

fasttrack

Financial Accounting-Standards & Technical

Grant Thornton 

AASB 1 - First time adoption of A-IFRS

AASB 1 First-time adoption of A-IFRS applies to all reporting periods beginning on or after 1 January 2005. It cannot be applied earlier and is subject to AASB 1031 Materiality. The standard applies to general purpose financial reports and those entities required to produce financial reports in accordance with Part 2M.3 of the Corporations Act. An entity must prepare an opening balance sheet under Australian equivalents to IFRS (A-IFRS) and one year of comparatives.

AASB 1 applies when an entity first complies with A-IFRS effective at the reporting date for its first A-IFRS financial report. Unlike previous requirements in Australia (in AASB 1001 and AAS 6 Accounting Policies and transitional requirements in various other Accounting Standards), AASB 1 requires retrospective application in most areas. This Standard:

- includes targeted exemptions from retrospective application (to avoid costs that would be likely to exceed the benefits to users of financial reports) and a small number of other exceptions for practical reasons;
- clarifies that an entity applies the latest version of A-IFRS;
- clarifies how a first-time adopter's estimates under A-IFRS relate to the estimates it made for the same date under previous GAAP;
- specifies that the transitional provisions in other A-IFRS do not apply to a first-time adopter; and
- requires detailed disclosure about the transition to A-IFRS.

Opening A-IFRS balance sheet

An entity shall prepare an opening A-IFRS balance sheet at the date of transition to A-IFRS. This is the starting point for its accounting under A-IFRS. An entity need not present its opening A-IFRS balance sheet in its first A-IFRS financial report.

Except as described in the standard, an entity shall, in its opening A-IFRS balance sheet:

- recognise all assets and liabilities whose recognition is required by A-IFRS;
- not recognise items as assets or liabilities if A-IFRS do not permit such recognition;
- reclassify items that it recognised under previous GAAP as one type of asset, liability or component of equity, but are a different type of asset, liability or component of equity under A-IFRS; and
- apply A-IFRS in measuring all recognised assets and liabilities

We summarise areas of impact, options permitted and treatments according to AASB 1:

Business combinations

A first-time adopter may elect not to apply AASB 3 Business Combinations retrospectively to past business combinations (business combinations that occurred before the date of transition to A-IFRS). However, if a first-time adopter restates any business combination to

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comply with AASB 3, it shall restate all later business combinations and shall also apply AASB 136 Impairment of Assets and AASB 138 Intangible Assets from that same date. For example, if a first-time adopter elects to restate a business combination that occurred on 30 June 2002, it shall restate all business combinations that occurred between 30 June 2002 and the date of transition to A-IFRS, and it shall also apply AASB 136 and AASB 138 from 30 June 2002.

Goodwill

The carrying amount of goodwill in the opening A-IFRS balance sheet shall be its carrying amount under previous GAAP at the date of transition to A-IFRS, after the following three adjustments:

- If required, the first-time adopter shall increase the carrying amount of goodwill when it reclassifies an item that it recognised as an intangible asset under previous GAAP. Similarly, if the first-time adopter recognises an intangible asset that was subsumed in recognised goodwill under previous GAAP, the first-time adopter shall decrease the carrying amount of goodwill accordingly (and, if applicable, adjust deferred tax and minority interests).
- A contingency affecting the amount of the purchase consideration for a past business combination may have been resolved before the date of transition to A-IFRS. If a reliable estimate of the contingent adjustment can be made and its payment is probable, the first-time adopter shall adjust the goodwill by that amount. Similarly, the first-time adopter shall adjust the carrying amount of goodwill if a previously recognised contingent adjustment can no longer be measured reliably or its payment is no longer probable.
- Regardless of whether there is any indication that the goodwill may be impaired, the first-time adopter shall apply AASB 136 Impairment of Assets in testing the goodwill for impairment at the date of transition to A-IFRS and in recognising any resulting impairment loss in retained earnings (or, if so required by AASB 136, in revaluation surplus). The impairment test shall be based on conditions at the date of transition to A-IFRS.

Fair value or revaluation as deemed cost

An entity may elect to measure an item of property, plant and equipment at the date of transition to A-IFRS at its fair value and use that fair value as its deemed cost at that date.

A first-time adopter may elect to use a previous GAAP revaluation of an item of property, plant and equipment at, or before, the date of transition to A-IFRS as deemed cost at the date of the revaluation, if the revaluation was, at the date of the revaluation, broadly comparable to:

- fair value; or
- cost or depreciated cost under A-IFRS, adjusted to reflect, for example, changes in a general or specific price index.

These elections are also available for:

- investment property, if an entity elects to use the cost model in AASB 140 Investment Property; and
- intangible assets that meet:
 - the recognition criteria in AASB 138 Intangible Assets (including reliable measurement of original cost); and
 - the criteria in AASB 138 for revaluation (including the existence of an active market).

An entity shall not use these elections for other assets or for liabilities.

Employee benefits

Under AASB 119 Employee Benefits as issued in December 2004, an entity may elect to use a 'corridor' approach for defined benefit superannuation plans that leaves some actuarial gains and losses unrecognised. Retrospective application of this approach requires an entity to split the cumulative actuarial gains and losses from the inception of the plan until the date of transition to A-IFRS into a recognised portion and an unrecognised portion. However, a first-time adopter may elect to recognise all cumulative actuarial gains and losses at the date of transition to A-IFRS, even if it uses the corridor approach for later actuarial gains and losses. If a first-time adopter uses this election, it shall apply it to all plans.

Cumulative translation differences

AASB 121 The Effects of Changes in Foreign Exchange Rates requires an entity:

- to classify some translation differences as a separate component of equity; and

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- on disposal of a foreign operation, to transfer the cumulative translation difference for that foreign operation (including, if applicable, gains and losses on related hedges) to the income statement as part of the gain or loss on disposal.

However, a first-time adopter need not comply with these requirements for cumulative translation differences that existed at the date of transition to A-IFRS. If a first-time adopter uses this exemption:

- the cumulative translation differences for all foreign operations are deemed to be zero at the date of transition to A-IFRS; and
- the gain or loss on a subsequent disposal of any foreign operation shall exclude translation differences that arose before the date of transition to A-IFRS and shall include later translation differences.

Compound financial instruments

AASB 132 Financial Instruments: Disclosure and Presentation requires an entity to split a compound financial instrument at inception into separate liability and equity components. If the liability component is no longer outstanding, retrospective application of AASB 132 involves separating two portions of equity. The first portion is in retained earnings and represents the cumulative interest accreted on the liability component. The other portion represents the original equity component. However, under this Standard, a first-time adopter need not separate these two portions if the liability component is no longer outstanding at the date of transition to A-IFRS.

Assets and liabilities of subsidiaries, associates and joint ventures

If a subsidiary (or associate or joint venture) becomes a first-time adopter later than its parent, the subsidiary shall, in its financial statements, measure its assets and liabilities at either:

- the carrying amounts that would be included in the parent's consolidated financial statements, based on the parent's date of transition to A-IFRS, if no adjustments were made for consolidation procedures and for the effects of the business combination in which the parent acquired the subsidiary; or
- the carrying amounts required by the rest of this Standard, based on the subsidiary's date of transition to A-IFRS.

Designation of previously recognised financial instruments

AASB 139 Financial Instruments: Recognition and Measurement permits a financial asset to be designated on initial recognition as available for sale or a financial instrument (provided it meets certain criteria) to be designated as a financial asset or financial liability at fair value through profit or loss (this designation has since been restricted by 2005-4 applicable for reporting periods commencing on or after 1 January 2006).

Share-based payment transactions

A first-time adopter is encouraged, but not required, to apply AASB 2 Share-based Payment to equity instruments that were granted on or before 7 November 2002. A first-time adopter is also encouraged, but not required, to apply AASB 2 to equity instruments that were granted after 7 November 2002 that vested before the later of (a) the date of transition to A-IFRS and (b) 1 January 2005. However, if a first-time adopter elects to apply AASB 2 to such equity instruments, it may do so only if the entity has disclosed publicly the fair value of those equity instruments, determined at the measurement date, as defined in AASB 2.

For all grants of equity instruments to which AASB 2 has not been applied (e.g. equity instruments granted on or before 7 November 2002), a first-time adopter shall nevertheless disclose the information required by paragraphs 44 and 45 of AASB 2. If a first-time adopter modifies the terms or conditions of a grant of equity instruments to which AASB 2 has not been applied, the entity is not required to apply paragraphs 26-29 of AASB 2 if the modification occurred before the later of (a) the date of transition to A-IFRS and (b) 1 January 2005.

Changes in existing decommissioning, restoration and similar liabilities included in the cost of property, plant and equipment

The UIG Interpretation identified in AASB 1048 Interpretation and Application of Standards as corresponding to IFRIC 1 Changes in Existing Decommissioning, Restoration and Similar Liabilities requires specified changes in a decommissioning, restoration or similar liability to be added to or deducted from the cost of the asset to which it relates; the adjusted depreciable amount of the asset is then depreciated prospectively over its remaining useful life. A first-time adopter need not comply with these requirements for changes in such liabilities that occurred before the date of

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transition to A-IFRS. If a first-time adopter uses this exemption, it shall:

- measure the liability as at the date of transition to A-IFRS in accordance with AASB 137 Provisions, Contingent Liabilities and Contingent Assets;
- to the extent that the liability is within the scope of the UIG Interpretation identified in AASB 1048 as corresponding to IFRIC 1, estimate the amount that would have been included in the cost of the related asset when the liability first arose, by discounting the liability to that date using its best estimate of the historical risk-adjusted discount rate(s) that would have applied for that liability over the intervening period; and
- calculate the accumulated depreciation on that amount, as at the date of transition to A-IFRS, on the basis of the current estimate of the useful life of the asset, using the depreciation policy adopted by the entity under A-IFRS.

Derecognition of financial assets and financial liabilities

A first-time adopter shall apply the derecognition requirements in AASB 139 prospectively for transactions occurring on or after 1 January 2004. In other words, if a first-time adopter derecognised financial assets or non-derivative financial liabilities under its previous GAAP as a result of a transaction that occurred before 1 January 2004, it shall not recognise those assets and liabilities under A-IFRS (unless they qualify for recognition as a result of a later transaction or event). An entity may however apply the derecognition requirements in AASB 139 retrospectively from a date of the entity's choosing, provided that the information needed to apply AASB 139 to financial assets and financial liabilities derecognised as a result of past transactions was obtained at the time of initially accounting for those transactions.

Hedge accounting

As required by AASB 139, at the date of transition to A-IFRS, an entity shall:

- measure all derivatives at fair value; and
- eliminate all deferred losses and gains arising on derivatives that were reported under previous GAAP as if they were assets or liabilities.

An entity shall not reflect in its opening A-IFRS balance sheet a hedging relationship of a type that does not qualify for hedge accounting under AASB 139.

If, before the date of transition to A-IFRS, an entity had designated a transaction as a hedge but the hedge does not meet the conditions for hedge accounting in AASB 139, the entity shall discontinue hedge accounting. Transactions entered into before the date of transition to A-IFRS shall not be retrospectively designated as hedges.

Estimates

An entity's estimates under A-IFRS at the date of transition to A-IFRS shall be consistent with estimates made for the same date under previous GAAP (after adjustments to reflect any difference in accounting policies), unless there is objective evidence that those estimates were in error.

Assets classified as held for sale and discontinued operations

Entities adopting A-IFRS on or after 1 January 2005 shall apply AASB 5 to comparative information presented in an entity's first A-IFRS financial report.

Comparative information

To comply with AASB 101 Presentation of Financial Statements, an entity's first A-IFRS financial report shall include at least one year of comparative information under A-IFRS.

Exemption from the requirement to restate comparative information for AASB 132, AASB 139, AASB 6, AASB 4, AASB 1023 and AASB 1038

In its first A-IFRS financial report, an entity that adopts A-IFRS before 1 January 2006 shall present at least one year of comparative information, but this comparative information need not comply with AASB 132 & AASB 139 Financial Instruments, AASB 6 Exploration for and Evaluation of Mineral Resources, AASB 4 Insurance Contracts, AASB 1023 General Insurance Contracts and AASB 1038 Life Insurance Contracts.

An entity that chooses to present comparative information that does not comply with AASB 132, AASB 139, AASB 6, AASB 4, AASB 1023 and AASB 1038 in its first year of transition shall:

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- apply its previous GAAP in the comparative information;
- disclose this fact, together with the basis used to prepare this information; and
- disclose the nature of the main adjustments that would make the information comply with AASB 132, AASB 139, AASB 6, AASB 4, AASB 1023 and AASB 1038. The entity need not quantify those adjustments. However, the entity shall treat any adjustment between the balance sheet at the comparative period's reporting date (i.e. the balance sheet that includes comparative information under previous GAAP) and the balance sheet at the start of the first A-IFRS reporting period (i.e. the first period that includes information that complies with AASB 132, AASB 139, AASB 6, AASB 4, AASB 1023 and AASB 1038) as arising from a change in accounting policy and give the disclosures required by paragraphs 28(a)-(e) and (f)(i) of AASB 108 Accounting Policies, Changes in Accounting Estimates and Errors.

In the case of an entity that chooses to present comparative information that does not comply with AASB 132, AASB 139, AASB 6, AASB 4, AASB 1023 and AASB 1038, references to the 'date of transition to A-IFRS' shall mean, in the case of those Standards only, the beginning of the first A-IFRS reporting period.

Explanation of transition to A-IFRS

An entity shall explain how the transition from previous GAAP to A-IFRS affected its reported financial position, financial performance and cash flows.

Reconciliations

An entity's first A-IFRS financial report shall include:

- reconciliations of its equity reported under previous GAAP to its equity under A-IFRS for both of the following dates:
- the date of transition to A-IFRS; and
- the end of the latest period presented in the entity's most recent annual financial report under previous GAAP;
- a reconciliation of the profit or loss reported under previous GAAP for the latest period in the entity's most recent annual financial report to its profit or loss under A-IFRS for the same period; and
- if the entity recognised or reversed any impairment losses

for the first time in preparing its opening A-IFRS balance sheet, the disclosures that AASB 136 Impairment of Assets would have required if the entity had recognised those impairment losses or reversals in the period beginning with the date of transition to A-IFRS.

AASB 108

AASB 108's requirements for disclosures about changes in accounting policies do not apply in an entity's first A-IFRS financial report.

Designation of financial assets or liabilities

An entity is permitted to designate a previously recognised financial asset or financial liability as a financial asset or financial liability at fair value through profit or loss or a financial asset as available for sale. The entity shall disclose the fair value of any financial assets or financial liabilities designated into each category at the date of designation and their classification and carrying amount in the previous financial report.

Use of fair value as deemed cost

If an entity uses fair value in its opening A-IFRS balance sheet as deemed cost for an item of property, plant and equipment, an investment property or an intangible asset, the entity's first A-IFRS financial report shall disclose, for each line item in the opening A-IFRS balance sheet:

- the aggregate of those fair values; and
- the aggregate adjustment to the carrying amounts reported under previous GAAP.

Interim financial reports

If an entity presents an interim financial report under AASB 134 Interim Financial Reporting for part of the period covered by its first A-IFRS financial report, the entity shall satisfy the following requirements in addition to the requirements of AASB 134.

- Each such interim financial report shall, if the entity presented an interim financial report for the comparable interim period of the immediately preceding financial year, include reconciliations of:
 - its equity under previous GAAP at the end of that comparable interim period to its equity under A-IFRS at that date; and

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- its profit or loss under previous GAAP for that comparable interim period (current and year-to-date) to its profit or loss under A-IFRS for that period.
- In addition to the reconciliations required above, an entity's first interim financial report under AASB 134 for part of the period covered by its first A-IFRS financial report shall include:
 - reconciliations of its equity reported under previous GAAP to its equity under A-IFRS for both of the following dates:
 - o the date of transition to A-IFRS; and
 - o the end of the latest period presented in the entity's most recent annual financial report under previous GAAP.
 - a reconciliation of the profit or loss reported under previous GAAP for the latest period in the entity's most recent annual financial report to its profit or loss under A-IFRS for the same period.

Operating Leases

Leases have been one of the sleeping giants of A-IFRS. The following two paragraphs from AASB 117 seem very innocuous. However, upon closer reflection the impacts of these paragraphs are far reaching.

33. Lease payments under an operating lease shall be recognised as an expense on a straight-line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit.

50. Lease income from operating leases shall be recognised in income on a straight-line basis over the lease term, unless another systematic basis is more representative of the time pattern in which use benefit derived from the leased asset is diminished.

The impact of these paragraphs is illustrated by the following example:

Corey and Co. has recently leased a new machine. The lease is classified as an operating lease with 5 payments each due at the start of the financial year. The first payment of \$100,000 is due immediately. The payments increase by 10% p.a. compound. Corey has a tax rate of 30%.

Operating Leases (cont)

	1	2	3	4	5	Total
	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000
Nominal payments	100	110	121	133	146	610
Straight line Expense	122	122	122	122	122	610
Journal entry:						
Dr Operating lease expense	122	122	122	122	122	
Cr Cash	100	110	121	133	146	
Dr Lease payment accrual				11	24	
Cr Lease payment accrual	22	12	1			
Dr Deferred tax asset	6.6	3.6	0.3			
Cr Deferred tax asset				3.3	7.2	

The straight line treatment of operating leases has created a liability in the balance sheet of the lessee in this example. For the lessor the alternative would be an asset and an acceleration of revenue.

The standard is silent about whether to calculate the present value the payments before straight lining them. If the payments were present valued then the above example would change to the following:

	1	2	3	4	5	Total
	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000
Nominal payments	100	110	121	133	146	610
P.V. of payments (using CPI)	100	105	112	118	125	560
Straight line Expense	112	112	112	112	112	560
Journal entry:						
Dr Operating lease expense	112	112	112	112	112	
Cr Cash	100	110	121	133	146	
Dr Interest expense		5	9	15	21	
Dr Lease payment accrual				6	13	
Cr Lease payment accrual	12	7				
Dr Deferred tax asset	3.6	2.1				
Cr Deferred tax asset				1.8	3.9	
Dr/Cr Tax provision/expense	3.6	2.1		1.8	3.9	

Operating Leases (cont)

Current interpretations of operating leases seem to indicate the following:

- operating leases with fixed payment increases are not discounted to present value to calculate the straight-line expense; and
- operating leases with CPI increases are expensed as incurred.

Make good provisions - leases

AASB 137 requires (paragraph 14) a provision for make good costs shall be recognised when:

- an entity has a present obligation (legal or constructive) as a result of a past event;
- it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
- a reliable estimate can be made of the amount of the obligation.

If these conditions are not met, no provision shall be recognised.

A make good provision in a lease contract may meet the definition of a provision under AASB 137. If this occurs the entity is required to raise a provision for the make good liability. This provision will be calculated at the present value of the liability and recorded as follows for an operating lease:

Asset associated with make good obligations on operating leases	\$100	
Provision for make good obligations on operating leases		\$100

On an annual basis the entity will raise the following entries:

Depreciation of asset:

Depreciation	\$x	
Accumulated depreciation		\$x

Unwinding of discount on the liability:

Interest expense	\$x	
Provision for make good obligations on operating leases		\$x

This treatment will cause an asset and liability to be raised on operating leases.

Example impacts

David Jones:

The Consolidated entity recognised a \$30.13M provision in relation to recognising operating leases on a straight line basis on transition to A-IFRS.

The Consolidated entity recognised a \$1.4M liability for make good costs on its leases on transition to A-IFRS.

Woolworths:

The Consolidated entity recognised a \$7.0M liability for make good costs on its leases on transition to A-IFRS.

What's new - Debtor provisioning

AASB 139 paragraph 58 requires an entity to assess at each reporting date whether there is any objective evidence that a financial asset or group of financial assets is impaired.

The effect of this paragraph is to eliminate general provisions for doubtful debts. Entities in the past have tended to use aging analyses or a percentage of debtors to create a provision for doubtful debts. AASB 139 requires 'objective' evidence and where a group of assets is to be assessed together they need to be similar in nature and risk. The impact of AASB 139 is likely to result in a decrease in debtor provisioning and a provision only being raised where a specific event has occurred.

Entities are now attempting to refine their debtor provisioning techniques to categorise debtors into groups with similar natures and risks (not based on aging) and using past history about these groups to create provisioning based on objective evidence.

The full impact of this change has not yet been felt.



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