the case of a fundamental error.	Not supported, from an accounting perspective, as above. If amendment is approved, allows impact of errors to be "hidden" by adjusting against equity. Restatement of comparatives has the effect of changing the past. This concern would be avoided by moving to a "comprehensive income" concept with different components.

Accounting policies, changes in accounting estimates and errors		
Proposed changes to IAS 8	**Existing Australian Accounting Standard requirements**	**Comments**
		The IAS proposal is consistent with GFS basis, as above. Therefore the proposed amendments may be favoured from AAS31 / GFS – Accounting Standard harmonisation perspective. Separate comments will be made on this issue as part of the AASB's project to revise AAS29/AAS31.

Events After the Balance Sheet Date		
Proposed changes to IAS 10	**Existing Australian Accounting Standard requirements**	**Comments**
Dividends – para 12 Change to clarify that dividends declared before the balance date are not recognised as liabilities if they are subject to approval by the shareholders after the balance date.	**Dividends** – AASB1044, para 13.1.1 Public announcement by an entity's governing body of a recommended dividend gives rise to a valid expectation in those affected. Accordingly, a dividend liability is recognised, even where shareholders must give their final approval for that dividend.	Not supported. If amendment approved, this may prevent recognition of a final dividend based on year-end profit, in the year to which it relates. That is, final approval may only ever occur after year-end for final dividends. This seems contrary to the notion of "valid expectations" and "equitable" or "constructive" obligations, which underlies both IAS 37 and AASB 1044. Therefore, the concept that year-end dividends are not a liability is not agreed with. Dividends are paid from after tax profits; but the tax expenses is not known and not calculated until after year-end. Yet, this post year-end determined income tax expense is allowed to be recognised in the income statement because there is a constructive or equitable obligation and the expense 'pertains' to the financial year. Similarly, accrued expenses may not be accurately determined until after year-end; but the liabilities exist and are recognised based on post-balance date evidence of the liability at balance date.

Events After the Balance Sheet Date		
Proposed changes to IAS 10	**Existing Australian Accounting Standard requirements**	**Comments**
		Therefore, Treasury does not support current AASB requirements. Further, the IASB proposed changes further restrict an entity's ability to recognise dividends at balance date. This primarily affects entities that operate under a constitution or enabling legislation that enables them to publicly announce a recommended dividend that requires shareholder approval. Finally, there are a number of reasons why this has a greater impact on the public sector: ➢ In the NSW public sector, dividends are negotiated between the entity and the shareholders (ie Government) and may be unilaterally determined by the Treasurer. But the entity does not publicly announce a final dividend prior to year or prior to agreement with the Government as shareholder, which occurs after balance date. ➢ Government have a higher preference for dividends compared to private sector shareholders. This is because an entity's need to retain profits for reinvestment is restricted to the narrow objectives of the entity. In other words, the entity does not retain funds to reinvest for any purpose that adds value, but only such purposes that are within the narrow of objective of the entity. Dividends therefore constitute a higher percentage of profits. This in turn creates greater need for the profit to be known accurately before the dividend is determined.

Events After the Balance Sheet Date		
Proposed changes to IAS 10	**Existing Australian Accounting Standard requirements**	**Comments**
		➢ Government entities can have highly fluctuating profits because of unrealised profits or losses. Actuarial adjustments to defined benefit superannuation funds are just one item that creates large profit fluctuations. But the actuarial figures may not be known until after balance date. ➢ Government sector entities are not monitored to the same extent as public listed private entities. In NSW, these entities are currently monitored on a quarterly basis only.

Property, plant and equipment		
Proposed changes to IAS 16	**Existing Australian Accounting Standard requirements**	**Comments**
Definition and review of residual value – paras 6 & 46 Amend the definition of residual value and require the residual value of an asset to be reviewed as at each reporting date, regardless of whether the asset is measured at cost or at a revalued amount.	**Definition and review of residual value** – AASB1021, para 5.6.1 AASB1021 comments that when a non current asset is not revalued, the estimate of residual value is expressed in terms of the amount expected as at the date of acquisition and not some future value which would take into account the effect of inflation on asset prices. Residual value is defined in AASB1008 to mean at the "inception of the lease".	Not supported, as may be used as an argument to justify not depreciating. Current Australian requirements help prevent entities from claiming that the residual value has risen to a price that leaves no depreciable amount and hence no depreciation.
Dismantling, removal and restoration costs – paras 20A & 20B Additional guidance on the principle that the cost of an item of PP&E includes the costs of dismantling and removing the asset and restoring the site on which the asset is located as measured in accordance with IAS 37 "Provisions, Contingent Liabilities and Contingent Assets".	**Dismantling, removal and restoration costs** – AASB1022, para .40 Consistent with AASB1022 "Accounting for the Extractive Industries". AASB1015, para 6.2 requires identifiable liabilities assumed in the context of acquiring an entity or operation to be measured at fair value.	Not supported. Proposed amendment seems to run counter to the concepts in AASB1044 regarding provisions. Compare treatment of smoke filters (Example 6 "Legal Requirement to Fit Smoke Filters" in IAS 37) to treatment of restoration costs (Example 3 "Offshore Oilfield" in IAS37).

Property, plant and equipment		
Proposed changes to IAS 16	**Existing Australian Accounting Standard requirements**	**Comments**
		There is no liability to fit smoke filters where there is a law requiring their fitting (Example 6). However there is a liability to remove an oil rig and restore the seabed where this a licence requirement. While IAS 37, para 19, attempts to distinguish these above two examples, the distinction is not clear and requires an additional review. Therefore, support exclusion from Australian Accounting Standards, as it should be addressed as a separate project.

Property, plant and equipment		
Proposed changes to IAS 16	**Existing Australian Accounting Standard requirements**	**Comments**
Exchanges of items of PP&E – paras 21, 21A & 22 Require that exchanges of items of PP&E to be measured at fair value, except that, when the fair value of neither of the assets exchanged can be determined reliably, the cost of the asset acquired in the exchange is measured at the carrying amount of the asset given up.	**Exchange of items of PP&E** – AASB1015, para 6.2 Assets must be measured at their acquisition dates at their fair values.	Requirement to measure at "fair value" supported but do not support "cost" exception. (NB. The AASB1015 option of using carrying amounts on reconstruction of entities was vetoed by Parliament). In addition, IAS16 does not address where there is part reciprocal and part non-reciprocal elements, per UIG 40 and there will be either revenue or contributions by owners.
Component approach to inspection costs – paras 22C & 22D Where an asset requires inspection to enable its continuing use, the inspection would be treated as a separate component for depreciation purposes.	**Component approach to inspection costs** AASB1021 does not provide this guidance.	Not supported. Do not believe that an inspection is an asset: ie as there is no separately identifiable physical component asset that represents the inspection that is being replaced and future economic benefits have not been increased above the originally assessed standard of performance.

Property, plant and equipment		
Proposed changes to IAS 16	**Existing Australian Accounting Standard requirements**	**Comments**
		However, believe that you can create an additional provision for depreciation for the estimated cost of an inspection and reverse the provision when the inspection occurs.
Originally assessed standard of performance – para 23 Replace “the originally assessed standard of performance” with the “standard of performance assessed immediately before the expenditure was made” in describing the criterion for determining whether subsequent expenditure relating to an item of PP&E should be capitalised.	**Originally assessed standard of performance –** AASB 1021, paras 5.7 and 5.7.2 AASB1021 uses the term “the originally assessed standard of performance” and provides an example to explain its meaning.	Not supported. Effect of amendment seems to further decrease the types of expenditure that should be expensed and blurs the concept of repairs v assets. The discussion at para 26 of proposed IAS 16 on repairs only refers to “immaterial replacements or renewals of PP&E”, which is a very narrow concept of an expense.
Revalued assets – paras 64(d) & (e) Requires additional disclosures for items of PP&E stated at revalued amounts.	**Revalued assets** Australian Standards do not require these additional disclosures.	Additional disclosures supported, however, do not support providing cost information where an entity adopts fair value recognition, as the information does not seem relevant.

Leases		
Proposed changes to IAS 17	**Existing Australian Accounting Standard requirements**	**Comments**
Classification of leases – separate elements – para 11A Clarify that, for a lease involving both land and buildings, the land and buildings elements are considered separately for lease classification purposes unless it is expected that title will be passed to the lessee at the end of the lease term. Where title to land that has an infinite economic life is not expected to be passed to the lessee, the land element is to be classified as an operating lease and the building element is to be classified as an operating lease or a finance lease in accordance with the substance of the transaction.	**Separate elements –** paras 5.3.11 and 5.3.12 Paragraphs 5.3.11 and 5.3.12 provide similar guidance on the classification of leases involving both land and buildings.	The conclusion that "…where title to land that has an infinite economic life is not expected to be passed to the lessee, the land element is to be classified as an operating lease" is not supported. While, AASB 1008 is consistent with the proposed changes to IAS17, neither of these Standards acknowledges that it may be possible for a long-term lease (where title does not pass) to be a finance lease. It ignores the financial reality that the reversionary right of a long term lease has such minimal net present value that it is, in effect, a finance lease.

Leases		
Proposed changes to IAS 17	**Existing Australian Accounting Standard requirements**	**Comments**
		Further the proposed treatment is a contradiction in that both AASB1008 and the proposed IAS 17 also states that leases of land and buildings are classified as operating or finance leases in the same way as leases of other assets (based on risks and benefits). See Treasury Circular NSWTC 00/19 (attached), which addresses this issue in more detail. This seems to be partially addressed by proposed amendments to IAS 40 "Investment Properties" – see comments. However neither, IAS40 or IAS 17 makes it clear that the lessor can treat long-term land leases as finance leases, where title does not pass.

Leases		
Proposed changes to IAS 17	**Existing Australian Accounting Standard requirements**	**Comments**
Classification of leases – allocation – para 11B Require that the minimum lease payments including any up-front premium be allocated between the land and the building elements in proportion to their relative fair values at the inception of the lease. If the minimum lease payments cannot be allocated between the land and buildings elements reliably, the entire lease would be classified as a finance lease unless it is clear that both elements are operating leases, in which case the entire lease would be classified as an operating lease.	**Allocation –** paras 5.3.12 and 5.3.14 Similar guidance on the allocation of minimum lease payments and up front premium between the land and buildings elements. AASB1008 does not address this.	Treatment is not supported where minimum lease payments (MLP) cannot be allocated between the land and buildings. It would seem highly unlikely that the MLP could not be allocated between land and buildings (based on relative fair values at inception). Also there is no real justification for treating as a finance lease, if this arises.

Leases		
Proposed changes to IAS 17	**Existing Australian Accounting Standard requirements**	**Comments**
Definition of initial direct costs – paras 3, 29A & 44 Define initial direct costs as "incremental costs that are directly attributable to negotiating and arranging a lease, except for such costs incurred by manufacturer or dealer lessors". Includes commissions, legal fees and internal costs that are incremental and directly attributable.	**Definition of initial direct costs –** para 20.1 Defines initial direct costs as those costs that are directly associated with negotiating and executing a lease agreement (including commissions, legal fees and costs of preparing and processing documentation for new leases).	Exclusion of "costs incurred by manufacturer or dealer lessors" in the definition of initial direct costs is not supported. Prefer Australian approach to define "initial direct costs" identically, but then to differentiate accounting treatment for direct financing leases compared to sales type leases. The Australian approach avoids the issue raised in the comments made on para 44 of IAS 17.
Lessor (manufacturers or dealers) accounting for initial direct costs under finance leases – para 34 Require costs incurred by a manufacturer or a dealer lessor in connection with negotiating and arranging a lease to be recognised as an expense in the income statement at the inception of the lease. These costs are recognised as an expense as they relate to the earning of the manufacturer's or dealer's selling profit.	**Lessor (sales type leases) accounting for initial direct costs under finance leases –** para 14.2 Requires a lessor of a sales type lease to recognise initial direct costs as a cost of sales in the period in which the lease transaction occurs. A sales type lease is defined in para 20.1 as "a finance lease in which the fair value of the asset at the inception of the lease differs from its carrying amount to the lessor".	Not supported. Do not support linking the accounting treatment to whether or not the lessor is a "manufacturer or dealer". It may be that an entity other than a manufacturer or dealer enters into a lease where the fair value of the asset at inception differs from its carrying amount. Therefore the more principles-based approach is to capture all instances where the fair value is different from the carrying amount (as is done in Australia for "sales type leases").

Leases		
Proposed changes to IAS 17	**Existing Australian Accounting Standard requirements**	**Comments**
Lessor (other than manufacturers or dealers) accounting for initial direct costs under finance leases – para 29A Require that initial direct costs be included in the initial measurement of the finance lease receivable and amortised over the lease term.	**Lessor (direct financing lease) accounting for initial direct costs under finance leases –** para 14.1 Requires a lessor to capitalise initial direct costs as part of the lease receivable. A direct financing lease is defined as a finance lease other than a sales-type lease.	Same comments as above.
Lessor accounting for initial direct costs under operating leases – para 44 Require a lessor to recognise initial direct costs over the lease term.	**Lessor accounting for initial direct costs under operating leases –** para 14.3 Requires a lessor to defer and amortise initial direct costs over the lease term.	Not fully supported as does not address what happens for manufacturer or dealer lessors. This is because the definition of initial direct costs excludes manufacturer or dealer lessors. Para 14.3 in AASB 1008 applies to all lessors of operating leases including lessors that are manufacturer or dealer (or sales-type) lessors.

Related Party Disclosures		
Proposed changes to IAS24	**Existing requirements – AASB1017**	**Comment**
Scope – para 2 Explicitly states that disclosure will not be required of management compensation, expense allowances and similar paid in the ordinary course of an entity's operation.	**Scope** Currently AASB1017 and AASB1034 require disclosures regarding director and executives remuneration. More detailed disclosures are proposed in ED 106 "Director, Executive and Related Party Disclosures".	Not supported. Disclosure of management compensation etc is an important corporate governance issue that requires disclosure. Recent corporate collapses highlight the need for such disclosures. If it is excluded from IAS24, it should be addressed elsewhere in the IAS. For example, the Australian ED 106 addresses this issue and proposes 2 Standards, one for executive and director disclosures, and the other for related party disclosures.

Related Party Disclosures		
Proposed changes to IAS24	**Existing requirements – AASB1017**	**Comment**
Exemptions – parent entities and wholly-owned subsidiaries – para 3 Exempt the separate financial statements of a parent or wholly owned subsidiary that are published with the consolidated financial statements from related party disclosure requirements. Exempt from disclosure in consolidated financial statements of intra group related party transactions and balances.	**Exemptions – parent entities and wholly-owned subsidiaries –** paras 5.3 & 6.6 Exemption from disclosure in consolidated financial statements of transactions with members in the wholly owned group. Disclosure of related party items eliminated on consolidation is required in the financial statements of the parent entity. Disclosure is also required in the financial statements of a parent entity or wholly owned subsidiary of related party items other than consolidated items.	Exemption of the financial statements of a parent or wholly owned subsidiary from the related party disclosure requirements is not supported. Agree with "Alternative Views", para B4-B6: "…potentially all of the revenues and expenses for such an entity [parent entity or wholly owned subsidiary] may derive from related party transactions…the disclosures required by IAS 24 are essential to understanding the financial position and financial performance of such an entity…."
Exemptions – state controlled enterprises Remove the exemption for financial statements of state-controlled enterprises from disclosing transactions with other state controlled enterprises. Retain the explanation in para 11 that the normal dealings of public utilities, government departments and agencies with an entity will not cause them to be related parties of the entity.	**Exemption –** para 9.1 The normal dealings of government departments and local governments do not give rise to related party relationships. At present AASB1017 does not apply to unincorporated state controlled enterprises. AAS 22 applies to unincorporated entities but excludes public sector entities from its scope.	Separate guidance is required regarding the application of the related party concept to the public sector. AASB also needs to take into account IFAC's ED 20.

Related Party Disclosures		
Proposed changes to IAS24	**Existing requirements – AASB1017**	**Comment**
Definition of related party – para 9 Adds to definition: 1. parties with joint control over the entity. 2. joint ventures in which the entity is venturer. 3. post employment benefit plans for the benefit of employees of the entity or of any related entity 4. non executive directors (in KMP category). Re 1: Para 11(b) will be added to explain joint venturers will not be related to each other simply because of joint control over a venture. Re 4: The description of KMP has been extended by adding "or its parent".	**Definition of Related Party** – para 9.1 Re 1 & 2: Current definition includes related parties based on significant influence or control by or of the reporting entity. Re 3: Such entities would commonly fail the current definition of control. Re 4: captured in (f) and (g) of definition, directors of entities related by control or significant influence. AASB staff comment notes that the revised definition will not change the extent of conformity.	Not fully supported. Suggest definition of related party should also refer to director related entities per AASB1018 para (f) and (g) of definition of "related party" (although this is an existing non-conformity). In Australia do not support inclusion of "post employment benefit plans" in definition of related party, per AASB staff comment.

Related Party Disclosures		
Proposed changes to IAS24	**Existing requirements – AASB1017**	**Comment**
Definition of related party and close members of family – para 9 Explicitly include in the definition of related party, close members of the families of owners and KMP. Add a definition of "close members" that includes the individuals marital partner and children, children of the marital partner and other dependents of the individual or marital partner. Include generic direction to consider in determining the substance of a relationship, not merely its legal form.	**Definition of relative –** para 9.1 Current definition does not include relatives of owners of the entity, but includes director related entities of directors, which include relatives. Definition is per Corporations Law and is wider than that proposed in IAS24 as extends to parents, grandparents, grand children and brothers and sisters. Does not include other dependents or de facto relationships.	Not fully supported. Suggest wider definition of "relatives" (to include brothers, sisters, grandparents, children), similar to s 9 of Australian Corporations Act 2001. Wider definition is preferred, as it is likely that influence generally extends beyond children and partner.
Separation of disclosures – para 15 Extend in relation to the two "outstanding balance" amounts required by (new) paras 14(b) and (c), the sub-classification required by para 72, IAS1. Require sub-classification of the balance amounts by: (a) parent (b) entities with joint control or significant influence (c) subsidiaries (d) associates (e) joint ventures in which the entity is a venturer (f) KMP of the entity or its parent; and (g) Other related parties.	**Separation of disclosures –** Sections 5&6 AASB1017 requires disclosures in respect of both transactions and balances with members of the wholly owned group to be separated from disclosures about transactions and balances with other related parties.	Not supported. A seven way sub-classification seems excessive (on cost benefit grounds). Support the Australian approach, which distinguishes between "Wholly-owned group" and "Other related parties".

Consolidation and Separate Financial Statements		
Proposed changes to IAS27	**Existing requirements – AASB1024/ AAS24**	**Comment**
Scope – Temporary control – paras 11 & 13 Include all subsidiaries other than those for which control is temporary and held exclusively for disposal within 12 months of acquisition (such subsidiaries shall be accounted for in accordance with IAS 39 "Financial Instruments: Recognition and Measurements").	**Temporary control –** AASB1024, pars 5 & (vi) and AAS24, para 10 Temporary control does not of itself affect the economic entity for which consolidated accounts are to be prepared.	Not supported. During the time that control is held and until such time as control ceases, the subsidiary is part of the economic entity and needs to be reflected in the consolidated accounts. Do not support tying a control test to an intention or state of mind (ie whether intend to dispose or not) as this is subjective and subject to change. Australia does not currently have the equivalent of IAS 39. The matter of IAS39 is therefore part of a broader harmonization issue and will be further addressed in comments on proposed improvements to IAS32 and IAS39, which is subject to a separate invitation to comment. This comment also applies to **"Investor's separate financial statements"**; and **"Investee no longer a subsidiary"**.

Consolidation and Separate Financial Statements		
Proposed changes to IAS27	**Existing requirements – AASB1024/ AAS24**	**Comment**
Exclusion from consolidation – para 8 Exclude a parent from preparing consolidated financial statements if it is a wholly owned subsidiary or if minority shareholders unanimously agree that the parent need not consolidate, its securities are not publicly traded, the immediate or ultimate parent entity prepares consolidated financial statements and the entity is not in the process of publicly issuing securities.	**Exclusion from consolidation** – AASB1024, para 10 and AAS24, para 39 Consolidated financial statements must be prepared by each parent of an economic entity that is a reporting entity.	Not supported. Whether or not financial statements are produced is more appropriately linked to the reporting entity concept. This would also be a particular issue in Government. For example, it would mean that NSW Health would not need to prepare consolidated financial statements (ie consolidating Area Health Services), as it is a wholly owned subsidiary of the NSW Government, which produces consolidated Total State Sector accounts. This would represent a substantial reduction in accountability. The proposed amendment does not recognise that shareholders are not the only users of general-purpose financial reports.

Investments in Associates		
Proposed changes to IAS28	**Existing requirements – AASB1016**	**Comment**
Separate financial statements – para 24A Require an investment in an associate to be accounted for in the investor's separate financial statements in accordance with paras 29, 30 and 33 of IAS 27 ie cost or in accordance with IAS39. Investments accounted for in accordance with IAS39 in the consolidated reports must also be treated on that basis in the separate financial statements.	**Separate financial statements –** paras 4.1&4.2 An investor that is required to prepare a consolidated financial report must recognise an investment in an associate by applying the equity method in its consolidated financial report and by applying the cost method in its own financial report.	Australia does not currently have the equivalent of IAS 39. The matter of IAS39 is therefore part of a broader harmonization issue and will be further addressed in comments on proposed improvements to IAS32 and IAS39, which is subject to a separate invitation to comment. This comment also applies to **"Cessation of significant influence"**.
Financial statements used – para 18 Require the difference between investee and investor reporting dates to be no greater than 3 months. The existing IAS 28 also requires adjustments to be recognised for significant transactions or events occurring in the period between reporting dates.	**Financial statements used –** 5.8 & 5.8.1 Where there is a difference between the investee and investor reporting dates, disclosure of the investee's reporting date is required. AASB1016 also requires note disclosure of significant transactions or events occurring in the period between reporting dates. There is no limitation on the difference between the reporting dates.	Not supported. Seems inappropriate to impose a 3 month limit on entities that only "significantly influence".

Investments in Associates		
Proposed changes to IAS28	**Existing requirements – AASB1016**	**Comment**
Carrying amount reduced to zero – 22, 22A & 22B Losses recognised under the equity method in excess of the investor's investment in ordinary shares are applied to the other components of the investor's interest in an associate in the order of their seniority. Other components of the investor's interest includes preferred shares and long term receivables or loans, but not trade receivables or trade payables.	**Carrying amounts reduced to zero –** 5.13 Equity method must be discontinued when carrying amount of investment reaches zero. UIG24 provides guidance that the carrying amount includes ordinary shares and other financial instruments which satisfy the characteristics of an ownership interest.	Application of losses to "other components" such as long-term receivables etc is not supported as these do not constitute the "ownership interest". UIG24 provides that other forms of interest are subject to the recoverable amount test to determine whether impairment has occurred.

Investment Properties		
Proposed changes to IAS40	**Proposed requirements – ED103**	**Comment**
Scope – paras 2 & 4 Amend the definition of investment property to permit property held by a lessee under an operating lease to qualify provided that: • the rest of the definition of investment property is met; and • the lessee uses the fair value model set out in IAS40, paras 27-49.	**Scope** The amendments proposed for IAS40 could be made to equivalent paragraphs in the proposed new Australian Standard based on ED103, since ED103 was derived from and closely parallels IAS40.	While the intention of the amendments is supported, it is believed that the issue is that long-term leases of land may in substance be finance leases rather than operating leases – as commented above re IAS 17. Do not support optional treatment, either risks and benefits have passed or not passed. Also, IAS40/IAS17 only partially address this issue from the lessee's perspective. The treatment for the lessor needs to be clarified ie treat as finance lease.
Consequential amendment – para 26A Require a lessee that classifies property held under an operating lease as investment property to treat the lease as if it were a finance lease.		As above.

	Treasury Circular **NSW TC 00/19** **4 September 2000**

ACCOUNTING FOR LONG-TERM LEASES OF LAND AND OTHER PROPERTY

Summary:

The purpose of this circular is to provide practical guidance on the appropriate accounting for long-term leases by NSW Public Sector agencies.

TC1991/21 provided that lease premiums and prepayments of future lease rentals in relation to long-term leases of land or property were to be treated in substance as proceeds for the sale by the lessor. TC1991/21 was withdrawn by TC00/04 because of a potential conflict with AAS17, which stated that such premiums or future lease rentals related to a long-term lease were to be amortised over the lease term.

Subsequent investigation has determined that AAS17 commentary guidance is contradictory. The conclusive test in AAS17 (the mandatory black letter) requires that a lease under which the lessor effectively transfers to the lessee substantially all of the risks and benefits incident to ownership of the leased asset must be treated as a finance lease whether or not legal ownership transfers.

The economic substance of such a lease is that it is the sale of land or property. The lessor retains the reversionary right to the property beyond the lease term. However, the reversionary right has no value to the lessor at the inception of a long-term lease. It should be recognised when it has value in accordance with AAS10 (and AASB1010).

This conclusion has been reached following a significant consultative process.

Agencies are required to account for long-term leases that involve lease premiums and prepayments of future lease rentals as sales in accordance with the mandatory black letter requirements of the standard. The reversionary right is an asset, initially of no value.

This Circular repeals that part of Treasury Circular TC 00/04 that relates to the Treasury Circular 1991/21 "Accounting for Long Term Leases of Land and other Property" and supercedes TC1991/21 "Accounting for Long Term Leases of Land and Other Property."

This Circular is issued as a Direction to agencies under section 9(2) of the *Public Finance and Audit Act 1983* and is applicable for financial years ending on or after 30 June 2000.

Ian Neale
for Secretary

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ACCOUNTING FOR LONG-TERM LEASES OF LAND AND OTHER PROPERTY

Background

The purpose of this circular is to establish policy and practical guidance on the accounting for long-term leases by NSW Public Sector agencies.

TC1991/21 provided that lease premiums and prepayments of future lease rentals in relation to long-term leases of land or property were to be treated in substance as proceeds for the sale by the lessor. TC00/04 withdrew that circular because of a potential conflict with AAS17 which stated that premiums or future lease rentals relating to long-term leases of land were to be amortised over the lease term.

AAS17 (AASB1008)

Australian Accounting Standard AAS 17 (and AASB1008) 'Leases' defines a finance lease as 'a lease under which the lessor effectively transfers to the lessee substantially all the risks and benefits incident to ownership of the leased asset and where legal ownership may or may not eventually be transferred'.

The classification of a lease depends on its economic substance. The commentary to the Standard states that the risks of ownership include those associated with unsatisfactory performance, obsolescence, idle capacity, losses in realisable value, uninsured damage and condemnation of the assets. The benefits include those obtained through use of the asset and gains in realisable value. The risks and rewards test is often called the *conclusive test*.

The commentary to the Standard provides criteria or guidance to assist with the classification of leases. Effective passing of substantially all the risks and rewards of ownership is normally presumed where the lease is non-cancelable and either the lease term is for 75 per cent or more of the remaining economic life of the asset or the present value of the minimum lease payments at the beginning of the lease equals or exceeds 90% of the fair value of the leased assets at the inception of the lease. These criteria are often referred to as the *indicative criteria*.

Recent changes to the commentary to the Standard state that a characteristic of land is that it normally has an infinite economic life. Where title to land possessing this characteristic is not expected to pass to the lessee at the end of the lease term, it states that the lessee does not receive substantially all the risks and rewards of ownership and accordingly, the lease of land is classified as an operating lease.

Application of AAS17 to Long-Term Leases

The ultimate classification of long-term leases of land or property needs to be assessed based on the conclusive criteria as discussed above. The commentary to AAS 17 provides guidance to assist with assessing whether the conclusive criteria have been met. The difficulty with the assessment of the classification of long-term leases is that there is a conflict in the guidance in the commentary to AAS 17.

The indicative criteria have been met as the lease is non-cancellable and the fair value of the asset has been received as the upfront lease payment. This creates a presumption the lease is a finance lease.

However, the commentary to AAS 17 also specifically states that where title to land is not expected to pass to the lessee at the end of the lease term, the lessee does not receive substantially all the risks and rewards of ownership and accordingly, the lease of land is classified as an operating lease.

Given the contradiction in the indicative criteria, the black letter definitions of finance and operating leases are critical in assessing the classification of long-term leases. The paragraphs in the commentary dealing with land specifically state that leases of land are classified as operating and finance leases in the same way as other leases. The emphasis is therefore on the black letter definition with the commentary merely there as guidance.

The fact that indicative criteria have been met and the fact that the transaction is an arms length transaction create a strong presumption that substantially all the risks and rewards of ownership have passed to the lessee. The lessee would not have paid fair market value for the land if it did not believe it was obtaining substantially all the risks and rewards of ownership. The economic substance of the lease is that it is a sale of the land.

The lessor does retain the risks and rewards beyond the lease period; however, these risks and rewards have no value at the inception of the lease and do not start to re-emerge until towards the end of the lease.

Accounting for the Difference Between The Carrying value and the Upfront Lease Payment

Any difference between the current carrying value of the asset and the upfront lease payments would be recognised in the statement of financial performance in the period that the lease is entered into.

Accounting for the Reversionary Right

Australian Accounting Standard AAS10 (and AASB1010) (AAS 38 and AASB1041from 1 July 2000) 'Revaluation of Non-Current Assets' states that the carrying value of a non-current asset may only be changed by revaluation of the class of non-current assets in which that asset is included. Such revaluations are required to be accounted for in accordance with the provisions of AAS10.

The lessor retains a reversionary right to the land or other property that, as stated above, has no value at the inception of o a long-term lease. The lessor currently controls the future economic benefits embodied in the reversionary right. The reversionary right therefore meets the definition of an asset but no value is recognised by the lessor at the inception of the lease. The value of the reversionary right will start to emerge towards the end of the lease. As the emerging value of the asset arising from the reversionary right is a non-current asset, changes in its value are required to be accounted for in accordance with AAS10 (AAS 38). It is appropriate to record it at $1 nominal value for the purpose of future reevaluations.

Accounting Policy Disclosure

The notes to the financial statements should disclose the accounting policy for lessors of long term leases with upfront premiums or prepayments of future lease rentals. It should disclose that the title to the land has been retained, but that it has been recognised at no value at the inception of the lease.