Department of Treasury and Finance

1 Treasury Place
GPO Box 4379
Melbourne Victoria 3001
Telephone: (03) 9651 5111
Facsimile: (03) 9651 2062
DX 210759

Reference: RMS10/11568
Contact: Peter Gibson
Telephone: 02 6215 3551
e-mail: Peter.Gibson@finance.gov.au

23 DEC 2010

Mr Kevin Stevenson
Chairman
Australian Accounting Standards Board
PO Box 204
Collins Street West Victoria 8007
AUSTRALIA
E-mail: standard@aasb.gov.au

Dear Mr Stevenson

AASB Invitation to Comment 24: Request for Views on Effective Dates and Transition Methods

The Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC) welcomes the opportunity to respond to the Australian Accounting Standards Board Invitation to Comment 24: *Request for views on Effective Dates and Transition Met0068ods.*

Overall, HoTARAC considers the new Leases standard will have the greatest impact as well as requiring the most time to learn about, train, plan for, and implement. HoTARAC believes Fair Value Measurement, Revenue from Contracts with Customers and Financial Instruments will have a moderate impact on entities, with the remaining new/amended IFRSs having a low impact.

The majority of HoTARAC members support the single date approach to implementing the new standards. The primary reason is due to the potential complexity in implementing a number of fundamentally interrelated projects. A minority of HoTARAC members support the sequential approach as it allows entities to more cost-effectively manage the various changes over a long period of time.

While HoTARAC generally supports the principle of early adoption, the majority of HoTARAC members believe that due to the significant interdependencies of the new IFRSs and the potential to create prolonged periods where comparability is impaired, entities should not in this instance be given the option to early adopt. A minority of HoTARAC members support the option of early

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adoption for new and amended standards provided that new and amended standards on associated topics are also early adopted at the same time.

HoTARAC is generally supportive of the proposed transition methods with the exception of *Defined Benefit Plans: Proposed amendments to IAS 19,* for the reasons as outlined in the attachment.

HoTARAC notes that the views presented in this letter and the attachment does not imply that HoTARAC automatically supports the introduction of any particular standard. HoTARAC's views about individual standards are contained in the response to individual exposure drafts.

Please contact Peter Gibson on 02 6215 3551 from the Australian Department of Finance and Deregulation if you would like to discuss any of the matters raised by HoTARAC.

Yours sincerely

Grant Hehir

CHAIR
HEADS OF TREASURIES ACCOUNTING AND REPORTING ADVISORY COMMITTEE

December 2010

D10/468285

Background Information

Question 1:
Please describe the entity responding to this Request for Views.

(a) Please state whether you are primarily a preparer of financial statements, an auditor, or an investor, creditor or other user of financial statements (including regulators and standard-setters). Please also say whether you primarily prepare, use or audit financial information prepared in accordance with IFRSs, US GAAP or both.

(b) If you are a preparer of financial statements, please describe your primary business or businesses, their size (in terms of the number of employees or other relevant measure), and whether you have securities registered on a securities exchange.

The Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC) is an intergovernmental committee that advises Australian Heads of Treasuries on accounting and reporting issues. The Committee comprises senior accounting policy representatives from all Australian States, Territories and the Australian Government. The members of HoTARAC would be best characterised as preparers of financial statements although they do have some roles as regulators and in setting standards (e.g. where accounting standards allow for choice or where additional information is considered necessary.)

As at 30 June 2010, HoTARAC member jurisdictions comprise of at least 1,300 public sector entities and hold total assets of approximately $A 1,444 billion.

Each HoTARAC jurisdiction is involved in the preparation of entity level financial statements as well as consolidated financial statements. Financial statements are prepared in accordance with IFRS as adopted in Australia by the Australian Accounting Standards Board (AASB).

(e) Please describe the degree to which each of the proposed new IFRSs is likely to affect you and the factors driving that effect (for example, preparers of financial statements might explain the ***frequency*** *or* ***materiality*** *of the transactions to their business and investors and creditors might explain the significance of the transactions to the particular industries or sectors they follow).*

Project: Leases

Impact: High

Factors driving that effect:

- Leases are frequent and material in the public sector.
- Major costs associated with implementation issues (e.g. system costs, time to review lease agreements and training). In particular, when released, this Standard will require a thorough review of all lease arrangements. It will impact on the most number of government entities and will affect the most number of people within these entities.

- Bringing operating leases onto the balance sheet will require negotiations with:
  - Ratings agencies: to ensure that changes in accounting standards do not adversely impact credit ratings when operations of government remain unchanged; and
  - Banks: to renegotiate debt covenants to ensure new debt ratios do not breach current contractual terms.
- It will impact on both the budget and outcomes reporting cycles.
- Also it will have a pervasive impact on financial statements, impacting the balance sheet presentation of assets and liabilities, and the timing of lease costs reflected through the operating statement.
- It will create a difference between the accounting and statistical treatment of leases, which has consequences for some levels of reporting under Australian Accounting Standards.

Project: Post-employment benefits – Defined benefit plans – Proposed amendments to IAS 19

Impact: Medium to High

Factors driving that effect:

- The dollar impact of these amendments is likely to be high (i.e. change in the basis of the interest calculation).
- Only a limited number of entities will be impacted. The main impact will be in terms of data collection for disclosure, increased actuarial costs and systems requirements (particularly in relation to other long term benefits, such as long service leave).

Project: Fair Value Measurement

Impact: Medium

Factors driving that effect:

- Fair value measurements are frequent and material in the public sector particularly in relation to property, plant and equipment.
- Although the changes to fair value measurement as a result of the new Standard are not likely to be material, the main impact will be in terms of education, policy development, implementation (e.g. additional internal information collection) and review (e.g. at what level in the hierarchy is a fair value using depreciated replacement cost likely to be).

Project: Financial Instruments

Impact: Medium

Factors driving that effect:

- At some level, all agencies will be impacted, although the highest impact may be on a relatively small number of entities with more complex financial instruments.
- The main impact will be in terms of education, policy development, system changes and additional internal information collection to populate disclosures.

Project: Revenue from contracts with Customers

Impact: Medium

Factors driving that effect:

- Revenue from contracts with customers represents only a small/medium component of revenue within the public sector, with the majority generally generated via taxation or the transfer of goods and services. A small number of entities that enter into construction contracts may be affected (e.g. whether they will be able to continue with the percentage of completion accounting method).
- The main impact will be in terms of training, implementation and review of existing contracts with customers to assess customer credit risk.

Project: Insurance contracts

Impact: Low

Factors driving that effect:

- Only a small number of entities undertake insurance activities and will be impacted. Actuaries are currently assessing the full impact.
- Some of those insurers are already applying the proposed requirements. However, there may be some complexity with certain types of insurance contracts, such as financial guarantees.
- The main impact will be in terms of data collection for disclosures and implementation changes (i.e. system changes, policy development and training).

Project: Presentation of items of OCI – Proposed amendments to IAS 1

Impact: Low

Factors driving that effect:

- Relatively minor amendments, which have already been, or can easily be, implemented.

Preparing for transition to the new requirements

Question 2:
Focusing only on those projects included in the table below:

Project	***Transition method***
Consolidation	*Limited retrospective*
Fair value measurement	*Prospective*
Financial instruments (IFRS 9)†	*Retrospective*
Insurance contracts	*Limited retrospective*
Joint arrangements	*Limited retrospective*
Leases	*Limited retrospective*
Post-employment benefits – Defined benefit plans	*Retrospective*
Presentation of items of OCI	*Retrospective*
Revenue from contracts with customers	*Retrospective*

† IFRS 9 is being finalised in phases. Impairment, hedge accounting, asset and liability offsetting are still under discussion and transition methods for these phases have not been finalised.

a) Which of the proposals are likely to require more time to learn about the proposal, train personnel, plan for, and implement or otherwise adapt?

HoTARAC considers the new *Leases* standard will **require the most time** to learn about, train personnel, plan for, and implement. The reasoning for this is outlined below:

- The new standard is a fundamental change to how leases are currently accounted for. Transitioning to the new standard will require a thorough review of all leasing arrangements to determine appropriate treatment under the new requirements.
- This will impact on the most number of entities and will affect the most number of people within agencies (i.e. lessees, lessors, budget, financial statements etc).
- Extensive training and system and process changes are likely to be required to accommodate the proposals.
- Liaison with third-party entities as a component of change management may be required, such as credit ratings agencies.
- Running of parallel systems to re-cast comparative information under the new requirements (i.e. duplication effort).

HoTARAC also believes that *Fair value Measurement Guidance* will **require moderately more time** to implement than the other standards.

- The new standard will require extensive training and planning, to assess to what extent, if any, current valuation processes will need to change. This will require engagement with third parties such as valuers and may require some significant policy changes (i.e. at what level in the hierarchy is a fair value using depreciated replacements likely to be?).

HoTARAC considers *Revenue from Contracts with Customers* and *Financial Instruments* will **require slightly more time** to implement than the remaining standards.

- *Revenue from Contracts with Customers*:
  - Contracts with customers will need to be reviewed to determine appropriate treatment under new requirements (i.e. identifying separate performance obligations and assessing customer credit risk etc).
  - Robust training and process changes are likely to be required to accommodate proposals.
- *Financial Instruments*:
  - While there has only been a moderate shift in treatments, due to the nature of financial instruments the standard may still be complex to interpret.
  - Reclassification of financial instruments may be required as well as changes to measurement.
  - Additional internal information collection processes will be required.
  - Due to the complex nature of the standard extensive training will be required.

b) What are the types of costs you expect to incur in planning for and adapting to the new requirements and what are the primary drivers of those costs? What is the relative significance of each cost component?

HoTARAC envisages the main costs expected in planning for and adapting to the new requirements to be:

- Extensive staff resources, particularly regarding the implementation of the Leases and Revenue standards.
- Possibly engagement of external consultants/contractors.
- Costs to modify relevant software and financial models.
- Development of guidance materials and extensive training for adoption of new standards.
- Communications/coordination with different parts of the organisation (for example, within the public sector this would involve liaising with agencies/entities which is a labour and time limited process).

However, the relative significance of individual types of costs would differ between topics, and would also differ between individual entities according to the internal expertise available, existing systems/processes/models etc.

Question 3:
Do you foresee other effects on the broader financial reporting system arising from these new IFRSs? For example, will the new financial reporting requirements conflict with other regulatory or tax reporting requirements? Will they give rise to a <u>need for changes in auditing standards</u>?

Government Finance Statistics (GFS)

The implementation of the new standards may affect the Australian public sector GFS/Generally Accepted Accounting Principles (GAAP) harmonisation – a method of reporting that blends accounting and statistical requirements. Currently Australian federal, state and territory government prepare whole of government (WoG) and general government sector (GGS) financial statements in accordance with AASB 1049, an Australian Accounting Standard Board (AASB) standard which harmonises GFS and GAAP for WoG and GGS. The introduction of the new standards may create potential convergence differences between GFS and GAAP, which may mean that dual systems are required to keep GFS and GAAP information on different bases.

For example, the revenue recognition and measurement proposals in ED 198 *Revenue from Contracts with Customers* conflict with how revenue would be recognised, measured and presented for GFS purposes. For GFS purposes, the full amount of the transaction price would be recognised as revenue up front, disregarding any customer credit risk and any potential obligation to provide a refund to the customer. Unlike the ED's proposals, GFS would only recognise such risk or obligation when it actually arises. Hence, this would give rise to additional reconciliation differences between GAAP (based on the ED) and GFS; thus requiring dual systems.

ED 202R *Leases* is another standard that may also lead to major harmonisation issues. As GFS currently distinguishes operating leases from finance leases, the proposals in the ED have a high probability of increasing GAAP/GFS divergence. HoTARAC understands lease accounting under GFS is unlikely to change in the near future.

Leases

As outlined in our response to ED/2010/9 *Leases*, recognising additional assets and liabilities is likely to affect key performance ratios such as debt/equity ratios as well as the ability to satisfy debt covenants. Foreseeable changes in debt ratios are likely to affect the regulatory environment: leading to changes in net debt targets and alterations to debt covenants.

Question 4:
Do you agree with the transition method as proposed for each project, when considered in the context of a broader implementation plan covering all the new requirements? If not, what changes would you recommend, and why? In particular, please explain the primary advantage of your recommended changes and their effect on the cost of adapting to the new reporting requirements.

As noted in our comments on ED/2010/3 *Defined Benefit Plans: Proposed amendments to IAS 19*:

- HoTARAC agrees that the proposed amendments should be applied retrospectively, except for sensitivity disclosure. If the sensitivity disclosure is approved, HoTARAC believes that comparative information should not be required given that hindsight may be inappropriately used in determining what is regarded as a reasonably possible change in assumption.

As noted in our comments on ED/2010/9 *Leases*:

- HoTARAC agrees with the proposed simplified retrospective approach.
  HoTARAC has no objection in principle to permitting full retrospective application. However, given the long-term nature of some leases, differences between the full and simplified approaches could produce undesirable long-term comparability issues between or within entities. Further, fully retrospective application would probably add to the complexity of initial implementation with little real benefit for users of financial statements.

HoTARAC has no significant concerns in relation to the proposals on transition methods of the following exposure drafts:

- Exposure Draft ED/2010/5 *Presentation of Items of Other Comprehensive Income;*
- Exposure Draft ED/2010/6 *Revenue from Contracts with Customers;*
- Exposure Draft ED/2009/5 *Fair Value Measurement* and ED/2010/7 *Measurement Uncertainty Analysis Disclosure for Fair Value Measurements – limited re-exposure of proposed disclosure;*
- Exposure Draft ED/2009/7 *Financial Instruments: Classification and Measurement* and Exposure Draft ED/2010/4 *Fair Value Option for Financial Liabilities;*
- Exposure Draft ED/2010/8 *Insurance Contracts;*
- Exposure Draft ED 10 *Consolidated Financial Statements.*

HoTARAC did not provide comment on ED 9 *Joint Arrangements.*

Effective dates for the new requirements and early adoption

Question 5: In thinking about an overall implementation plan covering all of the standards that are the subject of this Request for Views:

a) Do you prefer the single date approach or the sequential approach? Why? What are the advantages and disadvantages of your preferred approach? How would your preferred approach minimise the cost of implementation or bring other benefits? Please describe the sources of those benefits (for example, economies of scale, minimising disruption, or other synergistic benefits).

Single Date Approach

The majority of HoTARAC members support the single date approach to implementing the new standards with a mandatory effective date of 2014/15. The primary reason HoTARAC members support this approach is due to the potential complexity in implementing a number of fundamentally interrelated projects.

HoTARAC considers that the single date approach has the following **advantages**:

- *Interrelationships/interdependencies of standards:* due to the interrelationships between the standards, there may be an imperative to adopt a number of large topics at the same time. In addition, it may be difficult to stagger the effective dates for the other projects referred to in the Request for views.
- *Economies of Scale:* the single date approach exploits economies of scale (e.g. educate users and making system changes in one hit rather than piecemeal thus minimising disruption) similar to adoption of IFRS for the first time.
- *Scope Issues:* the single date approach avoids issues to do with the conflicting scope of standards. For example, financial guarantee guidance will move from IAS 39 *Financial Instruments: Recognition and Measurement* to the new Insurance Contract standard (ED/2010/8) – implementing these at the same time will avoid scope issues between the old and new standards.
- *Consequential amendments:* the single date approach reduces the need for consequential amendments to proposed standards which are implemented before other proposed standards under the sequential approach.
- *Clearer timeline:* Assigning a single effective date to multiple standard implementations may provide a clearer timeline and resource requirements for transition (beneficial to jurisdictions who have limited resources to analyse and advise on standard implementation).
- *Comparability and consistency:* the single date approach will maintain the comparability of financial reports as well as avoiding conceptual inconsistencies across standards.

HoTARAC believes that the single date approach has the following **disadvantages**:

- *Lead time:* the single date approach will require a long lead time in order for entities to cope with resourcing issues and may unduly delay some projects which could proceed earlier (where they are not interrelated and/or as fundamental).
- *Financial Crisis related projects:* Where all new IFRSs are implemented together, a significant lead time would be required; however, this could pose an issue in relation to Financial Crisis related projects (Financial Instruments, Consolidation and Fair Value Measurement Guidance). For example, under the sequential approach the Financial Crisis related projects could be implemented earlier than other EDs which have a discrete effect.

Sequential approach

A minority of HoTARAC members support the sequential approach, which could be achieved by providing the option to early adopt (see question 6 below). These members consider the sequential approach enables reporting entities to more cost-effectively manage the various changes over a long period of time. They also consider this approach may reduce the need to engage external (and more expensive) assistance to implement a large number of changes at the same time (over and above normal operations). Those members that favour a sequential approach recognise that there may be packages of very closely related changes that would need to be early adopted at the same time.

b) Under a single date approach and assuming the projects notes in the introduction are completed by June 2011, what should the mandatory effective date be and why?

If the single date approach is adopted and the projects are completed by June 2011, HoTARAC members consider a **mandatory effective date of 2014/15** is appropriate. This date will give entities sufficient time to prepare (e.g. compile comparative data, train employees, make system changes etc) and make amendments to legal/tax frameworks if required. In the instance where the projects are not completed by June 2011, HoTARAC members consider a mandatory effective date after 2014/15 would be more appropriate.

Some HoTARAC members also consider that it may also be beneficial to introduce other changes at the same time; e.g. Financial Statement Presentation project and the replacement of AASB 137 *Provisions, Contingent Liabilities and Contingent Assets.*

c) Under the sequential approach, how should the new IFRSs be sequenced (or grouped) and what should the mandatory effective dates for each group be? Please explain the primary factors that drive your recommended adoption sequence, such as the impact of interdependencies among the new IFRSs.

As discussed above, HoTARAC considers the sequential approach will be difficult to implement given the interrelations between the standards and therefore support the single date approach. However, if the sequential approach is used to implement the new IFRSs, the majority of HoTARAC would support the following sequence and effective dates:

Group 1 (effective date: 2013/14):

- Consolidation (Financial Crisis related project);
- Joint Arrangements;
- Post-Employment Benefits – Defined benefit plans; and
- Presentation of Items of Other Comprehensive Income (OCI)

Group 2 (effective date: 2014/15)

- Fair Value Measurement (Financial Crisis related project);
- Revenue from Contracts with Customers;
- Financial Instruments (Financial Crisis related project);
- Insurance Contracts; and
- Leases.

Primary factors driving this sequence:

- Group 1 are largely distinct projects with limited interdependencies with other standards. Group 1 standards also have a lower implementation impact on HoTARAC members and thus will require less implementation time. The mandatory effective date of 2013/14 will allow sufficient time to collect data and perform process and system changes required in particular, for the *Post-employment benefits* additional disclosure requirement.
- Group 2 standards are of a fundamental nature and will have a high impact on HoTARAC members. Group 2 standards are also highly interrelated and therefore should be implemented concurrently and have the longest lead time.

- A summary of Group 2 standard interrelations include:

Standard	**Interrelation**
Fair value measurement	Financial Instruments Revenue from Contracts with Customers Insurance Contracts
Revenue from contracts with customers	Fair Value Measurement Insurance Contracts Leases
Financial Instruments	Fair Value Measurement Insurance Contracts (scope overlap)
Insurance contracts	Revenue from Contracts with Customers Financial Instruments Fair Value Measurement
Leases	Revenue from Contracts with Customers

As noted in our response to ED/2010/5, HoTARAC believes that, alternatively, *Presentation of items of Other Comprehensive Income* could be delayed until there is full consideration of the conceptual basis for presenting amounts in other comprehensive income or profit or loss.

d) Do you think another approach would be viable and preferred? If so, please describe that approach and its advantages.

No.

Question 6:
Should the IASB give entities the option of adopting some or all of the new IFRSs before their mandatory effective date? Why or why not? Which ones? What restrictions, if any, should there be on early adoption (for example, are there related requirements that should be adopted at the same time)?

While HoTARAC generally supports the principle of early adoption, the majority of HoTARAC members believe that due to the significant interdependencies of some of the new IFRSs, entities should not be given the option to early adopt. The majority of HoTARAC members consider the option to early adopt may create a prolonged period of time in which the comparability of financial reports of entities may be impaired. Therefore, the majority of HoTARAC members do not consider it would be appropriate to permit early adoption.

A minority of HoTARAC members support the option of adopting some or all of the new IFRSs before their mandatory effective date, subject to adopting as a package certain related standards, as they believe this would allow flexibility in the allocation of resources.