Australian Accounting Standards Board

URGENT ISSUES GROUP

Issues Paper 04/3

(Final, 14/2/06)

Revision of Various UIG Abstracts for 2005

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Urgent Issues Group

Issues Paper

Issue: Revision of Various UIG Abstracts for 2005	Reference UIG 04/3 (Final, 14/2/06) Various Interpretations July 2004 – December 2005

1. REVISION OF ABSTRACTS FOR 2005

The AASB has carried out a program to adopt the IASB's International Financial Reporting Standards by 2005, following a strategic direction given by the Financial Reporting Council. The principal objective is to ensure that, for reporting periods beginning on or after 1 January 2005, for-profit entities applying AASB Accounting Standards will thereby also be complying with IASB Standards. The AASB has now formally made the Australian Standards equivalent to the IASB Standards.

The UIG has a similar task, to revise those UIG Abstracts expected to be retained for application to financial reports from 2005, to ensure consistency with the then applicable AASB Standards. As part of this process, the UIG has also considered the application in Australia of Interpretations of International Standards issued by the IASB's Standing Interpretations Committee (SIC) or the International Financial Reporting Interpretations Committee (IFRIC), which superseded the SIC. The AASB formally approved those corresponding UIG Interpretations in July 2004.

UIG Issues Paper 03/5 "Review of UIG Abstracts for 2005" examined in 2003 each of the Abstracts and each of the SIC Interpretations for application beyond 2005, summarising the planned UIG action in relation to each document, such as withdrawal, replacement by new or revised Accounting Standards, or retention. Issues Paper 04/3 was then prepared to address only those UIG Abstracts which were proposed in Issues Paper 03/5 for possible retention alongside the Australian equivalents to IASB Standards and Interpretations. The Australian equivalents of the SIC Interpretations were addressed separately in UIG Issues Paper UIG/SIC 04/1 "Adoption of Various SIC Interpretations in Australia" (Final, 15/7/04).

Nevertheless, this final version of Issues Paper 04/3 incorporates the analysis in Issues Paper 03/5 for Abstracts that were not proposed to be retained. For completeness, the Appendix also covers the UIG equivalents of the SIC Interpretations.

2. STATUS OF THE UIG'S DISCUSSIONS

The UIG considered Issues Paper 03/5 "Review of UIG Abstracts for 2005" (Initial, 10/6/03), which addressed in detail Abstracts 1 to 12, at its 17 June 2003 meeting. Issues Paper 03/5 Update #1 (24/7/03) covered Abstracts 1 to 53 and was discussed at the UIG meeting on 7 August 2003. Issues Paper 03/5 (Update #2, 11/9/03) was discussed at the UIG meeting on 18 September 2003. A summary of the outcomes at these meetings is included below.

The UIG then addressed the adoption of Australian equivalents to IASB Interpretations as well as other domestic issues, while the AASB was developing its (Pending) Accounting Standards for application from 2005. In-principle decisions on those Standards were necessary in order for the UIG to address the retention and revision of UIG Abstracts.

The UIG discussed Issues Paper 04/3 “Revision of Various UIG Abstracts for 2005” (Initial, 27/4/04) and draft Abstracts (corresponding to Abstracts 4, 31, 39 and 52) at its meeting on 4 May 2004. Issues Paper 04/3, Update #1 (3/6/04), Update #2 (15/7/04), Update #3 (19/8/04), Update #4 (28/9/04), Update #5 (18/11/04), Update #6 (3/2/05) and Update #7 (15/3/05) and more draft Abstracts/Interpretations were discussed at the UIG’s meetings on 10 June, 22 July, 26 August, 5 October and 25 November 2004 and 10 February and 22 March 2005 respectively. A summary of the outcomes at these meetings is included below.

UIG Meeting 17 June 2003

Members discussed the following:

(a) the withdrawal of Abstracts that were expected to be superseded by Australian equivalents of International Standards to be issued prior to 2005. Members noted that the process for the withdrawal of Abstracts was unclear and would need to be addressed with the AASB;

(b) when to withdraw Abstracts that have been superseded by the subsequent issue of Australian Standards or which are no longer relevant, and agreed that they should be withdrawn when identified, subject to providing a period of notice. Members agreed that Abstracts 2, 6, 8 and 12 should be formally withdrawn at the next meeting;

(c) whether, in view of the Year 2005 strategy, to review the applicability of SIC-15 *Operating Leases – Incentives* to Australian reporting entities, in particular in respect of accounting for lease incentives by lessors, and agreed to do so. Members agreed that consideration should be given to issuing as soon as possible SIC Interpretations that were expected to be retained from 2005;

(d) how to deal with cases where Australian circumstances may warrant the retention of differences from the International requirements, and agreed that in such cases the UIG should consult with the AASB; and

(e) noted that in a post-2005 environment the UIG would also continue to develop Abstracts addressing Australian issues, such as those addressing tax consolidation accounting.

UIG Meeting 7 August 2003

Members discussed the following:

(a) the process for withdrawing Abstracts, and agreed that the withdrawal of an Abstract was effective from the date of withdrawal, and that the Abstract remained part of the authoritative literature prior to the date of withdrawal. Members formally withdrew Abstracts 2, 6, 8 and 12, subject to the AASB’s reserve power of veto. Members also agreed to withdraw Abstracts 15, 18, 26, 35 and 48 at the next meeting;

(b) the potential need to retain parts of Abstracts 11, 17 and 40 in some form beyond 2005 for public sector entities;

(c) the potential need for Abstracts which would be retained beyond 2005 to be updated to remain consistent with revised Australian Standards;

(d) the referral of Abstracts to the IFRIC for consideration as the basis for International Interpretations on these issues, and agreed to refer Abstracts 30 and 53; and

(e) all of the remaining Abstracts, and made preliminary decisions on their disposition in relation to the 2005 pronouncements.

UIG Meeting 18 September 2003

Members formally withdrew Abstracts 15, 18, 26, 35 and 48, subject to the AASB's reserve power of veto.

Members discussed a number of Abstracts and updated their preliminary decisions on the disposition of the Abstracts. In particular, members agreed that Abstracts 34 and 54 should be withdrawn when superseded by 2005 Standards, views should be sought from the IFRIC in respect of Abstract 42, Abstract 45 should be retained until an AASB Standard which addresses the issue becomes operative and also should be referred to the IFRIC for consideration as an international Interpretation, and Abstracts 11, 17 and 40 should be retained unless superseded by AASB Standards.

UIG Meeting 4 May 2004

Members discussed the draft Abstracts 1004 and 1031. Members agreed that the requirements in the draft Abstract 1004 were either redundant or in conflict with revised AASB Standards and agreed not to retain the Abstract. Members took the view that Abstract 31 probably should be retained as it would continue to provide useful guidance in one pronouncement, but noted a range of amendments. Draft Abstracts 1039 and 1052 were not discussed, other than being referred to the UIG's tax consolidation sub-committee.

UIG Meeting 10 June 2004

Members approved revised draft Abstracts 1031 (GST) and 1039 (but concerning only the substantive enactment of tax bills in Australia). Members agreed that revised versions of Abstracts 10 and 11 were not required, and that those Abstracts would be superseded by other pronouncements applying after 2005. Members deferred further consideration of draft Abstract 1013 pending developments in relation to combinations by contract under AASB 3 *Business Combinations*. In addition, members agreed that further consideration should be given to whether draft Abstracts 1052 and 1053 would comply with International Standards. Members noted that the matter of whether parent entity financial reports needed to comply with International Standards was expected to be discussed by the AASB at its next meeting, which would have implications for Abstract 1052.

UIG Meeting 22 July 2004

Members approved revised draft Interpretations 1019 and 1030. Members agreed that revised versions of Abstracts 14, 45 and 46 were not required, and that those Abstracts would be superseded by other pronouncements applying after 2005.

Members discussed various issues relating to draft Interpretations 1017, 1040, 1042, 1047, 1051 and 1053. The issues concern consistency with the AASB equivalents of International Standards or whether a draft Interpretation is now covered by those Standards (re 1040 and 1047). Discussion of draft Interpretations 1038 and 1055 was deferred to the next meeting.

UIG Meeting 26 August 2004

Members approved revised draft Interpretations 1038 and 1055, clarifying the transitional requirements upon the initial application of the Interpretations in relation to AASB 1 *First-time Adoption of Australian Equivalents to International Financial Reporting Standards*.

Members discussed various issues relating to draft Interpretations 1017 and 1042, and agreed to consider them further with the benefit of additional views on the issues. Discussion of draft Interpretations 1040, 1047, 1051 and 1053 was deferred to the next meeting.

UIG Meeting 5 October 2004

Members approved revised draft Interpretations 1017 and 1047. Members agreed that a revised version of Abstract 40 was not required as that Abstract would be superseded by other pronouncements applying after 2005. Members also discussed various issues relating to draft Interpretations 1042, 1051 and 1053, and agreed to consider them further at the next meeting with the benefit of additional views on the issues.

UIG Meeting 25 November 2004

Members approved revised draft Interpretation 1042. Members agreed that revised versions of Abstracts 51 and 53 were not required, because Abstract 51 would be superseded by other pronouncements applying after 2005 and Abstract 53 appeared to be inconsistent with other pronouncements applying after 2005. Members also reached a consensus on revised draft Interpretation 1013 (for pre-date-of-transition stapling arrangements), but it was subsequently determined that the issues should be further considered at the UIG's February 2005 meeting.

Members decided to formally withdraw all existing UIG Abstracts with effect for annual reporting periods commencing on or after 1 January 2005, so that they would have no application alongside Australian equivalents to IFRSs. The AASB approved this withdrawal.

UIG Meeting 10 February 2005

Members agreed a Consensus on draft Interpretation 1013 and appointed a sub-committee to finalise the drafting prior to a formal vote to be taken out of session. The Consensus requires one of the entities whose securities are stapled as part of the stapling arrangement to be identified as the parent for the purpose of preparing consolidated financial reports. However, given differences over the treatment of minority interests in particular, it was again agreed subsequent to the meeting that the proposed Interpretation should be reconsidered at the next UIG meeting.

Members also discussed a draft Interpretation 1052 on tax consolidation accounting, and took the view that subsidiaries in the tax consolidated group should recognise and measure tax assets, tax liabilities and tax expense in accordance with AASB 112 *Income Taxes* in their separate financial statements. Members agreed that the tax consolidation sub-committee should continue to develop the draft Interpretation for consideration at the next meeting.

UIG Meeting 22 March 2005

Members approved the revised draft Interpretation 1013, agreeing that the combined financial report of the stapled entities would be the consolidated financial report of the parent under the stapling arrangement for the purposes of AASB 1 and AASB 127 *Consolidated and Separate Financial Statements*. Under this approach, the combined balance sheet presents the

combined equity of the stapled entities without identifying any minority interests. Members noted that the Interpretation would apply only to pre-date-of-transition stapling arrangements and thus would not apply to dual listed entity arrangements.

Members agreed a Consensus on draft Interpretation 1052 and that the tax consolidation sub-committee should finalise the drafting of the Interpretation prior to a formal vote to be taken out of session. The Consensus adopts the view that the transactions of a subsidiary in a tax-consolidated group continue in general to be taxable, so that the subsidiary should continue to recognise tax amounts in accordance with AASB 112. The final Interpretation was approved by vote of the UIG members in May 2005. The AASB then approved it in June 2005.

3. UIG INTERPRETATIONS

The AASB decided in June 2004 that all UIG Abstracts to apply from 2005 will be called UIG Interpretations instead, for consistency with the IASB Interpretations. The draft UIG Interpretations considered by the UIG in conjunction with this Issues Paper were based on the existing Abstracts, with amendments for consistency with the AASB Accounting Standards to apply from 1 January 2005. For example, references in the Abstracts to AASB Standards were updated to the new Standards and requirements in the Abstracts that are now covered by those Standards were deleted. The draft Interpretations also included editorial changes consistent with the UIG's principal general decisions in relation to the adoption of SIC Interpretations in Australia under the 2005 program, as described below.

Preface

A short preface was added to the draft Interpretations, to mirror the approach in the UIG Interpretations equivalent to IASB Interpretations. The preface summarises the main features of the Interpretation, including the initial application requirements, and the changes (if any) from the previous Australian requirements.

Interpretation Numbering

The domestic UIG Interpretations are now numbered from 1001 but so as to reflect their original numbering – for example, Abstract 19 became Interpretation 1019. Thus the Interpretations are not consecutively numbered. This is consistent with the approach of the AASB to numbering its Accounting Standards: purely domestic Standards are numbered from AASB 1001 (the existing numbering series).

AASB Standards numbered in the range 1–99 correspond to IFRS Standards and those numbered in the range 101–199 correspond to IAS Standards. Following this approach, UIG Interpretations numbered in the range 1–99 correspond to IFRIC Interpretations, and those numbered in the range 101–199 correspond to SIC Interpretations. This approach has the advantage of clearly indicating the origin of Interpretations, in the same way as for AASB Standards.

General Editorial Changes

The editorial changes to the text of the Abstracts are consistent with the AASB's approach to the text of its International-equivalent Standards. For example, "statement of financial position" is changed to "balance sheet", and "shall" is used in place of "must".

Application, Operative Date and Materiality

The application and operative date requirements in each Interpretation reflect the AASB's additional application paragraphs for Australian Standards equivalent to International Standards. Australian equivalent Standards are generally applicable to reporting entities preparing financial reports under the *Corporations Act 2001* (Part 2M.3), general purpose financial reports of other reporting entities, and other general purpose financial reports. However, some Standards, such as AASB 101 *Presentation of Financial Statements*, also apply to entities preparing financial reports under Part 2M.3 that are not reporting entities.

The application paragraphs indicate the operative date of 1 January 2005 for Interpretations issued prior to then. All Interpretations prohibit adoption prior to that date. This is consistent with the AASB's approach to implementation of the International-equivalent Standards, as set out in AASB 1 *First-time Adoption of Australian Equivalents to International Financial Reporting Standards*.

The application paragraphs also state that the requirements in the Interpretation apply only where material, in accordance with AASB 1031 *Materiality*. It is appropriate to clarify that materiality applies to Interpretations in the same way as it does to Standards.

All these application and operative date requirements are being combined in AASB Standards under the one heading "Application", whereas previously separate sections and headings were used for application paragraphs and for operative date paragraphs. The Interpretations also follow this approach, thus replacing the UIG's typical heading in Abstracts of "Application and Operative Date".

Transitional Provisions

Transitional provisions are normally not included in the Interpretations, whereas most UIG Abstracts included specific transitional requirements. As the revised Interpretations are to be first applied alongside the adoption of International-equivalent pronouncements for annual reporting periods beginning on or after 1 January 2005, transitional provisions (if any) for the initial application are covered by AASB 1 *First-time Adoption of Australian Equivalents to International Financial Reporting Standards*. The statement on first-time application and comparatives included in the preface of AASB Standards is also included in the preface to each Interpretation, in the Main Features section. The order of the paragraphs in that section is the same as in the new AASB Standards, but without sub-headings due to the brevity of the text.

The basic requirement in AASB 1 is that an entity uses the same accounting policies in its opening balance sheet that complies with Australian equivalents to IFRSs and throughout all periods presented in its first financial report that complies with Australian equivalents to IFRSs. Some specific exceptions are stated in AASB 1.

As stated in AASB 1, paragraph 11, when the accounting policies used in the first "IFRS-equivalent" balance sheet differ from those previously applied by an entity, the resulting adjustments are recognised directly in retained earnings or, if appropriate, another category of equity. This transitional provision applies to the revised Interpretations as at the date of an entity's transition to Australian equivalents to IFRSs. General retrospective transitional provisions are included in AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* for application in other circumstances.

4. APPLICATION OF THE REVISED INTERPRETATIONS

An introductory note in each new AASB Standard states that the Standard is to be read in the context of the other Standards, including AASB 1048 *Interpretation and Application of Standards*, which specifically identifies the UIG Interpretations approved by the AASB. The note adds that in the absence of explicit guidance, AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies. AASB 1048 will be reissued to list additional or revised UIG Interpretations after they are approved by the AASB, ensuring that the Interpretations on issue are incorporated by reference in AASB Standards and thus have legal backing for entities preparing financial reports under the Corporations Act.

Comments on the application in Australia of each of the existing Abstracts are included in the following Appendix. These comments summarise the Abstract and relevant Australian requirements, as well as any major issues. Decisions of the UIG relating to the revision or superseding of the Abstract are also noted.

5. CONSENSUS

The outcome for each UIG Abstract is set out in the Appendix.

The UIG Interpretations and the 2005 AASB Accounting Standards apply to annual reporting periods beginning on or after 1 January 2005, unless otherwise stated.

CONTENTS

UIG ABSTRACTS *Page*

1 Lessee Accounting for Surplus Leased Space Under a Non-Cancellable Operating Lease ... 11
2 Accounting for Non-Vesting Sick Leave ... 12
3 Lessee Accounting for Lease Incentives Under a Non-Cancellable Operating Lease ... 13
4 Disclosure of Accounting Policies for Restoration Obligations in the Extractive Industries ... 14
6 Accounting for Acquisitions – Deferred Settlement of Cash Consideration ... 15
7 Accounting for Non-Current Assets – Derecognition of Intangible Assets and Change in the Basis of Measurement of a Class of Assets ... 16
8 Accounting for Acquisitions – Recognition of Restructuring Costs as Liabilities ... 17
9 Accounting for Acquisitions – Recognition of Acquired Tax Losses ... 18
10 Accounting for Acquisitions – Gold Mining Companies ... 19
11 Accounting for Contributions of, or Contributions for the Acquisition of, Non-Current Assets ... 20
12 Accounting for the Costs of Modifying Computer Software for the Year 2000 ... 21
13 The Presentation of the Financial Report of Entities Whose Securities are “Stapled” ... 22
14 Directors’ Remuneration ... 27
15 Early Termination of Foreign Currency Hedges ... 28
16 Accounting for Share-Buy Backs ... 29
17 Developer and Customer Contributions in Price Regulated Industries ... 30
18 Early Termination of Gold Hedges ... 31
19 The Superannuation Contributions Surcharge ... 32
20 Equity Accounting – Elimination of Unrealised Profits and Losses on Transactions with Associates ... 33
21 Consistency – Different Cost Formulas for Inventories ... 34
22 Accounting for the Buy-Back of No Par Value Shares ... 35
23 Transaction Costs Arising on the Issue or Intended Issue of Equity Instruments ... 36
24 Equity Accounting – Carrying Amount of an Investment in an Associate ... 37
25 Redesignation of Hedges ... 38
26 Accounting for Major Cyclical Maintenance ... 39
27 Designation as Hedges – Sold (Written) Options ... 40
28 Consolidation – Special Purpose Entities ... 41
29 Early Termination of Interest Rate Swaps ... 42
30 Depreciation of Long-Lived Physical Assets, including Infrastructure Assets: Condition-Based Depreciation and Other Related Methods ... 43
31 Accounting for the Goods and Services Tax (GST) ... 44
32 Designation as Hedges – Rollover Strategies ... 45
33 Hedges of Anticipated Purchases and Sales ... 46
34 Acquisitions and Goodwill – First-Time Application of Accounting Standards ... 47
35 Disclosure of Contingent Liabilities ... 48

UIG ABSTRACTS *(cont.)* *Page*

36 Non-Monetary Contributions Establishing a Joint Venture Entity 49
37 Accounting for Web Site Costs 50
38 Contributions by Owners Made to Wholly-Owned Public Sector Entities 51
39 Effect of Proposed Tax Consolidation Legislation on Deferred Tax Balances 52
40 Non-Reciprocal Transfers within an Economic Entity for Monetary or No Consideration 53
41 Fair Value of Equity Instruments Issued as Purchase Consideration 55
42 Subscriber Acquisition Costs in the Telecommunications Industry 56
43 Classification of Financial Instruments with Conversion Options 60
44 Acquisition of In-Process Research and Development 61
45 Subsidiary becomes a Joint Venture Entity or an Associate 62
46 Initial Foreign Currency Translation for Redomiciled Entities 63
47 Professional Indemnity Claims Liabilities in Medical Defence Organisations 64
48 Status of Tax Consolidation Legislation 65
49 Revenue – Barter Transactions involving Advertising Services 66
50 Evaluating the Substance of Transactions involving the Legal Form of a Lease 67
51 Recovery of Unfunded Superannuation of Universities 68
52 Income Tax Accounting under the Tax Consolidation System 69
53 Pre-Completion Contracts for the Sale of Residential Development Properties 70
54 Defined Benefit Superannuation Disclosures by Employers 74
55 Accounting for Road Earthworks 75

SIC INTERPRETATIONS

7 Introduction of the Euro 76
10 Government Assistance – No Specific Relation to Operating Activities 77
12 Consolidation – Special Purpose Entities 78
13 Jointly Controlled Entities – Non-Monetary Contributions by Venturers 79
15 Operating Leases – Incentives 81
21 Income Taxes – Recovery of Revalued Non-Depreciable Assets 82
25 Income Taxes – Changes in the Tax Status of an Entity or its Shareholders 83
27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease 84
29 Disclosure – Service Concession Arrangements 85
31 Revenue – Barter Transactions Involving Advertising Services 86
32 Intangible Assets – Web Site Costs 87

UIG INTERPRETATIONS

A reverse listing by the new UIG Interpretations follows on the next page.

UIG INTERPRETATIONS

Page

Equivalents to SIC Interpretations

107 Introduction of the Euro 76
110 Government Assistance – No Specific Relation to Operating Activities 77
112 Consolidation – Special Purpose Entities [replaces Abstract 28] 78
113 Jointly Controlled Entities – Non-Monetary Contributions by Venturers [replaces Abstract 36] 79
115 Operating Leases – Incentives [replaces Abstract 3] 81
121 Income Taxes – Recovery of Revalued Non-Depreciable Assets 82
125 Income Taxes – Changes in the Tax Status of an Entity or its Shareholders 83
127 Evaluating the Substance of Transactions Involving the Legal Form of a Lease [replaces Abstract 50] 84
129 Disclosure – Service Concession Arrangements 85
131 Revenue – Barter Transactions Involving Advertising Services [replaces Abstract 49] 86
132 Intangible Assets – Web Site Costs [replaces Abstract 37] 87

Local Interpretations

1013 Consolidated Financial Reports in relation to Pre-Date-of-Transition Stapling Arrangements [replaces Abstract 13] 22
1017 Developer and Customer Contributions for Connection to a Price-Regulated Network [replaces Abstract 17] 30
1019 The Superannuation Contributions Surcharge [replaces Abstract 19] 32
1030 Depreciation of Long-Lived Physical Assets: Condition-Based Depreciation and Related Methods [replaces Abstract 30] 43
1031 Accounting for the Goods and Services Tax (GST) [replaces Abstract 31] 44
1038 Contributions by Owners Made to Wholly-Owned Public Sector Entities [replaces Abstract 38] 51
1039 Substantive Enactment of Major Tax Bills in Australia [replaces Abstract 39] 52
1042 Subscriber Acquisition Costs in the Telecommunications Industry [replaces Abstract 42] 56
1047 Professional Indemnity Claims Liabilities in Medical Defence Organisations [replaces Abstract 47] 64
1052 Tax Consolidation Accounting [replaces Abstract 52] 69
1055 Accounting for Road Earthworks [replaces Abstract 55] 75

UIG ABSTRACT 1

LESSEE ACCOUNTING FOR SURPLUS LEASED SPACE UNDER A NON-CANCELLABLE OPERATING LEASE (June 1995)

Summary of Consensus
When a lease is non-cancellable and future payments are for surplus space, a liability and an expense shall be recognised, discounted at the interest rate implicit in the lease and net of any probable sub-lease revenue.

Subsequent Australian Standards
AASB 1044 *Provisions, Contingent Liabilities and Contingent Assets* (October 2001) required the recognition of a provision for an onerous contract to the extent that the present obligation exceeded the unrecognised assets (paragraph 11.1).

2005 Australian Standards
AASB 137 *Provisions, Contingent Liabilities and Contingent Assets* requires a provision to be recognised for the present obligation under an onerous contract (paragraph 66). An onerous contract is defined as a contract for which the unavoidable costs of meeting the obligations under it exceed the economic benefits expected to be received under it. Appendix C accompanying AASB 137 gives examples of the recognition requirements of the Standard. It includes the following example of an onerous contract (Example 8): a lease that cannot be cancelled even though the leased property has been vacated and no re-letting is possible.

Issues
The unit of account under UIG Abstract 1 is the surplus leased space. The unit of account under AASB 1044 (and now AASB 137) is the whole of the lease contract. UIG Abstract 1 therefore is more likely to give rise to an expense because there may be situations where an entity has surplus leased space but, overall, the lease contract is not onerous.

Abstract 1 also makes clear the treatment of probable sub-lease revenue.

UIG Decision
Abstract 1 was not replaced by a UIG Interpretation. It is superseded by AASB 137.

UIG ABSTRACT 2

ACCOUNTING FOR NON-VESTING SICK LEAVE (June 1995)

Summary of Consensus

The liability for accumulated non-vesting sick leave is based on the amount of accumulated sick leave entitlement existing at the measurement date for which it is probable that the entity will be required to sacrifice economic benefits in the future. Last-In-First-Out (LIFO) is the attribution method required to be adopted in determining the liability. This means that unused entitlements at a reporting date give rise to a liability only when it is probable that sick leave taken in the future will exceed entitlements arising in the future.

Subsequent Australian Standards

AASB 1028 *Employee Benefits* (June 2001) incorporated the Consensus in paragraph 4.4.8. It stated that non-vesting accumulated sick leave entitlements are normally measured on a group basis, rather than on the basis of individual employees.

2005 Australian Standards

AASB 119 *Employee Benefits* covers sick leave. Whilst it does not state specifically that the LIFO method is required for compensated absences, it is implied by the opening sentence of paragraph 13 and illustrated in the Example in paragraph 15.

Issue

In measuring the liability, Abstract 2 and AASB 1028 indicate that the unit of measure is the entity's workforce (an average approach). In contrast, AASB 119 indicates that the unit of measure is the individual employee, in that the entity should estimate whether any employees are expected to take more sick leave in a reporting period than the entitlement accruing. A liability is therefore more likely to be recognised under AASB 119.

Example

An entity has ten employees, who are each entitled to five working days of paid sick leave for each year. Each employee has five working days of accumulated sick leave. The entity expects, based on experience which is expected to continue, that eight employees will take an average of four days paid sick leave per year. The remaining two employees will take six days each year.

Year	*0*	*1*	*2*	*3*	*4*
Leave Accruing Per Year		50	50	50	50
Leave Taken (8×4 + 2×6)		44	44	44	44
Accumulated Leave	50	56	62	68	74

Under AASB 119

The entity expects that it will pay an additional ten days of sick leave as a result of the unused entitlement that has accumulated at the end of year 0 (one day each year, for two employees, until the accumulated leave is used up). Therefore, the entity recognises a liability equal to ten days of sick pay.

Under Abstract 2/AASB 1028

The entity expects that, on average, sick leave taken each reporting period is less than the entitlement accruing in that period. Hence, unused entitlements do not give rise to a liability.

UIG Decision

Abstract 2 was withdrawn at the UIG's August 2003 meeting as it had been superseded by AASB 1028. AASB 1028 has now been superseded by AASB 119.

UIG ABSTRACT 3 [*now see* UIG Interpretation 115]

LESSEE ACCOUNTING FOR LEASE INCENTIVES UNDER A NON-CANCELLABLE OPERATING LEASE (August 1995)

Summary of Consensus

A lease incentive is an inducement to enter into a lease, such as up-front cash payments, a rent-free period or a contribution to fit-out or relocation costs. Abstract 3 requires lease incentives under non-cancellable operating leases to be recognised by lessees as liabilities, and specifies two methods by which the liability can be reduced. Abstract 3 does not address the accounting for lease incentives by lessors.

2005 Australian Standards

No Accounting Standard specifically considers this issue.

IASB Requirements

Interpretation SIC-15 *Operating Leases – Incentives* implicitly requires such lease incentives to be recognised by the lessee as a liability. SIC-15 addresses the accounting by both lessees and lessors.

Issues

Allocation to Interest Expense

SIC-15 requires the lessee to recognise the aggregate benefit of incentives as a reduction of rental expense over the lease term. This means that the lease payments are allocated between rental expense and reduction of the lease-incentive liability. In contrast, Abstract 3 allows a choice between this treatment, and allocation of the lease payments between rental expense, reduction of the liability, and interest expense.

Pattern of Allocation

SIC-15 requires the lessee to recognise the aggregate benefit of lease incentives as a reduction of rental expense over the lease term on a straight-line basis, unless another systematic basis is representative of the time pattern of the lessee's benefit from the use of the leased asset. In contrast, Abstract 3 requires the allocation to ensure that rental expense reflects the pattern of benefits derived from the rental property, which includes non-time bases such as units of production, operating hours or distance travelled.

UIG Decision

Abstract 3 was replaced by UIG Interpretation 115 *Operating Leases – Incentives* (July 2004), the Australian equivalent of Interpretation SIC-15.

UIG ABSTRACT 4

DISCLOSURE OF ACCOUNTING POLICIES FOR RESTORATION OBLIGATIONS IN THE EXTRACTIVE INDUSTRIES (August 1995)

Summary of Consensus

Abstract 4 requires reporting entities in the extractive industries to disclose the amount of restoration obligations recognised as a liability in their financial report. It also requires further detailed disclosures concerning the basis of recognition and the measurement of the liability, including whether restoration costs have been discounted and whether costs are based on current or anticipated technology. The disclosures concerning the recognition basis cover whether the total amount of restoration obligations is recognised at the time of a disturbance or on some gradual basis (such as production), and whether changes in estimates are dealt with on a prospective or retrospective basis.

2005 Australian Standards

AASB 137 *Provisions, Contingent Liabilities and Contingent Assets* defines a provision as a liability of uncertain timing or amount and for each class of provision requires disclosure of information about that provision, including an indication of the uncertainties about the amount or timing of outflows and major assumptions about future events. Provisions are to be measured on a discounted basis where the effect is material and should reflect a reasonable expectation of future changes in technology. Under AASB 137, a provision for restoration costs would be required to reflect the extent to which an entity is obliged to rectify damage already caused.

AASB 6 *Exploration for and Evaluation of Mineral Resources* addresses the accounting for exploration and evaluation of mineral resources and proposes disclosure of information identifying and explaining the amounts recognised in the financial statements. However, those disclosure requirements are expressed very generally, and will not apply to restoration obligations arising in respect of other phases of an extractive industry operation, such as development and production.

Issue

Whereas Abstract 4 does not specify the basis for the measurement of restoration obligations, but merely requires disclosure to identify the accounting policies adopted, AASB 137 specifies the measurement basis to be applied to provisions.

UIG Decision

Abstract 4 was not replaced by a UIG Interpretation. It is superseded by AASB 137.

[UIG Abstract 5 *Methods of Amortisation of Goodwill* was withdrawn in August 1996, and hence is not addressed in this Issues Paper.]

UIG ABSTRACT 6

ACCOUNTING FOR ACQUISITIONS – DEFERRED SETTLEMENT OF CASH CONSIDERATION (December 1995)

Summary of Consensus

When settlement of all or any part of the cash consideration given in the acquisition of an asset is deferred, the fair value of the purchase consideration must be determined by discounting the amounts payable in the future to their present value as at the date of acquisition. The discount rate to be used is the rate at which the acquirer could obtain a similar borrowing under comparable terms and conditions.

Subsequent Australian Standards

AASB 1015 / AAS 21 *Acquisitions of Assets* (November 1999) incorporated the Consensus in paragraphs 7.1 to 7.2.5. The discount rate to be used in determining the present value of the cash consideration is specified as the entity's incremental borrowing rate.

2005 Australian Standards

AASB 3 *Business Combinations* (paragraph 26) requires the fair value of any deferred component of the consideration to be determined by discounting the amounts payable to their present value at the date of exchange, taking into account any premium or discount likely to be incurred in settlement. No discount rate is specified.

AASB 116 *Property, Plant and Equipment* addresses the deferred settlement of payment for an item of property, plant and equipment beyond normal credit terms. It also does not specify a discount rate. Paragraph 23 comments that the cost of the item is the cash price equivalent, which implies that the deferred payment amount is effectively discounted at a rate specific to the asset.

Issue

When the entity's incremental borrowing rate differs from the asset-specific discount rate, the acquisition cost will differ under the 2005 Standards in comparison with the requirements of Abstract 6 and the pre-2005 Australian Standards. If the asset is a depreciable asset, the amount of depreciation will also differ.

UIG Decision

Abstract 6 was withdrawn at the UIG's August 2003 meeting as it had been superseded by AASB 1015 and AAS 21. AASB 3 and AASB 116 have now superseded those Standards.

UIG ABSTRACT 7

ACCOUNTING FOR NON-CURRENT ASSETS – DERECOGNITION OF INTANGIBLE ASSETS AND CHANGE IN THE BASIS OF MEASUREMENT OF A CLASS OF ASSETS (March 1996)

Summary of Consensus

Abstract 7 requires that internally generated non-current intangible assets are derecognised only when:

(a) the entity no longer controls future economic benefits embodied in the asset; or

(b) it is not probable that the asset will generate future economic benefits; or

(c) a carrying value for the asset can no longer be reliably determined.

Furthermore, any change in the basis of measurement adopted for a class of non-current assets is required to be treated as a revaluation. Abstract 7 responded to the practice of derecognising intangible assets previously held on a valuation basis when an entity moved to a historical cost basis (because historical cost could not be reliably determined, or because there was no historical cost).

Subsequent Australian Standards

AASB 1041 *Revaluation of Non-Current Assets* (July 2001) specified the accounting for changes in the measurement basis for classes of non-current assets (see section 6). When an entity discontinues the application of the fair value basis to a class of non-current assets, the carrying amounts of the assets become their 'deemed' cost (paragraph 6.3). A change in the measurement basis can be made only if it meets the criteria for a voluntary change in accounting policy.

2005 Australian Standards

AASB 138 *Intangible Assets* includes requirements for the recognition and measurement of intangible assets. If the recognition criteria are not satisfied, an intangible asset is not recognised or is derecognised. Subsequent measurement is based on either the cost model or the revaluation model. If the fair value of a revalued intangible asset can no longer be determined by reference to an active market, the carrying amount of the asset is the most recent revalued amount less subsequent amortisation and impairments (paragraph 82).

AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* allows an entity to change its accounting policies voluntarily only if the change results in the financial report providing reliable and more relevant information.

UIG Decision

Abstract 7 was not replaced by a UIG Interpretation. It was partly superseded by AASB 1041, but has now been fully superseded by AASB 108 and AASB 138.

UIG ABSTRACT 8

ACCOUNTING FOR ACQUISITIONS – RECOGNITION OF RESTRUCTURING COSTS AS LIABILITIES (June 1996)

Summary of Consensus

Abstract 8 requires restructuring costs to be recognised at the date of acquisition of another entity when it is demonstrably committed to the restructuring and a reliable estimate of the liability can be made. The Abstract includes other requirements such as for revisions of estimates and disclosures.

Subsequent Australian Standards

Abstract 8 was superseded by the issue of AASB 1044 *Provisions, Contingent Liabilities and Contingent Assets* (October 2001). Paragraphs 12.3 to 12.6.2 of AASB 1044 addressed provisions for restructuring recognised as part of an acquisition of an entity or operation. AASB 1044 required a provision to be recognised as at the acquisition date if specific criteria were satisfied, such as the main features of the restructuring having been developed into a detailed formal plan within the earlier of three months after the acquisition or the completion of the annual financial report.

2005 Australian Standards

AASB 3 *Business Combinations* (paragraph 41) states that the acquirer allocates the cost of a business combination in relation to liabilities for terminating or reducing the activities of the acquiree only when the acquiree has recognised at the acquisition date a liability for restructuring in accordance with AASB 137 *Provisions, Contingent Liabilities and Contingent Assets*. AASB 137 specifies that a provision for restructuring costs is recognised only when the general liability recognition criteria (present obligation; probable outflow; reliable measurement) are met and the entity has a detailed formal restructuring plan and has raised a valid expectation in those affected that the plan will be carried out (paragraph 72).

AASB 3 also clarifies that when an acquiree's restructuring plan is conditional upon it being acquired in a business combination, rather than a contractual obligation in the event that it is acquired, the plan is not a present obligation of the acquiree (paragraph 43).

UIG Decision

Abstract 8 was withdrawn at the UIG's August 2003 meeting as it had been superseded by AASB 1044. AASB 1044 has now been superseded by AASB 3 and AASB 137 on this issue.

UIG ABSTRACT 9

ACCOUNTING FOR ACQUISITIONS – RECOGNITION OF ACQUIRED TAX LOSSES (June 1996)

Summary of Consensus

Abstract 9 requires the benefits of tax losses acquired in an acquisition to be recognised as an asset as at the date of acquisition if the criteria for recognition in AASB 1020 and AAS 3 *Accounting for Income Tax (Tax-effect Accounting)* (October/November 1989) are satisfied. Where the benefits of tax losses acquired are recognised only subsequently, the amount of goodwill or discount on acquisition is adjusted by the fair value, at the date of acquisition, of the tax loss benefits. The cumulative effect of revisions to goodwill amortisation, or to the depreciation of non-monetary assets in the case of a discount on acquisition, is recognised in profit and loss.

Subsequent Australian Standards

The revised Standards AASB 1020 and AAS 3 *Income Taxes* (December 1999) covered the recognition of acquired tax losses in paragraphs 10.5 to 10.6.2. Where the benefits of tax losses acquired are recognised subsequent to the acquisition, these Standards required adjustments only to goodwill and any related accumulated amortisation. In contrast, Abstract 9 required adjustments to the carrying amount of non-monetary assets or other items if the subsequent recognition of deferred tax assets gave rise to a discount on acquisition, or an increased discount on acquisition.

2005 Australian Standards

AASB 3 *Business Combinations* (paragraph 44) makes clear that a tax benefit is recognised as at the date of acquisition if it satisfies the asset recognition criteria in paragraph 37 (i.e. probable benefits and reliable measurement) at that date. Paragraph 65 deals with the recognition of deferred tax assets after the initial business combination accounting is complete. The subsequent recognition of such deferred tax assets requires adjustments to goodwill but does not allow adjustment of or recognition of any discount on acquisition.

UIG Decision

Abstract 9 was not replaced by a UIG Interpretation. Abstract 9 was superseded by AASB 1020 and AAS 3 (the 1999 Standards), but the application date of those Standards was deferred several times until they were superseded by AASB 112 *Income Taxes*. Abstract 9 continued to be relevant under the 1989 tax-effect accounting Standards AASB 1020 and AAS 3. Abstract 9 has now been fully superseded by AASB 3.

UIG ABSTRACT 10

ACCOUNTING FOR ACQUISITIONS – GOLD MINING COMPANIES (November 1996)

Summary of Consensus

Abstract 10 stresses that the requirements of Accounting Standards AASB 1015 and AAS 21 *Accounting for the Acquisition of Assets* and AASB 1013 and AAS 18 *Accounting for Goodwill* should be applied to the acquisitions of gold mining entities, so that all identifiable assets and liabilities acquired, including exploration assets, are recognised and any goodwill appropriately stated.

Exploration assets acquired are to be accounted for consistently with the requirements of AASB 1022 and AAS 7 *Accounting for the Extractive Industries*. For example, acquired exploration assets are carried forward provided that the rights of tenure are current and the carrying amount is expected to be recovered through successful development or sale, or activities have not reached a stage where a reasonable assessment of the existence of economically recoverable reserves can be made and active and significant operations are continuing. Exploration assets acquired are required to be written off if the area of interest is abandoned, in the period when the decision to abandon is made.

2005 Australian Standards

AASB 3 *Business Combinations* includes requirements relating to the recognition and measurement of all of the acquiree's identifiable assets and liabilities. Under paragraph 37, the acquiree's identifiable assets are recognised at the acquisition date if they satisfy the recognition criteria: probable future economic benefits and reliable measurement. There is no exclusion for certain types of assets. Therefore the Standard clearly applies to exploration and related assets.

AASB 6 *Exploration for and Evaluation of Mineral Resources* addresses the accounting for exploration and evaluation assets, but does not deal with acquisition issues.

UIG Decision

Abstract 10 was not replaced by a UIG Interpretation. It is superseded by AASB 3.

UIG ABSTRACT 11

ACCOUNTING FOR CONTRIBUTIONS OF, OR CONTRIBUTIONS FOR THE ACQUISITION OF, NON-CURRENT ASSETS (December 1996)

Summary of Consensus

Abstract 11 applies to reporting entities which are not subject to Accounting Standards that include requirements on accounting for contributions relating to non-current assets. For example, it does not apply to governments or government departments.

Abstract 11 requires *non-reciprocal* contributions to be recognised as revenue and as an asset, at fair value, when the entity gains control of the contribution. A liability and expense is only recognised when a present obligation to repay a contribution arises.

2005 Australian Standards

AASB 1004 *Contributions*, which applies only to not-for-profit entities, requires income from the contribution of an asset to the entity to be recognised when all of the following conditions are satisfied:

(a) the entity obtains control of the contribution or the right to receive the contribution;
(b) it is probable that the economic benefits comprising the contribution will flow to the entity; and
(c) the amount of the contribution can be measured reliably.

AASB 1004 does not expressly address the recognition of assets, or of liabilities and expenses arising from contributions.

AASB 137 *Provisions, Contingent Liabilities and Contingent Assets* addresses the recognition of provisions, which are liabilities of uncertain timing or amount, and may be relevant to accounting for obligations to repay contributions.

In contrast, AASB 120 *Accounting for Government Grants and Disclosure of Government Assistance*, which applies only to for-profit entities, requires government grants related to assets to be presented in the balance sheet as deferred income with recognition of the grant in the income statement over the life of the asset.

UIG Decision

Abstract 11 was not replaced by a UIG Interpretation. It is superseded by AASB 120, AASB 137 and AASB 1004.

UIG ABSTRACT 12

ACCOUNTING FOR THE COSTS OF MODIFYING COMPUTER SOFTWARE FOR THE YEAR 2000 (April 1997)

Summary of Consensus

Costs relating to modifying internal-use computer software for Year 2000 compatibility must be recognised as an expense when incurred. The costs of modifying such software to overcome Year 2000 design faults does not give rise to an asset because the costs are incurred to maintain the software's existing service capacity (absent the Year 2000 design limitation), not to otherwise enhance the service capacity of the software beyond its existing condition or extend its useful service life.

2005 Australian Standards

Paragraph 4 of AASB 138 *Intangible Assets* indicates that computer software that is an integral part of the related hardware is treated as property, plant and equipment. Software that is not integral is treated as an intangible asset. Under both AASB 138 and AASB 116 *Property, Plant and Equipment*, subsequent software expenditure is recognised as an asset only if the asset recognition criteria are satisfied.

UIG Decision

Abstract 12 was withdrawn at the UIG's August 2003 meeting because the Abstract was no longer required: further Y2K costs were not expected to be incurred. AASB 116 and AASB 138 now apply to computer software costs.

UIG ABSTRACT 13 [*now see* UIG Interpretation 1013]

THE PRESENTATION OF THE FINANCIAL REPORT OF ENTITIES WHOSE SECURITIES ARE "STAPLED" (May 2000)

Summary of Consensus

When the equity securities of two or more legal entities are issued as a "stapled security", a reporting entity is created in the circumstances set out in Abstract 13. Such a reporting entity must prepare a general purpose financial report that combines the financial reports of the individual entities whose securities are stapled. The combined financial report is to be prepared in accordance with particular requirements of Accounting Standard AASB 1024 *Consolidated Accounts* or AAS 24 *Consolidated Financial Reports* and other applicable Standards and UIG Abstracts.

Abstract 13 also addresses the preparation of concise combined financial reports, which are permitted by the *Corporations Act 2001*.

2005 Australian Standards

AASB 3 *Business Combinations* defines a business combination as "the bringing together of separate entities or businesses into one reporting entity." This broad definition covers security staplings (whether security staplings involving pre-existing entities that satisfy the definition of a business in AASB 3, or staplings of new entities). Nevertheless, AASB 3 contains a number of scope exclusions, including combinations by contract alone without the obtaining of an ownership interest (here referred to as "combinations by contract alone"). Security staplings in which none of the combining entities obtain an ownership interest in the other entity (or entities) are covered by this exclusion. Consequently, many security staplings are scoped out of AASB 3. On the other hand, a security stapling in which one of the combining entities does obtain an ownership interest in the other entity (entities) would not be covered by the scope exclusion and would therefore be required to be accounted for under the purchase method in AASB 3.

In April 2004, the IASB issued an Exposure Draft of proposed amendments to its IFRS 3 *Business Combinations* to remove, inter alia, the scope exclusion relating to combinations by contract alone – the ED proposed a 'modified' purchase method to be applied to these transactions. The AASB proposed a similar amendment to its equivalent AASB 3 in ED 133.

At its September 2004 meeting, the IASB decided not to proceed with the proposals in its ED. Instead, IFRS 3 would retain the scope exclusion for combinations by contract alone. As part of its deliberations, the IASB confirmed that security staplings are intended to be captured by this scope exclusion (the reason being that typically these transactions are effected by contract without one of the *combining entities* obtaining an ownership interest in another combining entity). In light of the IASB's decision to reject the proposed amendments to IFRS 3, the AASB also rejected the proposed amendments to AASB 3. Therefore, on transition to Australian equivalents to IFRSs, no Standard will address the issue of accounting for a security stapling in which none of the combining entities obtains an ownership interest in the other combining entity (entities).

Issues

This raises the issues of how (i) security staplings effected prior to the date of transition to Australian equivalents to IFRS should be accounted for on transition, and (ii) security staplings effected after the date of transition should be accounted for under Australian equivalents to IFRSs.

<u>Security staplings effected prior to the date of transition to Australian equivalents to IFRS</u>

Given the broad AASB 3 definition of a business combination, security staplings are classed as business combinations. For a security-stapling business combination, an entity will be able to avail itself of the exemption for past business combinations within AASB 1 *First-Time Adoption of Australian Equivalents to International Financial Reporting Standards*. Under this exemption, an entity can retain the same classification as in its previous Australian GAAP financial report for all business combinations prior to the date of transition (and prior to the date of a business combination that is restated to comply with AASB 3). This means that the approach adopted in UIG Abstract 13 can be retained for security staplings that occurred prior to the date of transition (or prior to another business combination that is restated to comply with AASB 3).

However, under existing stapling arrangements, three sets of financial statements are prepared: single-entity financial statements, consolidated financial statements for each individual stapled entity (if a parent in its own right), and combined financial statements for the reporting entity created under the stapling arrangement. Some commentators express the view that the combined financial statements for the stapled reporting entity cannot be presented as the consolidated financial statements of any of the individual stapled entities since they represent different reporting entities. However, others take the view that the AASB 1 exemption allows the combined financial statements to be treated as the consolidated financial statements of the stapled entity that was the acquirer under the business combination, and that the previous consolidated financial statements are no longer required despite its previous status under company law.

<u>Security staplings effected after the date of transition to Australian equivalents to IFRS</u>

These security staplings give rise to two issues: (i) accounting for the business combination, and (ii) the preparation of consolidated financial reports.

Accounting for the Business Combination

Hierarchy of pronouncements

In light of its decision to retain the scope exclusion for combinations by contract alone in IFRS 3, the IASB stated that entities would need to account for such combinations by applying the requirements in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* on developing accounting policies in the absence of a Standard or an Interpretation that specifically applies to a transaction or event. In accordance with the requirements in IAS 8, management is required to use its judgement in developing and applying an accounting policy that results in information that is relevant to the economic decision-making needs of users and reliable, including that the financial statements reflect the economic substance of the transaction or event.

In making this judgement, management is required to refer to, and consider the applicability of, the requirements and guidance in Standards and Interpretations dealing with similar and related issues, and the definitions, recognition criteria and measurement concepts in the *Framework*. However, the IASB indicated that an entity is precluded from applying a superseded Standard, such as IAS 22 *Business Combinations*. With regard to the use of Standards and Interpretations dealing with similar and related issues, this may result in an entity referring to IFRS 3, despite the scope exclusion. Management is also required to consider the most recent pronouncements of other standard-setting bodies that use a similar

conceptual framework, other accounting literature and accepted industry practice, but only to the extent that these do not conflict either with the guidance in Standards and Interpretations dealing with similar and related issues or with the *Framework*. However, an entity could not adopt a "pooling of interests" method similar to that in the superseded IAS 22.

At its November 2004 meeting, the AASB agreed that the selection of an accounting policy in relation to security staplings would require an application of AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* in a manner consistent with that determined by the IASB.

The application of AASB 108 to security staplings could result in a number of accounting treatments being applied to these transactions, depending on which treatment is considered to provide the most relevant and reliable information. Given the exclusion of a pooling of interests method, it is expected that the approach set out in UIG Abstract 13 would not be permitted for security staplings occurring subsequent to the transition to Australian equivalents to IFRS. The following paragraphs identify a number of accounting treatments that could be applied.

Applying AASB 3

If an entity were to apply the principles in AASB 3, there are potentially two approaches that could be applied. The first approach adopts a strict application of the requirements in AASB 3 to a business combination in which the acquirer obtains control of the acquiree without obtaining an ownership in the acquiree. The second approach acknowledges that the combination is unusual where none of the combining entities obtains an ownership interest in the other entity (entities). Arguably, AASB 3 provides a precedent for combinations in which an acquirer obtains control in the absence of an ownership interest: a reverse acquisition. The second approach therefore applies the principles in a reverse acquisition to a security stapling in which none of the combining entities obtains an ownership interest in the other entity (entities).

Under the first approach, the acquirer recognises the identifiable assets, liabilities and contingent liabilities of the acquiree at their fair values as at the acquisition date. However, given that goodwill is determined by reference to the acquirer's ownership interest in the acquiree, in a security stapling where no ownership interest is obtained the acquirer would not recognise any goodwill.

Under the second approach, analogous to a reverse acquisition, an acquirer is "deemed" to have acquired an ownership interest in the acquiree. This ownership interest is determined by reference to the relative shareholding of the acquirer's original shareholders in the combined entity. This is used to impute a cost of the combination to the acquirer that is then used to apply purchase method accounting. This gives rise to the acquirer recognising goodwill, calculated as the excess of the cost of the combination over the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities.

Applying the Framework

A third approach involves an application of the definitions, recognition criteria and measurement concepts in the *Framework*. This approach relies on the objective of financial reports and the objective of consolidated financial statements. Conceptually, all assets over which control is obtained by virtue of a business combination should be recognised by the acquirer. Therefore, as well as recognising and measuring the identifiable assets, liabilities

and contingent liabilities of the acquiree as at the acquisition date, the acquirer should also recognise the full goodwill as at that date. Since the recognition of goodwill under this approach is on the basis of control rather than an ownership interest in the acquiree, in a security stapling where none of the combining entities obtain an ownership interest in the other entity (entities), this approach would result in full goodwill as at the acquisition date being recognised by the acquirer.

The accounting for a security stapling in which none of the combining entities obtain an ownership interest in the other entity (entities) can result in divergent outcomes, depending on which of these three approaches might be applied.

Consolidated Financial Reports

In accordance with AASB 3, an acquirer is required to be identified for all business combinations. The acquirer is the combining entity that obtains control of the other combining entities. Further, the definition of control within AASB 3 is consistent with the definition of control in AASB 127 *Consolidated and Separate Financial Statements.* Therefore, under one view, the combining entity identified as the acquirer for the purpose of business combination accounting would also be identified as the parent and therefore required to prepare consolidated financial reports.

For stapling arrangements caught by the definition of a business combination in AASB 3, one of the combining entities may effectively be considered to have obtained control of the other combining entity or entities. This is despite the fact that many stapled securities will be scoped out of AASB 3 due to the scope exclusion relating to combinations by contract alone. Therefore, under Australian equivalents to IFRSs, one of the combining entities should be identified as a parent and required to prepare consolidated financial reports.

Assuming all reporting entities arising from stapled securities effected prior to transition continue to be subject to an Interpretation that carries forward the combination basis of Abstract 13, on transition to Australian equivalents to IFRSs different requirements will be applied to security staplings depending on when they took place. Parent entities arising from "old" reporting entities would be preparing consolidated financial reports by combining financial reports in accordance with Interpretation 1013 whereas parent entities arising from "new" security staplings would be preparing consolidated financial reports in accordance with AASB 127.

However, where a parent entity is required to be identified, questions arise as to the recognition and classification of minority interests in its consolidated financial reports. Some commentators are of the view that the recognition of minority interests under AASB 127 cannot be avoided and that the minority interest in the stapling arrangements should be described as "parent entity shareholder's interest" or similarly. Others argue that under the exemption in AASB 1 the classification of the pre-transition stapling arrangement on a combined basis as required by Abstract 13 is retained and, as a result, no minority interest is recognised. They suggest the same approach for post-transition stapling arrangements.

UIG Decision

Abstract 13 was replaced by UIG Interpretation 1013 *Consolidated Financial Reports in relation to Pre-Date-of-Transition Stapling Arrangements* (April 2005), applying only to security staplings effected prior to an entity's date of transition to Australian equivalents to IFRS, in relation to the accounting allowed pursuant to AASB 1. The Interpretation does not apply to arrangements that are generally described as dual listed entities.

UIG Interpretation 1013 applies to annual reporting periods ending on or after 31 December 2005. However, early application is permitted for annual reporting periods beginning on or after 1 January 2005 that end before 31 December 2005, such as a shorter period due to a change in the reporting date.

AASB Interpretation 1002 *Post-Date-of-Transition Stapling Arrangements* was issued in December 2005, to address the accounting for those stapling arrangements. The requirements differ from the approach in Interpretation 1013 as Interpretation 1002 adopts the general principles in AASB 3 and AASB 127. Interpretation 1002 also applies to annual reporting periods ending on or after 31 December 2005, with early application permitted from 1 January 2005. Refer to UIG Issue Summary 05/12 "Post-Date-of-Transition Stapling Arrangements" (Final, 16/12/05) for details of the development of this Interpretation.

Dual listed entities have been addressed in UIG Interpretation 1001 *Consolidated Financial Reports in relation to Pre-Date-of-Transition Dual Listed Company Arrangements* (July 2005), applying to annual reporting periods ending on or after 31 December 2005, with early application permitted from 1 January 2005. Refer to UIG Issues Paper 05/6 "Pre-Date-of-Transition Dual Listed Company Arrangements" (Final, 28/7/05) for details of the development of this Interpretation.

UIG ABSTRACT 14

DIRECTORS' REMUNERATION (June 1997)

Summary of Consensus
The amount of director's remuneration disclosed under Accounting Standards AASB 1017 or AAS 22 *Related Party Disclosures* (February 1997) must include all items within the definition of directors' remuneration in those Standards. Abstract 14 clarifies that the amount of directors' remuneration is based on the cost to the entity or related party. It also identifies specific items to be included in directors' remuneration (such as fringe benefits tax on benefits provided, goods and services provided to the director and other indirect benefits) or to be excluded from directors' remuneration.

2005 Australian Standards
AASB 1046 *Director and Executive Disclosures by Disclosing Entities* was issued in January 2004. As its title suggests, AASB 1046 applies only to disclosing entities, as defined in the *Corporations Act 2001*. Appendix 1 to the Standard incorporated the attachment to Abstract 14 which provided guidance on items included in remuneration.

AASB 124 *Related Party Disclosures* was originally issued in July 2004 but was reissued in December 2005. The 2005 version applies to all entities (whether corporate or non-corporate) other than not-for-profit public sector entities. It supersedes AASB 1046 also, with the disclosure requirements for disclosing entities added to the revised Standard.

UIG Decision
Abstract 14 was not replaced by a UIG Interpretation. It was superseded first by AASB 1046 and then by the revised AASB 124. The revised AASB 124 does not include the guidance of Appendix 1 of AASB 1046.

UIG ABSTRACT 15

EARLY TERMINATION OF FOREIGN CURRENCY HEDGES

(December 2000)

Summary of Consensus

If a foreign currency hedge of an anticipated purchase or sale of goods or services is terminated early, the deferred gains and losses that arose on the foreign currency hedge prior to its termination must:

(a) if the transaction is expected to occur – continue to be deferred and then included in the measurement of the purchase or sale when it takes place; or

(b) if the transaction is no longer expected to occur – be recognised in the profit or loss or other operating statement as at the date of termination.

Abstract 15 was first issued in November 1997.

Subsequent Australian Pronouncements

Abstract 15 was superseded by Abstract 33 *Hedges of Anticipated Purchases and Sales* (May 2000), which applied to early terminations that occurred on or after 2 November 2000. Abstract 33 dealt with the hedging issues more generally. Abstract 15 was then revised to note the limitation on its application.

2005 Australian Standards

See discussion of Abstract 33 below.

UIG Decision

Abstract 15 was withdrawn at the UIG's September 2003 meeting as it had been superseded by UIG Abstract 33 and financial reports that incorporated early terminations of foreign currency hedges that occurred before 2 November 2000 would normally have been completed.

UIG ABSTRACT 16

ACCOUNTING FOR SHARE-BUY BACKS (January 1998)

Summary of Consensus
When shares included in the equity of an entity are bought back by the entity, the equity of the entity must be reduced by the cost of the acquisition of the shares bought back. Abstract 16 also includes disclosure requirements (which apply to both par value and no par value shares) and specific guidance for accounting for share buy backs under a par value regime.

Subsequent Australian Pronouncements
UIG Abstract 22 *Accounting for the Buy-Back of No Par Value Shares* was issued in November 1998 following a change to the Corporations Law that resulted in all company shares being deemed not to have a par value.

2005 Australian Standards
AASB 132 *Financial Instruments: Disclosure and Presentation* (paragraph 33) states that equity instruments reacquired by an entity are deducted from equity. No gain or loss is recognised in profit or loss on the purchase, sale, issue or cancellation of an entity's own equity instruments. In accordance with the *Corporations Act 2001*, Australian companies are required to cancel shares bought back.

UIG Decision
Abstract 16 was not replaced by a UIG Interpretation. It was partly superseded by Abstract 22, but has now been fully superseded by AASB 132.

UIG ABSTRACT 17 [*now see* UIG Interpretation 1017]

DEVELOPER AND CUSTOMER CONTRIBUTIONS IN PRICE REGULATED INDUSTRIES (May 1998)

Summary of Consensus

The Abstract requires an entity receiving developer or customer contributions of non-current assets (usually property, plant and equipment) in return for access to services to recognise the contribution as revenue and as an asset at the fair value of the contributed assets as at the date at which the recipient obtains control of the contribution (which is when the network is extended or modified as required). The Abstract requires cash contributions to be recognised as revenue when the network is extended or modified consistent with the terms of the contribution. Developer and customer contributions for access to services are treated as reciprocal transactions.

2005 Australian Standards

AASB 1004 *Contributions* deals with non-reciprocal contributions but applies only to not-for-profit entities. However, AASB 118 *Revenue* deals with reciprocal transactions and requires revenue from the contribution of an asset to be recognised at its fair value. AASB 118 deals with revenue implications but not other issues arising from contributions. The requirements of AASB 137 *Provisions, Contingent Liabilities and Contingent Assets* would apply in respect of the recognition and measurement of a liability in the event that the terms of the contribution are not met.

AASB 116 *Property, Plant and Equipment* addresses the fair value of items of property, plant and equipment and the recoverable amount of network assets is now covered by AASB 136 *Impairment of Assets*.

UIG Decision

Abstract 17 was replaced by UIG Interpretation 1017 *Developer and Customer Contributions for Connection to a Price-Regulated Network* (November 2004).

The Interpretation does not refer to reciprocal and non-reciprocal transactions in setting out its requirements. It applies only to contributions made by developers or customers to government trading enterprises or private sector utility entities in order to gain access to a service that is subject to price regulation. It does not deal with accounting for the provision of services to the customer following connection to the utility network.

UIG ABSTRACT 18

EARLY TERMINATION OF GOLD HEDGES (December 2000)

Summary of Consensus
If a hedge of an anticipated sale of gold is terminated early, the gains or losses that arose on the termination must:

(a) if the transaction is expected to occur – be deferred and then included in the measurement of the sale when it takes place; or

(b) if the transaction is no longer expected to occur – be recognised in the profit or loss or other operating statement as at the date of termination.

Abstract 18 was first issued in May 1998.

Subsequent Australian Pronouncements
Abstract 18 was superseded by Abstract 33 *Hedges of Anticipated Purchases and Sales* (May 2000), which applied to early terminations that occurred on or after 2 November 2000. Abstract 33 dealt with the hedging issues more generally. Abstract 18 was then revised to note the limitation on its application.

2005 Australian Standards
See discussion of Abstract 33 below.

UIG Decision
Abstract 18 was withdrawn at the UIG's September 2003 meeting as it had been superseded by UIG Abstract 33 and financial reports that incorporated early terminations of gold hedges that occurred before 2 November 2000 would normally have been completed.

UIG ABSTRACT 19 [*now see* UIG Interpretation 1019]

THE SUPERANNUATION CONTRIBUTIONS SURCHARGE (June 1998)

Summary of Consensus

Obligations in respect of the superannuation contributions surcharge (imposed on superannuation providers) give rise to a liability and an expense of a superannuation plan when it is probable that it will be required to make a future sacrifice of economic benefits and the amount of the liability can be measured reliably. The Abstract discusses reliable estimation of the liability. Various disclosures are also required in superannuation plans' financial reports.

As the relevant legislation imposes the superannuation contribution tax on superannuation providers, some argue that the tax is of the nature of an income tax from the perspective of the superannuation fund, because the tax payable is based on the level of contributions from certain classes of member. However, the Abstract does not specify how the expense relating to the liability should be classified.

2005 Australian Standards

No Accounting Standard specifically considers this issue. However, AASB 137 *Provisions, Contingent Liabilities and Contingent Assets* addresses requirements generally for the recognition of provisions, which are liabilities of uncertain timing or amount.

UIG Decision

Abstract 19 was replaced by UIG Interpretation 1019 *The Superannuation Contributions Surcharge* (September 2004).

UIG ABSTRACT 20

EQUITY ACCOUNTING – ELIMINATION OF UNREALISED PROFITS AND LOSSES ON TRANSACTIONS WITH ASSOCIATES (October 1998)

Summary of Consensus

Unrealised profits/losses resulting from "upstream" and "downstream" transactions between an associate and the investor (or its controlled entities or associates) are eliminated to the extent of the investor's interest in the associate. Upstream transactions are, for example, sales of assets from an associate to the investor. Downstream transactions are, for example, sales of assets from the investor to an associate.

2005 Australian Standards

AASB 128 *Investments in Associates* (paragraph 22) requires profits and losses resulting from upstream and downstream transactions between an investor (including its consolidated subsidiaries) and an associate to be recognised by the investor only to the extent of unrelated investors' interests in the associate. Therefore, the investor's share in the associate's profit or loss on these transactions is eliminated.

Issue

Unlike Abstract 20, AASB 128 does not specifically address the elimination of unrealised profits and losses on transactions between associates of an investor.

UIG Decision

Abstract 20 was not replaced by a UIG Interpretation. It is superseded by AASB 128.

UIG ABSTRACT 21

CONSISTENCY – DIFFERENT COST FORMULAS FOR INVENTORIES

(October 1998)

Summary of Consensus

Abstract 21 states that the requirements of Interpretation SIC-1 *Consistency – Different Cost Formulas for Inventories* (December 1997) are applicable to Australian reporting entities. That is, the same cost formula must be adopted for all inventories having similar nature and use to the reporting entity. Therefore, different cost formulas may be justified for inventories with different nature or use. However, a difference in the geographical location of inventories (and in the respective tax rules), by itself, is not sufficient to justify the use of different cost formulas.

2005 Australian Standards

AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* (paragraph 13) states that an entity shall select and apply its accounting policies consistently for similar transactions and events, unless a Standard specifically requires or permits categorisation for which different policies may be appropriate.

More directly, AASB 102 *Inventories* (paragraph 25) states that an entity shall use the same cost formula for all inventories having a similar nature and use to the entity. Different formulas may be justified for inventories with a different nature or use. The point about geographical location is also made in paragraph 26.

UIG Decision

Abstract 21 was not replaced by a UIG Interpretation. It is superseded by AASB 102.

UIG ABSTRACT 22

ACCOUNTING FOR THE BUY-BACK OF NO PAR VALUE SHARES

(November 1998)

Summary of Consensus

When no par value shares included in the equity of an entity are bought back, the equity of the entity must be reduced by the cost of the acquisition of the shares bought back. These requirements are consistent with Abstract 16 *Accounting for Share Buy-Backs*, which applies to shares bought back under a par value regime.

2005 Australian Standards

AASB 132 *Financial Instruments: Disclosure and Presentation* (paragraph 33) states that equity instruments reacquired by an entity are deducted from equity. No gain or loss is recognised in profit or loss on the purchase, sale, issue or cancellation of an entity's own equity instruments. In accordance with the *Corporations Act 2001*, Australian companies are required to cancel shares bought back.

UIG Decision

Abstract 22 was not replaced by a UIG Interpretation. It is superseded by AASB 132.

UIG ABSTRACT 23

TRANSACTION COSTS ARISING ON THE ISSUE OR INTENDED ISSUE OF EQUITY INSTRUMENTS (June 2000)

Summary of Consensus

Transaction costs arising on the issue of equity instruments must be recognised by the issuer directly in equity as a reduction of the proceeds. The Abstract was reissued in June 2000 to add the requirements that any transaction costs in excess of the proceeds must be recognised as an expense, and that where no equity instruments are issued, all the transaction costs must be recognised as an expense.

Subsequent Australian Standards

The requirements in Abstract 23 with respect to transaction costs that do not exceed the proceeds of the equity instruments issued were superseded by section 9 of AASB 1015 and AAS 21 *Acquisitions of Assets* (November 1999): paragraph 9.1 required the transaction costs to be recognised directly in equity. Transaction costs were defined as those costs incurred directly in connection with the issue of the equity instruments and that would not have been incurred had the equity instruments not been issued.

The requirements concerning unsuccessful issues of equity instruments that were added to the revised Abstract in 2000 were not superseded by AASB 1015 and AAS 21.

2005 Australian Standards

AASB 132 *Financial Instruments: Disclosure and Presentation* (paragraph 37) states that the incremental transaction costs of an equity transaction are deducted from equity. Furthermore, the costs of an equity transaction that is abandoned are recognised as an expense.

UIG Decision

Abstract 23 was not replaced by a UIG Interpretation. It is superseded by AASB 132.

UIG ABSTRACT 24

EQUITY ACCOUNTING – CARRYING AMOUNT OF AN INVESTMENT IN AN ASSOCIATE (November 1998)

Summary of Consensus

In applying paragraph 5.13 of AASB 1016 / AAS 14 *Investments in Associates* (August 1998), the carrying amount of an investment in an associate must only include ordinary shares and other financial instruments which satisfy the characteristics of an ownership interest as defined in AASB 1016.

2005 Australian Standards

Abstract 24 was consistent with SIC-20 *Equity Accounting Method – Recognition of Losses* (June 2000). AASB 128 *Accounting for Investments in Associates*, the Australian equivalent of IAS 28 as amended by the IASB in March 2005, paragraph 29, requires an investor to cease recognising its share of an associate's losses when its share equals or exceeds its interest in the associate. The interest in the associate is the carrying amount of the investment in the associate and any other long-term interests in the associate that, in substance, form part of the investor's net investment in the associate. This resulted in a change in Australian practice because, previously, long-term receivables or loans did not usually qualify as an ownership interest in Australia.

UIG Decision

Abstract 24 was not replaced by a UIG Interpretation. It is superseded by AASB 128.

UIG ABSTRACT 25

REDESIGNATION OF HEDGES (December 2000)

Summary of Consensus

If a hedge of an anticipated purchase or sale of goods or services is redesignated as a hedge of another exposure, the gains and losses that arose on the hedge prior to its redesignation must:

(a) if the original hedged transaction is expected to occur as designated – continue to be deferred and then included in the measurement of the original hedged transaction when it takes place; or

(b) if the original hedged transaction is no longer expected to occur as designated – be recognised in the profit or loss or other operating statement as at the date of the redesignation.

Abstract 25 was first issued in April 1999. That version of the Abstract addressed the issue on the basis of whether the original hedged transaction was "expected to occur", rather than "expected to occur as designated". The change was made so that Abstract 25 became consistent with the general requirements in UIG Abstract 33 *Hedges of Anticipated Purchases and Sales*, which was issued in May 2000.

2005 Australian Standards

AASB 139 *Financial Instruments: Recognition and Measurement* addresses hedge accounting. Paragraph 88 states that one of the conditions for hedge accounting is that at the inception of a hedge there is formal designation and documentation of the hedging relationship, including identifying the hedging instrument and the hedged item or transaction.

Hedge accounting is required to be discontinued prospectively when the hedge no longer meets the criteria for hedge accounting or the entity revokes the designation (paragraph 92 re fair value hedges, and paragraph 101 re cash flow hedges). A redesignation of a hedge would require the revocation of the original designation. Paragraph 101 addresses the recognition of the cumulative gain or loss on the hedging instrument that has been recognised directly in equity.

UIG Decision

Abstract 25 was not replaced by a UIG Interpretation. It is superseded by AASB 139.

UIG ABSTRACT 26

ACCOUNTING FOR MAJOR CYCLICAL MAINTENANCE (June 1999)

Summary of Consensus
Abstract 26 prohibits the recognition of a provision for future maintenance anticipated under major cyclical maintenance programs, whether recognised as a liability, or as accumulated depreciation or as a reduction in the carrying amount of the asset.

Subsequent Australian Standards
Example 2.7 of Appendix 2 to AASB 1044 *Provisions, Contingent Liabilities and Contingent Assets* (October 2001) illustrated that no provision was to be recognised for the anticipated expenditure to replace the lining of a furnace or to overhaul aircraft. These examples were consistent with the requirements of Abstract 26, which was effectively superseded by AASB 1044.

2005 Australian Standards
The examples in AASB 1044, which were drawn from Examples 11A and 11B of Appendix C to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, now appear in Appendix C to AASB 137 *Provisions, Contingent Liabilities and Contingent Assets*.

UIG Decision
Abstract 26 was withdrawn at the UIG's September 2003 meeting as it had been superseded by AASB 1044, which in turn was superseded by AASB 137.

UIG ABSTRACT 27

DESIGNATION AS HEDGES – SOLD (WRITTEN) OPTIONS (July 1999)

Summary of Consensus

The Abstract clarifies that a sold option by itself will not qualify for designation as a hedge. The Abstract sets out various circumstances in which an arrangement that involves a sold option (defined in paragraph 7) will qualify for designation as a hedge, for example when the combination of the arrangement and the hedged item provides at least as much potential for gain on the combined position from possible favourable percentage movements in exchange rates or commodity prices as the loss from equivalent unfavourable movements.

2005 Australian Standards

AASB 139 *Financial Instruments: Recognition and Measurement* addresses hedge accounting. Paragraph 88 states that one of the conditions for hedge accounting is that the hedge is expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk.

UIG Decision

Abstract 27 was not replaced by a UIG Interpretation. It is superseded by AASB 139.

UIG ABSTRACT 28 [*now see* UIG Interpretation 112]

CONSOLIDATION – SPECIAL PURPOSE ENTITIES (May 2000)

Summary of Consensus
Abstract 28 requires a special purpose entity (SPE) to be consolidated when the substance of the relationship between an entity and a SPE indicates that the SPE is controlled by that entity. Abstract 28 also provides extensive guidance on whether an entity controls a SPE.

2005 Australian Standards
No Accounting Standard specifically addresses this issue. AASB 127 *Consolidated and Separate Financial Statements* does not refer to SPEs.

IASB Requirements
Interpretation SIC-12 *Consolidation – Special Purpose Entities* (June 1998) provides guidance on whether an entity controls a SPE. It was revised by the IASB in November 2004.

UIG Decision
Abstract 28 was replaced by UIG Interpretation 112 *Consolidation – Special Purpose Entities* (July 2004), the Australian equivalent of Interpretation SIC-12. Interpretation 112 was amended in December 2004, consistent with the SIC-12 amendments.

UIG ABSTRACT 29

EARLY TERMINATION OF INTEREST RATE SWAPS (December 2000)

Summary of Consensus

Abstract 29 addresses the accounting for the early termination of interest rate swaps which are effective as hedges of the financial risks underlying interest receipts or payments associated with recognised assets or liabilities. The gains and losses that arise on the termination of the swap must:

(a) if the hedged anticipated interest transaction is expected to occur as designated – continue to be deferred and included on a systematic basis in the measurement of those anticipated interest transactions when they occur; or

(b) if the hedged anticipated interest transaction is no longer expected to occur as designated – be recognised in the profit or loss or other operating statement as at the date of the termination.

Abstract 29 was first issued in December 1999. That version of the Abstract addressed the issue on the basis of whether the hedged anticipated interest transaction was "expected to occur", rather than "expected to occur as designated". The change was made so that Abstract 29 became consistent with the general requirements in UIG Abstract 33 *Hedges of Anticipated Purchases and Sales*, which was issued in May 2000.

2005 Australian Standards

AASB 139 *Financial Instruments: Recognition and Measurement* addresses hedge accounting. Paragraph 88 states that one of the conditions for hedge accounting is that at the inception of a hedge there is formal designation and documentation of the hedging relationship, including identifying the hedging instrument and the hedged item or transaction.

Hedge accounting is required to be discontinued prospectively when the hedging instrument expires or is sold, terminated or exercised (paragraph 101 re cash flow hedges). Paragraph 101 also addresses the recognition of the cumulative gain or loss on the hedging instrument that has been recognised directly in equity.

UIG Decision

Abstract 29 was not replaced by a UIG Interpretation. It is superseded by AASB 139.

UIG ABSTRACT 30 [*now see* UIG Interpretation 1030]

DEPRECIATION OF LONG-LIVED PHYSICAL ASSETS, INCLUDING INFRASTRUCTURE ASSETS: CONDITION-BASED DEPRECIATION AND OTHER RELATED METHODS (January 2000)

Summary of Consensus

Abstract 30 prohibits the use of condition-based depreciation methods which include any of the following characteristics:

(a) depreciation expense not referable to the depreciable amount of the asset;

(b) lack of consideration of obsolescence, demand or related factors;

(c) failure to separately identify expenditures on maintenance or enhancement which can be reliably measured;

(d) renewals accounting; and

(e) failure to account for major components of a complex asset when this is necessary to reliably determine depreciation expense.

2005 Australian Standards

AASB 116 *Property, Plant and Equipment* does not expressly prohibit condition-based depreciation methods. Paragraph 56 of AASB 116 requires consideration of all of the following factors when determining the useful life of an asset:

(a) expected usage of the asset;

(b) physical wear and tear;

(c) technical or commercial obsolescence, e.g. changes in market demand; and

(d) legal or similar limits on the use of an asset.

UIG Decision

Abstract 30 was replaced by UIG Interpretation 1030 *Depreciation of Long-Lived Physical Assets: Condition-Based Depreciation and Related Methods* (September 2004). The clarification of the unacceptability of condition-based depreciation methods applies equally to AASB 116 as it did to the previous Accounting Standards.

UIG ABSTRACT 31 [*now see* UIG Interpretation 1031]

ACCOUNTING FOR THE GOODS AND SERVICES TAX (GST) (January 2000)

Summary of Consensus
Revenues, expenses and assets are required to be recognised net of GST, with the exception of GST which is not recoverable from the taxation authority. Receivables and payables are stated with the amount of GST included, and GST payable to or recoverable from the taxation authority is recognised in the statement of financial position. Cash flows are to be stated on a gross basis. The GST component of cash flows arising from investing and financing activities that is payable to or recoverable from the taxation authority is classified as an operating cash flow.

The costs of updating existing accounting systems or creating new systems to deal with the GST are to be recognised as an asset only when they enhance future economic benefits.

2005 Australian Standards
AASB 102 *Inventories*, paragraph 11, provides that the cost of purchase of inventories does not include taxes that are subsequently recoverable from taxation authorities. AASB 118 *Revenue* requires that amounts collected on behalf of third parties such as goods and services taxes are excluded from revenue.

AASB 107 *Cash Flow Statements*, paragraphs 18 and 19, requires cash flows to be presented on a gross basis except that some investing and financing cash flows may be presented on a net basis, paragraph 21. AASB 107 does not directly address the classification of cash flows arising from the GST and similar taxes, but provides that taxes on income are classified as cash flows from operating activities unless they can be specifically identified with financing and investing activities.

AASB 116 *Property, Plant and Equipment* and AASB 138 *Intangible Assets* deal with the accounting for costs incurred in relation to computer software, whether classified as tangible assets or as intangible assets.

UIG Decisions
Abstract 31 was replaced by UIG Interpretation 1031 *Accounting for the Goods and Services Tax (GST)* (July 2004).

The requirements relating to the classification of the GST component of financing and investing cash flows are retained in Interpretation 1031. The requirements relating to accounting for the costs of updating existing systems or creating new systems for the GST are not included in Interpretation 1031 because they are now covered by AASB 116 and AASB 138.

UIG ABSTRACT 32

DESIGNATION AS HEDGES – ROLLOVER STRATEGIES (December 2000)

Summary of Consensus
Rollover strategies are strategies that specify the replacement of maturing short-term transactions with successive new short-term transactions as a means of hedging an underlying longer-term exposure to financial risks. Rollover strategies must be accounted for as hedges only when:

(a) it is expected that the strategy will be effective in reducing exposure to the risks intended to be hedged; and

(b) the strategy is designated prospectively as a hedge of the underlying exposure.

Gains and losses arising as transactions under a rollover strategy are deferred and included in the measurement of the hedged anticipated purchase or sale if it is still expected to occur as designated. Otherwise, the gains and losses are recognised as profit and loss.

Abstract 32 was first issued in January 2000. That version of the Abstract addressed the treatment of gains and losses on the basis of whether the hedged anticipated purchase or sale was "expected to occur", rather than "expected to occur as designated". The change was made so that Abstract 32 became consistent with the general requirements in UIG Abstract 33 *Hedges of Anticipated Purchases and Sales*, which was issued in May 2000.

2005 Australian Standards
AASB 139 *Financial Instruments: Recognition and Measurement* addresses hedge accounting. Paragraph 88 states that one of the conditions for hedge accounting is that at the inception of a hedge there is formal designation and documentation of the hedging relationship, including identifying the hedging instrument and the hedged item or transaction.

Paragraphs 91(a) (fair value hedges) and 101(a) (cash flow hedges) state that the replacement or rollover of a hedging instrument into another hedging instrument is not an expiration or termination (which would generally require the hedge accounting to be discontinued) if such replacement or rollover is part of the entity's documented hedging strategy.

UIG Decision
Abstract 32 was not replaced by a UIG Interpretation. It is superseded by AASB 139.

UIG ABSTRACT 33

HEDGES OF ANTICIPATED PURCHASES AND SALES (May 2000)

Summary of Consensus
The Abstract applies to hedges of anticipated purchases or sales of goods or services, including commodities. It sets out the criteria for the application of hedge accounting, addressing hedge effectiveness, prospective designation and occurrence of the anticipated transaction as designated.

The gains and losses that arise on an instrument accounted for as a hedge must be deferred and included in the measurement of the hedged anticipated purchases or sales when they occur. If, subsequent to the inception of the hedge, it becomes probable that some or all of the hedged anticipated purchases or sales will not occur as designated, hedge accounting must be discontinued and the related deferred gains and losses must be recognised immediately in the profit and loss.

Abstract 33 supersedes Abstract 15 *Early Termination of Foreign Currency Hedges* and Abstract 18 *Early Termination of Gold Hedges* in respect of early terminations that occur on or after 2 November 2000.

2005 Australian Standards
AASB 139 *Financial Instruments: Recognition and Measurement*, paragraph 88, sets out the conditions to be met for a hedging relationship to qualify for hedge accounting. For example, at the inception of a hedge there must be formal designation and documentation of the hedging relationship, including identifying the hedging instrument and the hedged item or transaction. The hedge must be expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk, and this is required to be assessed on an ongoing basis. A forecast transaction subject to a cash flow hedge is required to be highly probable.

Paragraphs 89 to 102 specify how hedge accounting is then applied.

UIG Decision
Abstract 33 was not replaced by a UIG Interpretation. It is superseded by AASB 139.

UIG ABSTRACT 34

ACQUISITIONS AND GOODWILL – FIRST-TIME APPLICATION OF ACCOUNTING STANDARDS (June 2000)

Summary of Consensus

Reporting entities applying Australian accounting standards for the first time must apply the purchase method of accounting to all acquisitions of entities or operations (i.e. past acquisitions), where practicable (except for reconstructions within an economic entity under AAS 21 *Acquisitions of Assets* (November 1999)).

2005 Australian Standards

Upon first-time adoption of Australian equivalents to IFRSs, an entity must apply the transition requirements of AASB 1 *First-time Adoption of Australian Equivalents to International Financial Reporting Standards*. Under AASB 1, a first-time adopter may elect not to apply AASB 3 *Business Combinations* retrospectively to past business combinations. However, if a first-time adopter restates any past business combination to comply with AASB 3, they must restate all later business combinations and they are also required to apply AASB 136 *Impairment of Assets* and AASB 138 *Intangible Assets* from that same date.

If a first-time adopter does not apply AASB 3 retrospectively to past business combinations, this brings with it a number of transitional requirements relating to those past business combinations. For example, an entity that does not apply AASB 3 to past business combinations must reclassify any intangible asset acquired in a past business combination as goodwill, if that intangible asset does not qualify for recognition as an asset under AASB 138 [AASB 1, Appendix B, paragraph B2(c)(i)].

UIG Decision

Abstract 34 was not replaced by a UIG Interpretation. It is superseded by AASB 1 and AASB 3.

UIG ABSTRACT 35

DISCLOSURE OF CONTINGENT LIABILITIES (August 2000)

Summary of Consensus
Abstract 35 provides various disclosure requirements for contingent liabilities, in order to retain requirements previously in AASB 1034 / AAS 37 *Financial Report Presentation and Disclosures* (December 1996) until new Standards incorporating contingent liability disclosure requirements were issued and operative. AASB 1034 applied to entities required to prepare financial reports in accordance with Chapter 2M of the Corporations Law.

Subsequent Australian Standards
AASB 1044 *Provisions, Contingent Liabilities and Contingent Assets* (October 2001) included disclosure requirements for contingent liabilities, superseding the requirements in Abstract 35 for reporting entities and financial reports held out to be general purpose financial reports. Some argued that Abstract 35 still applied to non-reporting entities reporting under the Corporations Law, because of its broader scope (paragraph 7), but others took the view that the issue of AASB 1044 effectively removed the requirements for such entities.

2005 Australian Standards
Paragraphs 86-88 of AASB 137 *Provisions, Contingent Liabilities and Contingent Assets*, which superseded AASB 1044, sets out disclosure requirements relating to contingent liabilities.

UIG Decision
Abstract 35 was withdrawn at the UIG's September 2003 meeting as it had been superseded by AASB 1044, which in turn was superseded by AASB 137.

UIG ABSTRACT 36 [*now see* UIG Interpretation 113]

NON-MONETARY CONTRIBUTIONS ESTABLISHING A JOINT VENTURE ENTITY (December 2000)

Summary of Consensus

Abstract 36 requires that under the equity method, unrealised profits and losses arising on a venturer's contribution of non-monetary assets on the establishment of a joint venture are eliminated to the extent of the venturer's ownership interest in the joint venture entity. However, unrealised losses must not be eliminated to the extent that the transaction provides evidence of an impairment of the non-monetary assets.

The Abstract also requires that eliminated unrealised profits and losses must be recognised by the venturer as they are realised by the joint venture entity (i.e. as the contributed assets are consumed or sold) and, if not recognised by then, when the venturer disposes of its investment in the joint venture.

2005 Australian Standards

AASB 131 *Interests in Joint Ventures*, paragraphs 48-50, requires a venturer that sells or contributes assets to a joint venture to reflect the substance of the transaction when recognising any portion of the gain or loss on the transaction. For example, where the significant risks and benefits of ownership are transferred, the venturer recognises only that portion of the gain or loss that is attributable to the interests of the other venturers. However, the venturer recognises the full amount of the loss where the transfer provides evidence of a reduction in the net realisable value of current assets or an impairment loss.

IASB Requirements

Interpretation SIC-13 *Jointly Controlled Entities – Non-Monetary Contributions by Venturers* (November 1998) also addresses the recognition of profits or losses on non-monetary contributions to joint venture entities. However, there are some differences to the requirements of Abstract 36. For example, the full amount of the loss must not be eliminated when the transaction provides evidence of impairment. A gain or loss also is not recognised where an entity contributes non-monetary assets similar to those contributed by other venturers and the transaction lacks commercial substance.

UIG Decision

Abstract 36 was replaced by UIG Interpretation 113 *Jointly Controlled Entities – Non-Monetary Contributions by Venturers* (July 2004), the Australian equivalent of SIC-13.

Paragraph Aus7.1 was added to Interpretation 113 to address the subsequent recognition of unrealised profits and losses on the contribution of non-monetary assets.

UIG ABSTRACT 37 [*now see* UIG Interpretation 132]

ACCOUNTING FOR WEB SITE COSTS (January 2001)

Summary of Consensus

Web site costs can be recognised as an asset only when they satisfy recognition criteria adopted from Statement of Accounting Concepts SAC 4 *Definition and Recognition of the Elements of Financial Statements* (March 1995), and must be amortised from the time the web site is ready for use in accordance with AASB 1021 / AAS 4 *Depreciation* (August 1997). Web site costs incurred in maintaining performance, or to determine the feasibility of approaches to building or extending the site, must be expensed as incurred.

2005 Australian Standards

AASB 116 *Property, Plant and Equipment* does not address web site costs specifically.

IASB Requirements

Interpretation SIC-32 *Intangible Assets – Web Site Costs* (March 2002) is broadly consistent with Abstract 37. However, there are differences in the structure and commentary in these Interpretations. For example:

(a) attached to SIC-32 (though not formally part of the Interpretation) is a detailed table which provides examples of the application of SIC-32; and

(b) Abstract 37 paragraph 15 indicates that planning costs such as documenting the specifications for a web site, including the technology to be adopted in achieving the desired functionality, may qualify for capitalisation. SIC-32 does not address this specific issue, but states generally in paragraph 9(a) that costs incurred in the planning stage should be recognised as an expense.

UIG Decision

Abstract 37 was replaced by UIG Interpretation 132 *Intangible Assets – Web Site Costs* (July 2004), the Australian equivalent of SIC-32.

UIG ABSTRACT 38 [*now see* UIG Interpretation 1038]

CONTRIBUTIONS BY OWNERS MADE TO WHOLLY-OWNED PUBLIC SECTOR ENTITIES (January 2001)

Summary of Consensus

Abstract 38 establishes criteria for determining whether a transfer of assets (or of assets and liabilities) to wholly-owned public sector entities from other entities in the same group of entities satisfies the definition of "contributions by owners" in Accounting Standard AASB 1004 / AAS 15 *Revenue*, based on the rights held directly or indirectly by the controlling government. The equity nature of such a transfer may be indicated by the issuance of equity instruments or a formal agreement that establishes a financial interest in the net assets of the transferee that can be sold, transferred or redeemed. A transfer may also be designated in advance or concurrently by the transferor as a contribution by owners.

The Abstract prohibits redesignation of transfers, and requires the consistent classification of contributions by and distributions to owners. The Abstract also provides extensive discussion and illustrations.

2005 Australian Standards

No Accounting Standard specifically considers this issue. AASB 120 *Accounting for Government Grants and Disclosure of Government Assistance*, which applies only to for-profit entities, explicitly does not deal with government participation in the ownership of entities.

Similarly, AASB 1004 *Contributions*, which applies only to not-for-profit entities, addresses only contributions of assets that are income, and specifically excludes contributions by owners. The Standard continues to include the definition of "contributions by owners" that was in the previous revenue Standards AASB 1004 / AAS 15. The replacement Standard AASB 118 *Revenue* does not address contributions by owners.

Australian Accounting Standard AAS 29 *Financial Reporting by Government Departments* requires contributions by owners and distributions to owners to be recognised directly in equity. AAS 29 includes a definition of contributions by owners that is consistent with the other Standards.

UIG Decision

Abstract 38 was replaced by UIG Interpretation 1038 *Contributions by Owners Made to Wholly-Owned Public Sector Entities* (September 2004).

UIG ABSTRACT 39 [*now see* UIG Interpretation 1039]

EFFECT OF PROPOSED TAX CONSOLIDATION LEGISLATION ON DEFERRED TAX BALANCES (December 2002)

Summary of Consensus

A tax consolidation Bill is to be taken into account in the recognition and measurement of deferred tax assets and liabilities only when the Bill has been enacted or substantively enacted prior to or on the reporting date. A Bill is taken to be substantively enacted when it is tabled and there is majority support for the Bill through both Houses of Parliament. Where commencement of the Bill is linked to another Bill, the first Bill must not be taken to be substantively enacted until the second Bill is substantively enacted.

The Abstract clarifies how the tax consolidation legislation – when relevant to an entity – can affect the deferred tax balances recognised by the entity prior to the implementation of the tax consolidation system by the entity. The Abstract deals with both the 1989 and the 1999 versions of the income tax accounting Standards AASB 1020 / AAS 3.

2005 Australian Standards

While AASB 112 *Income Taxes* requires tax assets and liabilities to be measured based on tax rates and tax laws that have been enacted or substantively enacted by the reporting date, it does not specify conditions for substantive enactment either generally or in relation to linked Bills. Furthermore, AASB 112 does not deal with accounting under a tax consolidation system.

UIG Decisions

Abstract 39 was replaced by UIG Interpretation 1039 *Substantive Enactment of Major Tax Bills in Australia* (July 2004), covering only the substantive enactment requirements. Interpretation 1039 addresses tax Bills in general, since the principal tax consolidation Bills have now been enacted.

Interpretation 1052 *Tax Consolidation Accounting* (June 2005) addresses tax consolidation accounting in general, but pre-implementation effects were not covered.

UIG ABSTRACT 40

NON-RECIPROCAL TRANSFERS WITHIN AN ECONOMIC ENTITY FOR MONETARY OR NO CONSIDERATION (September 2001)

Summary of Consensus

Abstract 40 applies to transfers of an asset, group of assets or net assets with a non-reciprocal component that occur within a group of entities for no consideration or for wholly monetary consideration. The fair value of the transfer less any consideration should be recognised by the acquirer as revenue unless it meets the definition of a contribution by owners in Accounting Standard AASB 1004 / AAS 15 *Revenue*.

The Abstract addresses both non-reciprocal transfers and transfers with reciprocal and non-reciprocal components. It discusses the fair value of a transfer, and distinguishes a reciprocal transfer for zero or minimal consideration from a non-reciprocal transfer where no consideration is given.

2005 Australian Standards

Transfers that are Business Combinations

Under AASB 3 *Business Combinations* (July 2004), if the transfer is in fact a business combination, the contribution would result in a "discount on acquisition", which is normally recognised immediately in profit or loss. However, under paragraph Aus56.1, which applied only to business combinations involving entities/businesses within the same reporting entity, the "discount" is recognised as a gain unless it is appropriately recognised as a contribution by owners (defined as in AASB 1004). The measurement is based on the net fair value of the identifiable assets, liabilities and contingent liabilities.

Furthermore, AASB 3 (July 2004) allowed an entity not reporting under the *Corporations Act 2001* to account for a "reconstruction within a reporting entity" (where it is a business combination, and thus covered by the Standard) based on the carrying amounts of the assets and liabilities involved. This was an Australian-specific option in AASB 3.

However, these Australian-specific requirements in AASB 3 were amended by AASB 2005-6 *Amendments to Australian Accounting Standards* (June 2005) with effect for annual reporting periods beginning on or after 1 January 2006. AASB 3 now does not apply to business combinations involving entities or businesses under common control.

Transfers that are not Business Combinations

AASB 1004 *Contributions*, which applies only to not-for-profit entities, contains the requirements for contributions that were previously in AASB 1004 / AAS 15. Thus it addresses only contributions of assets that are income, specifically excluding those that are contributions by owners. The Standard requires income from the contribution of an asset to be recognised when the entity obtains control of the contribution or the right to receive the contribution, and the recognition criteria are satisfied. The income is measured at the fair value of the contribution and hence the assets contributed are also recognised at fair value.

Various other Standards specify required or permitted initial measurement bases for assets acquired other than through a business combination. For example:

(a) inventories – AASB 102, paragraph Aus10.1, deems the cost of inventories acquired by not-for-profit entities at no cost, or for nominal consideration, to be the current replacement cost;

(b) investments in associates – AASB 128, paragraph 13, specifies that the equity method will be applied, with some exceptions. Initial measurement is at cost. Other Standards specify the measurement bases for those exceptions;

(c) interests in joint ventures – AASB 131, paragraph 38, specifies that the equity method will be applied to investments in jointly controlled entities, with some exceptions;

(d) financial assets and financial liabilities – AASB 139, paragraph 43, requires a financial asset or liability acquired to be measured at fair value plus, in some cases, transaction costs; and

(e) biological assets – AASB 141, paragraph 12, requires biological assets to be measured at fair value less estimated point-of-sale costs, or else at cost where the fair value is not reliably measurable.

UIG Decision

Abstract 40 was not replaced by a UIG Interpretation. It is superseded by AASB 3, AASB 1004 and various other Standards.

UIG ABSTRACT 41

FAIR VALUE OF EQUITY INSTRUMENTS ISSUED AS PURCHASE CONSIDERATION (September 2001)

Summary of Consensus
The fair value of equity instruments issued as purchase consideration should be estimated by reference to the best available market price. Paragraph 5(b) notes that "in some instances, the notional price at which they could be placed in the market is a better indicator of fair value". Paragraph 10 provides general guidance on the determination of this placement price. The Abstract also establishes disclosure requirements for when a market price is not used.

At the 1 October 2002 meeting, the UIG decided not to revise Abstract 41 to achieve greater consistency with Interpretation SIC-28 *Business Combinations – 'Date of Exchange' and Fair Value of Equity Instruments* (December 2001) in respect of the determination of fair values because Abstract 41 reflects the fair value/placement price approach in Accounting Standards AASB 1013 / AAS 18 *Accounting for Goodwill* (June 1996) and AASB 1015 / AAS 21 *Acquisitions of Assets* (November 1999).

2005 Australian Standards
AASB 3 *Business Combinations* is more restrictive than Abstract 41 and SIC-28, allowing departure from a published price only when it has been affected by the thinness of the market (compared with SIC-28, which also allowed departure due to undue price fluctuation).

Paragraphs 48 and 48A of AASB 139 *Financial Instruments: Recognition and Measurement* also provide further guidance on determining the fair value of equity instruments.

UIG Decision
Abstract 41 was not replaced by a UIG Interpretation. It is superseded by AASB 3 and AASB 139.

UIG ABSTRACT 42 [*now see* UIG Interpretation 1042]

SUBSCRIBER ACQUISITION COSTS IN THE TELECOMMUNICATIONS INDUSTRY (October 2001)

Summary of Consensus

The Abstract requires direct subscriber acquisition costs to be capitalised, and subsequently amortised, when they meet the asset definition and recognition criteria in Statement of Accounting Concepts SAC 4 *Definition and Recognition of the Elements of Financial Statements* (March 1995). All other subscriber acquisition costs are to be expensed.

Direct subscriber acquisition costs are directly attributable to establishing specific subscriber contracts, and would not have been incurred had those contracts not been entered into. These costs include commissions paid for obtaining subscriber contracts, subsidised provision of telephones to subscribers and costs of recording subscriber information.

The type of subscriber contract may affect the degree to which the asset recognition criteria are satisfied. At one end of the spectrum are minimum service or fee contracts. Directly attributable costs associated with these types of contracts would normally satisfy the asset recognition criteria. As the level of subscriber commitment in the contract reduces, from exclusive-carrier contracts through preferred-carrier contracts to dial-around contracts, it may be more and more difficult to demonstrate the probable future economic benefit of the subscriber acquisition costs. For these latter types of contracts, it would be necessary to have reliable data for the entity on subscriber usage and lapse rates. The Abstract indicates that it would be rare for the recognition criteria to be satisfied for dial-around contracts.

2005 Australian Standards

No Standard or other Interpretation specifically addresses subscriber acquisition costs. AASB 138 *Intangible Assets* (paragraphs 51 to 67) provides requirements for accounting for internally generated intangible assets. Internally generated intangible assets arising from development (but not research) are recognised as assets when the entity satisfies the recognition criteria in paragraphs 21, 22 and 57. Paragraph 63 prohibits the recognition of expenditure on internally generated brands, mastheads, publishing titles, customer lists and items similar in substance.

AASB 118 *Revenue* is accompanied by an Appendix that illustrates the application of the Standard in a number of commercial situations, including the rendering of services. Example 14 in that Appendix deals with financial service fees, with example 14(b)(iii) explaining that fees charged for managing investments are recognised as revenue as the services are provided. That example goes on to note that incremental costs that are directly attributable to securing an investment contract are recognised as an asset if they can be identified separately and measured reliably and if it is probable that they will be recovered. It adds that the investment management asset is amortised as the entity recognises the related revenue.

Issues

There are different views whether subscriber acquisition costs can be recognised as intangible or other assets, and the following discussion considers the views on this issue.

<u>Does it matter whether the asset is an intangible asset?</u>

AASB 118 and the corresponding IAS 18 *Revenue* support the recognition of an investment management asset without considering whether the asset is an intangible asset and trying to fit its recognition into the intangible assets requirements. Investment management contracts

and telecommunication subscriber contracts are both service contracts. The investment management asset is measured under AASB 118 on the basis of directly attributable (incremental) costs, which is the same basis required in Abstract 42 in relation to subscriber contracts. Both pronouncements require amortisation of the asset in relation to the services provided. The similarities are significant, and sufficient in the view of some commentators, to justify the approach in Abstract 42 without resorting to the intangible asset requirements.

Is there an intangible asset?

The illustrative examples for AASB 3 *Business Combinations* indicate that customer contracts and the related customer relationships acquired in a business combination are intangible assets that meet the contractual-legal criterion for recognition separately from goodwill. By analogy, the internally generated customer contract should be accounted for as a separate asset. The alternative view is that the customer contract established by the entity through its normal business activities may be an intangible asset but not an internally generated one, since an external party is required to come to an agreement in order for there to be a contract. Under either view, the customer contract normally would satisfy the definition of an asset, given control by the entity and probable future economic benefits.

However, some argue that minimum service contracts are monetary assets, which are defined in AASB 138 paragraph 8 as "money held and assets to be received in fixed or determinable amounts of money", rather than intangible assets, which are defined as "identifiable non-monetary assets without physical substance".

Does a customer contract arise from development or commercial activities?

AASB 138 distinguishes research (or the research phase of an internal project) and development (or the development phase). The Standard does not envisage an intangible asset being internally generated from commercial activities or any other activity, other than research or development. Only internally generated intangible assets arising from development (or the development phase) can be recognised under AASB 138, when the recognition criteria are satisfied. Development is defined as:

> "the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services before the start of commercial production or use."

"Development phase" is not defined, but paragraph 52 of AASB 138 indicates that it has a broader meaning than "development" without giving any indication of its scope.

Some argue that a customer contract arises from development because it is the application of research findings (e.g. mobile phone technology) to a plan or design (e.g. the contract) for the production of new services prior to the use of that asset (which occurs after the contract is signed). Others take the view that a customer contract arises from commercial activities rather than from development, because commercial use of the underlying technology will have begun with the negotiation of the first customer contract and the provision of services under contract to further customers typically is not a development activity but rather the extension of existing services. They suggest that the examples of development activities given in paragraph 59 are quite different from customer service contracts.

If customer contracts are intangible assets in an acquisition, they are likely to be characterised as intangible assets when generated internally. There is considerable doubt that they could be classified as arising from development activities. Under this view, AASB 138 would not appear to allow the recognition of any customer contract as an internally generated intangible

asset. However, it may be possible to recognise the asset under the general recognition criteria, if AASB 138 is regarded as not addressing internally generated intangible assets that arise through activities other than research and development.

Would a customer contract satisfy the recognition criteria in AASB 138?

If relevant, AASB 138 requires the recognition of internally generated intangible assets arising from development (but not research) when the entity can demonstrate *all* of the following (paragraph 57):

- technical feasibility of completing the intangible asset so that it will be available for use or sale;
- its intention to complete the intangible asset and use or sell it;
- its ability to use or sell the intangible asset;
- how the intangible asset will generate probable future economic benefits. Among other things, the entity should demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset [satisfying AASB 138 paragraph 21(a)];
- the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset; and
- its ability to measure the expenditure attributable to the intangible asset during its development reliably [satisfying AASB 138 paragraph 21(b)].

Each of the requirements in paragraph 57 would normally be satisfied in relation to a customer contract, since the entity presumably expects to be able to provide the contracted services. As indicated above, demonstrating the requirements of paragraph 57 would satisfy the general recognition requirements of AASB 138 paragraph 21, i.e. probable future economic benefits and reliable measurement. An entity would also have to satisfy paragraph 22 concerning the use of reasonable and supportable assumptions in assessing the probability of future economic benefits under the customer contract.

Does AASB 138 prohibit capitalisation of subscriber acquisition costs?

The Standard states (paragraph 64) that expenditure on internally generated brands, mastheads, publishing titles, customer lists and items similar in substance cannot be distinguished from the cost of developing the business as a whole, and so cannot be recognised as intangible assets. Are subscriber acquisition costs “similar in substance” to expenditure on internally generated brands, mastheads, publishing titles or customer lists?

Brands, mastheads, customer lists etc. do not provide any contractual right to custom from a customer. Similar to a customer list, a dial-around facility places no obligation on the customer to use that facility. In contrast, a minimum services contract does provide for a minimum level of custom from the customer. From this perspective, the level of customer commitment in the related contract may distinguish subscriber contracts from the listed items.

The items listed in paragraph 64 cannot be distinguished from developing the business as a whole because promotional expenditure on those items is expected to benefit a business through a variety of unidentified transactions. However, customer contracts are not similar in substance to these items, because the benefit will be gained from that specific relationship.

Is the provision of a telephone a customer acquisition cost?

Some entities provide customers with a telephone for which no charge (or a reduced charge) is made to the customer. Customer acquisition costs are defined as those incremental costs directly attributable to the customer entering a contract and include credit checking, transaction processing and dealer commissions, if any. Some argue that the cost of providing

telephones and similar equipment are not customer acquisition costs and should be recognised as an expense in the period in which the customer enters the contract and is provided with the telephone because the entity ceases to control that particular asset and it becomes the property of the customer. In that case, there needs to be some reliable basis for classifying any up-front payment by the customer between the amount relating to the telephone and the amount relating to the future services under the contract.

Others argue that the costs of the telephones would not have been incurred by the entity in the absence of a program to encourage customers to enter contracts with the entity for the use of telecommunication services, and take the view that such costs should be recognised as a component of customer acquisition costs.

UIG Decision

Abstract 42 was replaced by UIG Interpretation 1042 *Subscriber Acquisition Costs in the Telecommunications Industry* (December 2004), to clarify that direct subscriber acquisition costs can be recognised as assets when the costs satisfy the asset definition and recognition criteria.

UIG ABSTRACT 43

CLASSIFICATION OF FINANCIAL INSTRUMENTS WITH CONVERSION OPTIONS (November 2001)

Summary of Consensus

Abstract 43 provides guidance on when financial instruments with conversion options are, in substance, financial instruments that mandatorily convert to equity instruments, and so are subject to particular classification rules in AASB 1033 / AAS 33 *Presentation and Disclosure of Financial Instruments* (December 1996). Such a financial instrument is classified by the issuer as a financial liability to the extent that the holder of the instrument is not exposed to changes in the fair value of the issuer's equity instruments. Otherwise, the financial instrument (or component part) is classified as equity.

2005 Australian Standards

AASB 132 *Financial Instruments: Disclosure and Presentation* does not specifically address the issue of mandatorily converting financial instruments. The general requirements in paragraphs 15 and 28 require a non-derivative financial instrument (or its component parts) to be classified as a financial liability, a financial asset or an equity instrument in accordance with its substance.

A financial liability is defined in paragraph 11 to include a liability that is a non-derivative contract that will or may be settled in the issuer's own equity instruments, provided that the issuer is or may be obliged to deliver a variable number of the issuer's equity instruments. In other words, as explained in paragraph 21 of AASB 132, the number of equity instruments to be delivered varies so that the fair value of those instruments equals the amount of the contractual obligation. The holder is not exposed to changes in the fair value of the equity instruments.

Conversely, a contract that will be settled by the entity delivering a fixed number of its equity instruments is an equity instrument (paragraph 22). The holder of such a contract is exposed to changes in the fair value of the issuer's equity instruments.

UIG Decision

Abstract 43 was not replaced by a UIG Interpretation. It is superseded by AASB 132.

UIG ABSTRACT 44

ACQUISITION OF IN-PROCESS RESEARCH AND DEVELOPMENT (March 2002)

Summary of Consensus
Acquired in-process research and development (IPR&D) must be recognised as a research and development asset at the date of acquisition only when the "expected beyond any reasonable doubt to be recoverable" recognition criterion in AASB 1011 / AAS 13 *Accounting for Research and Development Costs* is satisfied.

2005 Australian Standards
AASB 3 *Business Combinations*, paragraph 45, and paragraph 34 of AASB 138 *Intangible Assets* require the recognition of acquired in-process research and development when it meets the definition of an intangible asset (separable or arising from contractual or other legal rights) and its fair value can be measured reliably.

UIG Decision
Abstract 44 was not replaced by a UIG Interpretation. It is superseded by AASB 3 and AASB 138.

UIG ABSTRACT 45

SUBSIDIARY BECOMES A JOINT VENTURE ENTITY OR AN ASSOCIATE

(April 2002)

Summary of Consensus

The Abstract requires the net effect of a change in the status of an investment from a subsidiary to a joint venture entity or an associate to be recognised as a revenue or an expense and specifies the adjustments to be made in the preparation of consolidated financial statements. The Abstract addresses the initial application of the equity method of accounting as if the investee had always been an associate. This approach is consistent with AASB 1016 and AAS 14 *Accounting for Investments in Associates*.

2005 Australian Standards

No Accounting Standard directly addresses this issue. However, AASB 127 *Consolidated and Separate Financial Statements* addresses the loss of control of a subsidiary, including illustrative guidance. AASB 128 *Investments in Associates* requires the equity method of accounting for investments in associates to be applied from the date the investee becomes an associate, but does not include specific guidance on initial application circumstances.

AASB 131 *Interests in Joint Ventures* requires the equity method in accounting for interests in joint venture entities.

UIG Decision

Abstract 45 was not replaced by a UIG Interpretation. It is superseded by AASB 127, AASB 128 and AASB 131.

UIG ABSTRACT 46

INITIAL FOREIGN CURRENCY TRANSLATION FOR REDOMICILED ENTITIES

(April 2002)

Summary of Consensus

When an entity changes its place of domicile and also its reporting currency for the purposes of Accounting Standard AASB 1012 *Foreign Currency Translation*, the Abstract requires the initial translation to the new reporting currency to be carried out as at the beginning of the reporting period in which the entity changes its place of domicile. The financial information as at that date and for the comparative periods is to be translated at the spot rate at the beginning of that reporting period, unless the entity has relevant and reliable historical financial statements (or the information required to prepare them) in the new reporting currency. Any balancing amount in the reporting currency is adjusted against retained profits or accumulated losses.

The transitional provisions in AASB 1012 are then applied, and thereafter the usual foreign currency translation requirements of AASB 1012 are applied by the entity to foreign currency transactions and in consolidating foreign operations.

2005 Australian Standards

AASB 121 *The Effects of Changes in Foreign Exchange Rates* replaces the reporting currency notion used in AASB 1012 with two concepts: an entity's functional currency (the currency of its primary economic environment, and the currency in which it measures the items in its financial report) and the entity's presentation currency (the currency in which it presents its financial report). The Standard defines a foreign currency as a currency other than the functional currency, and addresses the translation of foreign currency transactions to the functional currency, and the translation of functional currency balances and amounts into the presentation currency (if different).

The Standard also addresses a change in an entity's functional currency, requiring the translation procedures applicable to the new functional currency to be applied prospectively from the date of the change. This translation into the new functional currency is required to use the exchange rate at that date for all items. The resulting translated amounts for non-monetary items are treated as their historical cost in the new functional currency.

UIG Decision

Abstract 46 was not replaced by a UIG Interpretation. It is superseded by AASB 121.

UIG ABSTRACT 47 [*now see* UIG Interpretation 1047]

PROFESSIONAL INDEMNITY CLAIMS LIABILITIES IN MEDICAL DEFENCE ORGANISATIONS (June 2002)

Summary of Consensus

Abstract 47 requires medical defence organisations (MDOs) to recognise liabilities in relation to unpaid reported claims and, in specific circumstances, incurred but not reported claims. It addresses both claims-incurred and claims-made indemnity arrangements. This Abstract is based on the view that despite MDOs having the discretion to refuse assistance to their members in relation to a claim, such action is rare and the discretion is considered not to have substance for financial reporting purposes.

2005 Australian Standards

AASB 1023 *General Insurance Contracts* states that insurance contracts covering professional liability and legal expenses are general insurance contracts. AASB 1023, paragraph 5.2.5, also briefly addresses claims-made insurance contracts, noting that the event that gives rise to a claim could have occurred in a previous reporting period and that, for the insurer, claims-made insurance contracts give rise to outstanding claims liabilities and IBNER claims adjustments, but not IBNR claims. However, AASB 1023 does not deal specifically with the "discretionary" professional indemnity arrangements offered by MDOs, although it would cover the insurance policies issued by medical indemnity insurers.

Abstract 47 is consistent with AASB 137 *Provisions, Contingent Liabilities and Contingent Assets* in that a pattern of past practice in assisting members with their claims (regardless of the MDO's formal discretion) gives rise to a constructive obligation requiring a provision to be recognised.

UIG Decision

Abstract 47 was replaced by UIG Interpretation 1047 *Professional Indemnity Claims Liabilities in Medical Defence Organisations* (November 2004).

UIG ABSTRACT 48

STATUS OF TAX CONSOLIDATION LEGISLATION (July 2002)

Summary of Consensus

Abstract 48 clarifies the initial version of Abstract 39 (July 2001) in relation to the series of tax consolidation Bills, stating that the first Bill is not taken to be enacted until the second Bill has been enacted or substantively enacted, since the commencement date of the first Bill was linked to Royal Assent of the second Bill.

Consequently, the first tax consolidation Bill, although passed by Parliament on 28 June 2002, did not become enacted or substantively enacted for financial reporting purposes until the second Bill became so, when it was passed by Parliament on 21 October 2002. Abstract 48 therefore had particular application to reporting periods ending on or after 28 June 2002 but before 21 October 2002.

2005 Australian Standards

While AASB 112 *Income Taxes* requires tax assets and liabilities to be measured based on tax rates (and tax laws) that have been enacted or substantively enacted by the balance sheet date, it does not address the specific issue of linked Bills.

UIG Decision

Abstract 48 was withdrawn at the UIG's September 2003 meeting as it was relevant to certain reporting periods ending in 2002. UIG Interpretation 1039 *Substantive Enactment of Major Tax Bills in Australia* (July 2004) now addresses substantive enactment generally.

UIG ABSTRACT 49 [*now see* UIG Interpretation 131]

REVENUE – BARTER TRANSACTIONS INVOLVING ADVERTISING SERVICES
(August 2002)

Summary of Consensus
A seller cannot reliably measure revenue from a barter transaction at the fair value of advertising services it has *received*. However, a seller can reliably measure revenue at the fair value of the advertising services it has *provided*, by reference only to non-barter transactions that:

(a) involve similar advertising;

(b) occur frequently;

(c) represent a predominant number of transactions and amount when compared with all transactions involving similar advertising to the barter transaction;

(d) involve consideration that has a reliably measurable fair value; and

(e) do not have the same counterparty as in the barter transaction.

2005 Australian Standards
AASB 118 *Revenue* does not directly address barter transactions.

IASB Requirements
Interpretation SIC-31 *Revenue – Barter Transactions Involving Advertising Services* specifically addresses this issue.

UIG Decision
Abstract 49 was replaced by UIG Interpretation 131 *Revenue – Barter Transactions Involving Advertising Services* (July 2004), the Australian equivalent of SIC-31.

UIG ABSTRACT 50 [*now see* UIG Interpretation 127]

EVALUATING THE SUBSTANCE OF TRANSACTIONS INVOLVING THE LEGAL FORM OF A LEASE (September 2002)

Summary of Consensus

Abstract 50 requires that a series of transactions which involve the legal form of a lease is linked and must be accounted for as one transaction when the overall economic effect cannot be understood without reference to the series of transactions as a whole. This is the case, for example, when the transactions are closely interrelated, negotiated as a single transaction, and take place concurrently or in a continuous sequence.

Abstract 50 also provides requirements on how to account for some arrangements that do not meet the definition of a lease under AASB 1008 / AAS 17 *Leases* (October 1998), and provides indicators for assessing the substance of an arrangement.

2005 Australian Standards

AASB 117 *Leases* does not address this issue.

IASB Requirements

Interpretation SIC-27 *Evaluating the Substance of Transactions Involving the Legal Form of a Lease* specifically addresses this issue.

UIG Decision

Abstract 50 was replaced by UIG Interpretation 127 *Evaluating the Substance of Transactions Involving the Legal Form of a Lease* (July 2004), the Australian equivalent of SIC-27.

UIG ABSTRACT 51

RECOVERY OF UNFUNDED SUPERANNUATION OF UNIVERSITIES

(December 2002)

Summary of Consensus

A university that has recognised a liability for its unfunded superannuation obligations recognises an asset for amounts expected to be recovered from third parties only when:

(a) the university controls future economic benefits in respect of the recovery (past practice under existing arrangements with Australian governments is sufficient to indicate control);

(b) it is probable that the recovery will be received; and

(c) the amount of the recovery receivable can be measured reliably.

2005 Australian Standards

AASB 137 *Provisions, Contingent Liabilities and Contingent Assets* does not specifically address the recovery of unfunded superannuation. However, paragraph 53 allows recognition of a reimbursement of expenditure required to settle a provision only when it is "virtually certain" that the reimbursement will be received from another party if the entity settles the obligation. This contrasts with the "probable" threshold for the recognition of a reimbursement in AASB 1044 *Provisions, Contingent Liabilities and Contingent Assets* and in Abstract 51.

In addition, AASB 119 *Employee Benefits* requires the right to reimbursement of expenditure to settle defined benefit obligations to be recognised as an asset only when the reimbursement is virtually certain. Hence this Standard adopts the same threshold as AASB 137.

UIG Decision

Abstract 51 was not replaced by a UIG Interpretation. It is superseded by AASB 119 and AASB 137. Each university must determine in its circumstances whether the recovery of an unfunded superannuation receivable is virtually certain.

UIG ABSTRACT 52 [*now see* UIG Interpretation 1052]

INCOME TAX ACCOUNTING UNDER THE TAX CONSOLIDATION SYSTEM
(May 2003)

Summary of Consensus
Under Abstract 52, the head entity in a tax-consolidated group must recognise current and deferred tax amounts in respect of its own transactions, events and balances as well as those of its wholly-owned subsidiaries. Wholly-owned subsidiaries in a tax-consolidated group generally must not recognise current and deferred tax amounts in respect of their own transactions, events and balances, unless the head entity is in default of its payment obligations. Abstract 52 also addresses the accounting for subsidiaries joining or leaving the tax-consolidated group, tax sharing arrangements, and disclosure requirements.

Abstract 52 deals with tax consolidation accounting under two pairs of Accounting Standards: AASB 1020 / AAS 3 *Accounting for Income Tax (Tax-effect Accounting)* [the 1989 Standards] and AASB 1020 / AAS 3 *Income Taxes* [the 1999 Standards].

2005 Australian Standards
AASB 112 *Income Taxes* supersedes both the 1989 and 1999 Australian Standards, adopting the "balance sheet approach" to accounting for income taxes as in the 1999 Standards. AASB 112 does not deal with accounting under a tax consolidation system, although the preface notes that entities would have to apply any UIG Interpretations relating to tax consolidation.

UIG Decision
Abstract 52 was replaced by UIG Interpretation 1052 *Tax Consolidation Accounting* (June 2005).

Refer to UIG Issue Summary 04/6 "Tax Consolidation Accounting" (Final, 8/8/05) for details of the development of this Interpretation.

UIG ABSTRACT 53

PRE-COMPLETION CONTRACTS FOR THE SALE OF RESIDENTIAL DEVELOPMENT PROPERTIES (April 2003)

Summary of Consensus

Pre-completion sales contracts entered into by an entity carrying out a residential property development project are construction contracts entered into by a contractor and must be accounted for in accordance with Accounting Standard AASB 1009 / AAS 11 *Construction Contracts*, as appropriate.

Where the outcome of the project can be reliably estimated, revenue and expenses must be recognised by applying the percentage of completion method to that proportion of the project represented by the individual units of property sold.

2005 Australian Standards

AASB 111 *Construction Contracts* does not specifically address the issue. AASB 118 *Revenue* deals with the sale of goods and the rendering of services, but not with construction contracts.

Issues

There are different views whether these pre-completion contracts can be treated as construction contracts under IASB Standards (particularly IAS 11) and the Australian equivalents. The IFRIC discussed the UIG's project when Abstract 53 was being developed, and considered at the time that the issue should not be added to its agenda. The IFRIC is currently undertaking a project on combining and segmenting construction contracts. Under Abstract 53, separate contracts with individual purchasers are to be combined for accounting purposes by the developer into a single construction contract for each development project.

Some have expressed the view, which appears to be based on the form of the arrangements rather than their substance, that the pre-completion sales contracts do not qualify for percentage of completion accounting for one or more of the following reasons.

Are Pre-Completion Contracts Construction Contracts?

Abstract 53 is predicated on the contracts being construction contracts in substance (if not in form), as explained in the Abstract.

The alternative view is that they do not satisfy the definition of a construction contract in IAS 11/AASB 111, which define a construction contract as a contract specifically negotiated for the construction of an asset. It is argued that in a pre-completion contract, the purchaser is acquiring an individual completed unit, and is not contracting for the construction of a building. Furthermore, it is argued that the preponderance of factors suggest that the developer/owner is not merely a contractor but is taking the substantial risks of ownership of land, completion of the building and individual units, and sales of all units in most cases and that the ongoing "delivery" that occurs in a typical construction contract for a building on the owner's site does not occur in pre-completion contracts as the developer/owner remains the owner until completion.

The UIG addressed these issues/characteristics in considering whether the contracts were for the sale of goods or the provision of services, or were construction contracts. The UIG agreed that the substance of the contracts clearly was the construction of residential development property, even if they did not involve all the features of a "typical" construction contract. In

doing so the UIG considered that the purchaser did assume risks and benefits of ownership and that the developer had construction and settlement risk. This view is explained in Abstract 53, paragraphs 8 and 9.

Some commentators argue that the definition of "construction contract" or the examples of construction contracts have changed from AASB 1009 / AAS 11 to AASB 111, so that pre-completion contracts are now excluded as construction contracts even if they were included before. They point to the definition in those previous Standards including "(b) a contract relating to the supervision and coordination of the construction activity on a project, including the negotiation of contracts with others for the construction activity; and (c) a contract for architectural, engineering and other services relating to construction activity". They suggest that pre-completion contracts were covered by the type (b) contracts. However, they note that IAS 11/AASB 111 do not include a direct equivalent of type (b) contracts, whereas type (c) contracts have their equivalent in paragraph 5(a): "contracts for the rendering of services which are directly related to the construction of the asset, for example, those for the services of project managers and architects."

Can the Percentage of Completion Method be Applied?

Abstract 53 explains how the percentage of completion method is to be applied to these contracts.

An alternative view is that the pre-completion contracts do not satisfy the criteria in IAS 18/ AASB 118, paragraph 20, for applying the percentage of completion method when they are viewed as providing a service rather than a construction contract. Under this view, it is argued that because a buyer pays a small deposit (e.g. 10% to 20%) it is not probable that the economic benefits associated with the transaction will flow to the entity. It is suggested that while industry views may differ, Abstract 53 does not test the requirements against specific cases or circumstances to demonstrate when these tests would be met (i.e., showing how 100% of the purchase price is collectible based on firmly committed bank finance etc.).

In developing Abstract 53, the UIG considered the impact of the small proportion of the final price paid as a deposit, the practice of using deposit bonds, and the experience of the industry with defaults and withdrawals. The UIG was advised by industry members and auditors that the default rate was very low and that in some cases the contracts were securitised. Abstract 53 recognises that a number of uncertainties need to be resolved before a developer can commence recognising profits under the percentage of completion method (paragraph 15). The Abstract therefore includes the recognition conditions applicable to service contracts as well as construction contracts, such as the reliable estimate of costs, the stage of completion and the contract outcome. It also addresses some particular uncertainties relating to whether a residential property development project will be completed, such as whether the financing has been arranged, whether construction has progressed beyond a preliminary stage and whether amounts receivable under the contracts are recoverable. Having set out the principles involved, it is not then necessary to go on to demonstrate their application to specific cases, unless implementation was considered to be problematic.

Sale of Goods

Another argument opposing Abstract 53 holds that the pre-completion contracts are contracts for the sale of goods (i.e. completed residential units), and that they don't satisfy the revenue recognition conditions relating to the sale of goods in IAS 18/AASB 118, paragraph 14, until the contracts are settled. It is argued that the developer retains continuing managerial involvement to the degree usually associated with ownership, retains effective control over

the asset, and because of the small deposit made by buyers the significant risks and rewards of ownership have not been transferred.

Abstract 53 does not address these recognition requirements because it takes the view that the pre-completion contracts are first and foremost construction contracts, in substance. "Goods" are defined in IAS 18/AASB 118 as including goods produced by the entity for the purpose of sale and goods purchased for resale, such as merchandise purchased by a retailer or land and other property held for resale. This definition also appears in the previous Accounting Standards AASB 1004 / AAS 15 *Revenue*.

<u>Combining Pre-Completion Contracts as One Project Construction Contract</u>

Abstract 53 requires the developer to combine, for accounting purposes, the separate contracts with individual purchasers relating to a development project into a single construction contract for that project. Some commentators have expressed the view that this requirement is inconsistent with the requirements in IAS 11/AASB 111 for combining contracts into one contract. They argue that even where the contracts for individual units are regarded as construction contracts, the criteria for combining individual contracts are not satisfied as they are negotiated with each purchaser separately and not as a single package. IAS 11 and AASB 111, paragraph 9, provide for a contractor to treat a group of construction contracts, whether with a single customer or several customers, as a single construction contract when the group of contracts is negotiated as a single package, the contracts are so closely interrelated that they are in effect part of a single project with an overall profit margin, and the contracts are performed concurrently or in a continuous sequence.

As acknowledged in the Abstract, developers normally assess the economics of a development project as a whole, inclusive of common-area infrastructure costs, rather than only for each individual unit, and negotiate the entire development with planning authorities and financiers. It is argued that in respect of a property development, from the developer's perspective it is necessary to view the construction as a single project:

(a) the contracts are negotiated with individual purchasers within the constraints of the project as a whole, which is tantamount to negotiating the contracts as a single package;
(b) the developer seeks an overall profit margin on the project as a whole; and
(c) the contracts are performed concurrently or in a continuous sequence by the developer as construction of the development proceeds.

<u>Comparison with US GAAP</u>

Further objections to Abstract 53 are raised in relation to perceived differences with US GAAP. FASB Statement of Financial Accounting Standards SFAS 66 *Accounting for Sales of Real Estate* (October 1982) requires use of the percentage of completion method for certain real estate transactions that may be similar to pre-completion sales. But the view is put that the criteria for recognising revenue are "much tighter" than under Abstract 53. The criteria are different in some respects, but each set seeks to address when profits can be reliably measured and recognised.

SFAS 66 distinguishes retail land sales and other real estate sales. In relation to the latter, the Standard states that the percentage of completion method may be used because of the length of the construction period in some cases, such as apartments and condominiums. However, this approach is not applied in respect of the land component. Abstract 53 applies to the whole project, including the land component, but profit is not normally recognised under the

Abstract until the project has progressed beyond a preliminary stage – and then only in proportion to the units that are the subject of sale contracts, based on expected revenue.

IFRIC View

An extract from *IFRIC Update* (November 2004) setting out the view of the IFRIC is reproduced below:

> "The IFRIC considered a question on the application of IAS 11 *Construction Contracts* and IAS 18 *Revenue* that had been referred to it by the UIG. The UIG was concerned that its Abstract 53 *Pre-completion Contracts for the Sale of Residential Development Properties* might not comply with IFRSs.
>
> "The IFRIC tentatively agreed that pre-completion contracts might not meet the definition of construction contracts set out in IAS 11 because the contracts in question are not specifically negotiated for the construction of residential units. Rather, they are agreements for the purchase and sale of such units. In addition, when pre-completion contracts did not meet the definition, the guidance in IAS 18 would prohibit revenue recognition before legal title is transferred, if the risks and rewards of ownership did not pass to the buyer before then.
>
> "The IFRIC tentatively agreed that the issue should not be added to the agenda. The IFRIC noted that the definition of a construction contract in IAS 11 was sufficiently clear on this matter; it did not include typical pre-completion contracts and further guidance was not required. The IFRIC also has a project on its agenda seeking to clarify the criteria for combining and segmenting contracts. The features of pre-completion contracts that might have a relevance to the criteria for combining contracts could be considered as part of that project. The Board is also undertaking a project on revenue recognition, which will address revenue recognition on real estate transactions. The IFRIC agreed that, in the meantime, the guidance in the Appendix to IAS 18 is sufficient to prevent premature recognition of revenue on pre-completion contracts."

UIG Decision

Abstract 53 was not replaced by a UIG Interpretation, on the grounds that the Abstract appeared to be inconsistent with Australian equivalents to IFRSs, particularly in relation to whether the pre-completion contracts are construction contracts under AASB 111 *Construction Contracts*.

It is superseded by AASB 111 and AASB 118 *Revenue* as applicable.

UIG ABSTRACT 54

DEFINED BENEFIT SUPERANNUATION DISCLOSURES BY EMPLOYERS

(August 2003)

Summary of Consensus

Employers that sponsor a defined benefit superannuation plan must disclose:

(a) for each plan and in aggregate, accrued benefits, the net market value of the plan assets and the difference between the two preceding items, and vested benefits – as disclosed in the most recent financial report of the superannuation plan; and

(b) where available, more recent information of the amount of any of the above items, its basis and date of preparation.

Where more recent information provided under (b) includes disclosures about all of those items, determined on a comparable basis and at a common date, an employer need not make the disclosures based on the most recent financial report of the superannuation plan.

2005 Australian Standards

AASB 119 *Employee Benefits* requires an entity to determine the present value of defined benefit obligations and the fair value of any plan assets with sufficient regularity that the amounts recognised in the employer's financial statements do not differ materially from the amounts that would be determined at the reporting date (paragraph 56).

AASB 119 encourages, but does not require, an entity to involve a qualified actuary in the measurement of all material post-employment benefit obligations. For practical reasons, an entity may request a qualified actuary to carry out a detailed valuation of the obligation before the reporting date. Nevertheless, the results of that valuation are updated for any material transactions and other material changes in circumstances (including changes in market prices and interest rates) up to the reporting date (paragraph 57).

Extensive disclosure requirements concerning defined benefit plans are set out in paragraphs 120-125 of AASB 119.

UIG Decision

Abstract 54 was not replaced by a UIG Interpretation. It is superseded by AASB 119.

UIG ABSTRACT 55 [*now see* UIG Interpretation 1055]

ACCOUNTING FOR ROAD EARTHWORKS (May 2004)

Summary of Consensus

The Abstract clarifies that some road earthworks are depreciable and that some road earthworks are non-depreciable, depending on the circumstances. Road earthworks can represent another exception (besides land) to the expectation that all physical assets have limited useful lives, based on the similarity between land and earthworks. An entity is required to identify which of its road earthwork assets are depreciable and which are non-depreciable. The application of a single estimated average useful life across all of an entity's road earthworks, or all of its depreciable road earthworks, is unlikely to result in a reliable depreciation estimate.

Any assessment that certain road earthworks do not have a limited useful life is to be based on engineering reviews of the useful life of the earthworks, including expected physical deterioration and technical obsolescence, and after consideration of commercial obsolescence factors. For example, planned obsolescence for a road would result in a limited useful life. Damage to earthworks through storms or other events may result in the useful life becoming limited, with depreciation then required, or in the need to write off those earthworks.

2005 Australian Standards

AASB 116 *Property, Plant and Equipment* specifies requirements for the depreciation of property, plant and equipment, which encompasses road earthworks as tangible assets. Each significant part of an item of property, plant and equipment is to be depreciated separately, to allow for different useful lives and depreciation methods. Disclosure is required of the useful lives or the depreciation rates used for each class of property, plant and equipment. The Standard states that land has an unlimited useful life, with some exceptions, such as quarries and sites used for landfill.

UIG Decision

Abstract 55 was replaced by UIG Interpretation 1055 *Accounting for Road Earthworks* (September 2004).

INTERPRETATION SIC-7 [*see* UIG Interpretation 107]

INTRODUCTION OF THE EURO (May 1998)

Summary of Consensus

Interpretation SIC-7 specifies that the requirements of International Accounting Standard IAS 21 *The Effects of Changes in Foreign Exchange Rates* regarding the translation of foreign currency transactions and financial statements of foreign operations should be strictly applied to the changeover from national currencies to the Euro. This means:

(a) exchange differences on foreign currency monetary items should be recognised as income or expense immediately, with the exception of anticipatory hedges;

(b) cumulative exchange differences relating to translation of financial statements of foreign entities should be classified as equity and recognised in income or expense only on disposal of the investment; and

(c) exchange differences relating from translation of liabilities denominated in currencies participating in the changeover should not be included in the carrying amount of related assets.

Pre-2005 Australian Requirements

The issues were effectively covered in AASB 1012 *Foreign Currency Translation*: whilst a change in reporting currency by a foreign operation is normally treated as a change in accounting policy (paragraph 7.8), paragraph 7.9 indicates, consistently with SIC-7, that a change to a regional currency such as that resulting from the introduction of the Euro is not a change in accounting policy.

2005 Australian Standards

The requirements of Interpretation SIC-7 were not incorporated into AASB 121 *The Effects of Changes in Foreign Exchange Rates*, the Australian equivalent of IAS 21.

UIG Decision

The UIG approved Interpretation 107 *Introduction of the Euro* (July 2004), the Australian equivalent of SIC-7.

INTERPRETATION SIC-10 [*see* UIG Interpretation 110]

GOVERNMENT ASSISTANCE – NO SPECIFIC RELATION TO OPERATING ACTIVITIES

Summary of Consensus

Government assistance to enterprises meets the definition of government grants in IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*, even if there are no conditions specifically relating to the operating activities of the enterprise other than the requirement to operate in certain regions or industry sectors. Such grants should therefore not be credited directly to equity.

Pre-2005 Australian Requirements

Interpretation SIC-10 was not previously promulgated in Australia because the issues were already dealt with in AAS 27 *Financial Reporting by Local Governments*, AAS 29 *Financial Reporting by Government Departments*, AAS 31 *Financial Reporting by Governments* and AASB 1004 / AAS 15 *Revenue.* These Standards define “contributions” as “non-reciprocal transfers to the entity”, and provide specific requirements and guidance on the recognition of revenue arising from the contribution of assets to an entity.

2005 Australian Standards

The AASB has drawn a distinction between the accounting required by for-profit entities and by not-for-profit entities in respect of government grants. AASB 1004 continues to apply to not-for-profit entities, but AASB 120 *Accounting for Government Grants and Disclosure of Government Assistance* applies to for-profit entities.

The requirements of SIC-10 were not incorporated into AASB 120, the Australian equivalent of IAS 20, or AASB 1004.

UIG Decision

The UIG approved Interpretation 110 *Government Assistance – No Specific Relation to Operating Activities* (July 2004), the Australian equivalent of SIC-10. UIG Interpretation 110 applies when AASB 120 applies, i.e. to for-profit entities.

INTERPRETATION SIC-12 [*see* UIG Interpretation 112]

CONSOLIDATION – SPECIAL PURPOSE ENTITIES

Summary of Consensus

Interpretation SIC-12 requires a special purpose entity (SPE) to be consolidated when the substance of the relationship between an entity and an SPE indicates that the SPE is controlled by that entity. The Interpretation also provides extensive guidance on whether an entity controls an SPE.

Pre-2005 Australian Requirements

The UIG developed Abstract 28 *Consolidation – Special Purpose Entities* on the basis of SIC-12, so it contains essentially the same requirements as the Interpretation.

2005 Australian Standards

AASB 127 *Consolidated and Separate Financial Statements*, the Australian equivalent of IAS 27, does not refer to SPEs.

UIG Decision

The UIG approved Interpretation 112 *Consolidation – Special Purpose Entities* (July 2004), the Australian equivalent of SIC-12. Interpretation 112 superseded UIG Abstract 28.

Interpretation 112 was amended in December 2004, consistent with amendments made to SIC-12.

INTERPRETATION SIC-13 [*see* UIG Interpretation 113]

JOINTLY CONTROLLED ENTITIES – NON-MONETARY CONTRIBUTIONS BY VENTURERS

Summary of Consensus

Interpretation SIC-13 addresses the accounting for gains and losses on non-monetary contributions by a venturer to a jointly-controlled entity and the presentation of any unrealised gains or losses in the consolidated financial statements of the venturer.

Pre-2005 Australian Requirements

UIG Abstract 36 *Non-Monetary Contributions Establishing a Joint Venture Entity* required unrealised profits and losses arising on a venturer's contribution of non-monetary assets to establish a joint venture entity to be eliminated under the equity method of accounting to the extent of the venturer's ownership interest in the joint venture entity. Abstract 36 also required that where such unrealised profits and losses had been eliminated, they must be recognised by the venturer as they were realised by the joint venture entity (as the contributed assets are consumed or sold) and, if not recognised by then, when the venturer disposed of its investment in the joint venture.

Differences

Joint Venture Interests Accounting

Abstract 36 was developed in the context of AASB 1006 / AAS 19 *Interests in Joint Ventures*, which required the equity method of accounting for interests in joint venture entities, whereas IAS 31 *Interests in Joint Ventures* allows a venturer to account for its interest using either the proportionate consolidation method or the equity method of accounting. However, AASB 131, the Australian equivalent of IAS 31, does not permit use of the proportionate consolidation method.

Treatment of Profits or Losses

Unlike SIC-13, Abstract 36 did not include any exceptions to the proportionate recognition of profits or losses on non-monetary contributions. SIC-13 includes three circumstances in which all the profit or loss is to be treated as unrealised.

Abstract 36 required that unrealised losses must not be eliminated to the extent that the transaction provided evidence of impairment. SIC-13 does not address this, because IAS 31.48 requires the full amount of any loss to be recognised when the transaction provides evidence of impairment.

Abstract 36, paragraph 6, specified when a venturer recognises unrealised profits or losses that have been eliminated under the equity method of accounting. This is not dealt with explicitly in SIC-13. However, IAS 31.49 deals with when a venturer can recognise its share of profits or losses of a joint venture where the venturer purchases assets from the joint venture. While IAS 31.49 establishes the principle to be applied for such purchase transactions, Abstract 36 applied the principle to a venturer's contribution (sale) transactions.

Contributions of Similar Assets

Abstract 36 differs from SIC-13 in respect of the treatment of contributions of non-monetary assets similar to those contributed by other venturers. Whereas Abstract 36 required such contributions to be measured at fair value and the recognition of the venturer's proportionate share of the profit or loss, SIC-13 prohibited the recognition of a profit or loss in these circumstances. However, amendments to IAS 16 *Property, Plant and Equipment* and

consequential amendments to SIC-13 removed this difference except in those cases where the contribution transaction lacks commercial substance.

2005 Australian Standards
AASB 131 *Interests in Joint Ventures*, the Australian equivalent of IAS 31, does not address non-monetary contributions by venturers.

UIG Decision
The UIG approved Interpretation 113 *Jointly Controlled Entities – Non-Monetary Contributions by Venturers* (July 2004), the Australian equivalent of SIC-13. Interpretation 113 superseded UIG Abstract 36.

Paragraph Aus7.1 was added to Interpretation 113 to address the subsequent recognition of unrealised profits and losses on the contribution of non-monetary assets.

INTERPRETATION SIC-15 [*see* UIG Interpretation 115]

OPERATING LEASES – INCENTIVES

Summary of Consensus

Interpretation SIC-15 addresses the accounting by both lessees and lessors for lease incentives provided under operating leases. Lease incentives include up-front payments by the lessor to or on behalf of the lessee, reimbursement of lessee costs, and rent-free or reduced-rent periods. The Interpretation treats incentives for the agreement of new or renewed operating leases as an integral part of the net consideration for the use of the leased asset over the lease term. It also addresses costs incurred by a lessee on its own behalf.

Pre-2005 Australian Requirements

UIG Abstract 3 *Lessee Accounting for Lease Incentives Under a Non-Cancellable Operating Lease* required lease incentives to be recognised by the lessee as a liability and was similar to the SIC-15 requirements. However, there are no specific Australian requirements concerning lessor accounting for lease incentives.

Differences

Scope

Abstract 3 did not address accounting by lessors, or accounting by lessees for lease incentives under cancellable operating leases. These are covered by SIC-15.

Allocation of Interest Expense

SIC-15 requires the lessee to recognise the aggregate benefit of incentives as a reduction of rental expense over the lease term. This means that the lease payments are allocated between rental expense and reduction of the lease-incentive liability. In contrast, Abstract 3 allowed a choice between this treatment, and allocation of the lease payments between rental expense, reduction of the liability, and interest.

Pattern of Allocation

SIC-15 requires the lessee to recognise the aggregate benefit of lease incentives as a reduction of rental expense over the lease term on a straight-line basis, unless another systematic basis is representative of the time pattern of the lessee's benefit from the use of the leased asset. In contrast, Abstract 3 required the allocation to ensure that rental expense reflects the pattern of benefits derived from the rental property, which includes non-time bases such as units of production, operating hours or distance travelled.

2005 Australian Standards

The requirements of SIC-15 were not incorporated into AASB 117 *Leases* or AASB 140 *Investment Property*, the Australian equivalents of IAS 17 and IAS 40.

UIG Decision

The UIG approved Interpretation 115 *Operating Leases – Incentives* (July 2004), the Australian equivalent of SIC-15. Interpretation 115 superseded UIG Abstract 3.

INTERPRETATION SIC-21 [*see* UIG Interpretation 121]

INCOME TAXES – RECOVERY OF REVALUED NON-DEPRECIABLE ASSETS

Summary of Consensus

The deferred tax liability or asset that arises from the revaluation of a non-depreciable asset under IAS 16 *Property, Plant and Equipment* is measured based on the tax consequences that would follow from recovery of the carrying amount of the asset through sale, regardless of the basis of measuring the carrying amount of that asset. Accordingly, if the tax law specifies a tax rate applicable to the taxable amount derived from the sale of an asset that differs from the tax rate applicable to the taxable amount derived from using an asset, the former rate is applied in measuring the deferred tax liability or asset related to a non-depreciable asset.

Pre-2005 Australian Requirements

Interpretation SIC-21 was not previously promulgated in Australia because the issue had been addressed in AASB 1020 / AAS 3 *Income Taxes* (1999). Under those Standards, the measurement of deferred tax liabilities and assets was required to reflect the tax consequences that would follow from the manner in which the management or governing body expected, as at the reporting date, to recover or settle the carrying amount of its assets and liabilities (paragraph 4.7). Paragraph 8.1.3 stated the view adopted in the Standards that the carrying amount of a non-depreciable asset such as land would be recovered only through sale. Therefore a tax rate applicable to the sale of such an asset would be applied.

Furthermore, the issue did not arise under the 1989 Standards AASB 1020 / AAS 3 *Accounting for Income Tax (Tax-Effect Accounting)* because revaluation adjustments through reserves were not tax-effected.

2005 Australian Standards

The requirements of SIC-21 were not incorporated into AASB 112 *Income Taxes*, the Australian equivalent of IAS 12.

UIG Decision

The UIG approved Interpretation 121 *Income Taxes – Recovery of Revalued Non-Depreciable Assets* (July 2004), the Australian equivalent of SIC-21.

INTERPRETATION SIC-25 [*see* UIG Interpretation 125]

INCOME TAXES – CHANGES IN THE TAX STATUS OF AN ENTITY OR ITS SHAREHOLDERS

Summary of Consensus

The current and deferred tax consequences of a change in tax status should be included in net profit or loss for the period, unless those consequences relate to transactions and events that result in a direct credit or charge to the recognised amount of equity, in which case the tax consequences should be recognised directly in equity.

Pre-2005 Australian Requirements

AASB 1020 / AAS 3 *Accounting for Income Tax (Tax-Effect Accounting)* (1989) did not address this issue specifically. Tax amounts were not recognised directly in equity.

AASB 1020 / AAS 3 *Income Taxes* (1999) paragraph 11.1 required any adjustments resulting from an entity changing its tax status to be recognised in accordance with the regular requirements of the Standard. Paragraph 10.2 required that taxation amounts be directly debited or credited to equity when they related to amounts recognised directly in equity, subject to some exceptions in paragraph 10.4.

Therefore, Interpretation SIC-25 was not previously promulgated in Australia.

2005 Australian Standards

The requirements of SIC-25 were not incorporated into AASB 112 *Income Taxes*, the Australian equivalent of IAS 12.

UIG Decision

The UIG approved Interpretation 125 *Income Taxes – Changes in the Tax Status of an Entity or its Shareholders* (July 2004), the Australian equivalent of SIC-25.

INTERPRETATION SIC-27 [*see* UIG Interpretation 127]

EVALUATING THE SUBSTANCE OF TRANSACTIONS INVOLVING THE LEGAL FORM OF A LEASE

Summary of Consensus

Interpretation SIC-27 requires a series of transactions which involve the legal form of a lease to be treated as linked and accounted for as one transaction when the overall economic effect of the transactions cannot be understood without reference to the series of transactions as a whole.

SIC-27 also provides requirements on how to account for some arrangements that do not meet the definition of a lease under IAS 17 *Leases*, and provides indicators for assessing the substance of an arrangement.

Pre-2005 Australian Requirements

The UIG developed Abstract 50 *Evaluating the Substance of Transactions involving the Legal Form of a Lease* on the basis of SIC-27, so it contains essentially the same requirements.

2005 Australian Standards

The requirements of SIC-27 were not incorporated into AASB 117 *Leases*, the Australian equivalent of IAS 17.

UIG Decision

The UIG approved Interpretation 127 *Evaluating the Substance of Transactions Involving the Legal Form of a Lease* (July 2004), the Australian equivalent of SIC-27. Interpretation 127 superseded UIG Abstract 50.

INTERPRETATION SIC-29 [*see* UIG Interpretation 129]

DISCLOSURE – SERVICE CONCESSION ARRANGEMENTS

Summary of Consensus
Service concession operators and providers (grantors) should disclose a range of information each reporting period, including a description of the arrangement, significant terms of the arrangement that may affect future cash flows, the nature and extent of rights and obligations under the service concession arrangement, and changes in the arrangement during the period.

Pre-2005 Australian Requirements
SIC-29 was not promulgated in Australia because disclosure requirements were included in the scope of the AASB's project on service concession arrangements.

2005 Australian Standards
The requirements of SIC-29 were not incorporated into any Australian Standard, as the IASB retained the Interpretation.

UIG Decision
The UIG approved Interpretation 129 *Disclosure – Service Concession Arrangements* (July 2004) , the Australian equivalent of SIC-29.

INTERPRETATION SIC-31 [*see* UIG Interpretation 131]

REVENUE – BARTER TRANSACTIONS INVOLVING ADVERTISING SERVICES

Summary of Consensus

A seller cannot reliably measure revenue from a barter advertising transaction at the fair value of advertising services it has *received*. However, a seller can reliably measure revenue at the fair value of the advertising services it has *provided* in a barter transaction, by reference only to non-barter transactions that:

(a) involve similar advertising;

(b) occur frequently;

(c) represent a predominant number of transactions and amount when compared with all transactions involving similar advertising to the barter transaction;

(d) involve consideration that has a reliably measurable fair value; and

(e) do not have the same counterparty as in the barter transaction.

Pre-2005 Australian Requirements

The UIG developed Abstract 49 *Revenue – Barter Transactions involving Advertising Services* on the basis of SIC-31, so it contains essentially the same requirements.

2005 Australian Standards

The requirements of SIC-31 were not incorporated into AASB 118 *Revenue*, the Australian equivalent of IAS 18.

UIG Decision

The UIG approved Interpretation 131 *Revenue – Barter Transactions Involving Advertising Services* (July 2004), the Australian equivalent of SIC-31. Interpretation 131 superseded UIG Abstract 49.

INTERPRETATION SIC-32 [*see* UIG Interpretation 132]

INTANGIBLE ASSETS – WEB SITE COSTS

Summary of Consensus

A web site arising from internal development is an internally generated intangible asset subject to the requirements of IAS 38 *Intangible Assets*. Web site costs incurred in the planning stage should be expensed when incurred. Costs incurred in the other stages of development of a web site should be expensed when incurred if the web site is solely or primarily for promoting and advertising the entity's own products and services. Otherwise, such costs should be included in the web site asset when they can be directly attributed to preparing the web site for its intended use. The web site must be capable of generating probable future economic benefits in order for any costs to be recognised as an intangible asset.

Costs incurred in the operating stage of the web site are expensed unless the general asset recognition criteria are satisfied.

Pre-2005 Australian Requirements

UIG Abstract 37 *Accounting for Web Site Costs* and Interpretation SIC-32 address the same issues. The two pronouncements are broadly consistent, however there are differences in the structure and commentary of the Interpretations, particularly flowing from SIC-32 being an Interpretation of IAS 38. In addition, Abstract 37 (paragraph 15) states that it may be appropriate to capitalise some planning stage costs, such as documenting the specifications of a web site (including the technology to be adopted in achieving the desired functionalities). In contrast, SIC-32 states that all expenditure incurred in the planning stage should be expensed when incurred. The Interpretation describes the planning stage as including the definition of objectives and specifications.

2005 Australian Standards

The requirements of SIC-32 were not incorporated into AASB 138 *Intangible Assets*, the Australian equivalent of IAS 38.

UIG Decision

The UIG approved Interpretation 132 *Intangible Assets – Web Site Costs* (July 2004), the Australian equivalent of SIC-32. Interpretation 132 superseded UIG Abstract 37.