New South Wales
TREASURY

Professor David Boymal
Chairman
Australian Accounting Standards Board
PO Box 204
Collins St West Victoria 8007

E-mail: standard@aasb.com.au

Contact:	B Richardson
Telephone:	(02) 9228 4832
Our Reference:	T05/1897
Doc #:	X07/05413
Your Reference:	ED 159

3 December 2007

Dear Professor Boymal

ED 159 *Proposed Improvements to Australian Accounting Standards*

New South Wales Treasury welcomes the opportunity to make a submission on the above Exposure Draft.

We agree with the general comments, and most of the additional comments, of the Heads of Treasuries Accounting and Reporting Advisory Committee's (HoTARAC) response to the Exposure Draft. However, NSW Treasury has differing opinions to HoTARAC or additional comments to make on the following specific proposals:

- to amend the definition of 'recoverable amount' in IAS 16;
- to amend two paragraphs in IAS 17 to eliminate a perceived inconsistency between specific classification guidance and general guidance for leases of land and buildings;
- to replace in IAS 19 the term 'fall due' with the notion of employee entitlement in the definition of short-term employee benefits and other long-term employee benefits;
- to amend IAS 20 to clarify that the benefit of a loan received from a government with a below market rate of interest should be quantified by the imputation of interest in accordance with IAS 39; and
- to include property under construction or development for future use as an investment property within the scope of IAS 40.

We also request confirmation that not-for-profit entities will continue to be exempt from making an unreserved statement of compliance with IFRSs per paragraph Aus16.3 of AASB 101 *Presentation of Financial Statements*.

NSW Treasury's detailed views in relation to the above matters follow.

Yours sincerely

Robert Williams
for Secretary

NSW Treasury provides the following comments relating to areas where we either have different views than HoTARAC or wish to make additional observations.

Question 9: Should the definition of recoverable amount in IAS 16 be amended to remove the perceived inconsistency with 'recoverable amount' used in other IFRSs? If not, why?

Consistent with HoTARAC, NSW Treasury does not support the proposal. However, NSW Treasury wants to emphasise that we do not support the proposal because NSW Treasury does not agree that 'net selling price' is equivalent to 'fair value less costs to sell'. Fair value under IAS 16 is a broader concept than fair value under IAS 36. The commentary on 'fair value less costs to sell' in IAS 36 (paragraphs 25-29) refers to market based valuations only, as evidenced by binding sale agreements, current bid prices or recent transactions for similar assets. IAS 36 does not envisage or refer to situations where there is no market based evidence. In contrast, IAS 16 refers to fair value based on depreciated replacement cost, in the absence of market based evidence. Therefore, IAS 36 has a narrower concept of fair value than IAS 16.

If the contrary is argued (i.e. that the concept of fair value under IAS 36 and IAS 16 is identical), then it would not be possible for an asset measured at fair value under IAS 16, based on depreciated replacement cost to be impaired (except where selling costs are material). This is because the 'recoverable amount' is based on the *higher* of 'fair value less costs to sell' and 'value in use'. However, IAS 36 clearly envisages that impairment in this circumstance may arise (IAS 36, paragraph 5(b)).

Therefore, in NSW Treasury's view, the definition of recoverable amount in IAS 16 should remain, and consequential amendments should be made to the other Accounting Standards, to achieve consistency with the current IAS 16 definition.

Question 11: Do you agree with the proposal to amend paragraphs 14 and 15 of IAS 17 to eliminate a perceived inconsistency between the specific classification guidance for leases of land and buildings and the general lease classification guidance in IAS 17? If not, why?

HoTARAC and NSW Treasury find the proposal unclear in its current form. The exposure draft does not clearly articulate the existing problem and the impact of the proposed solution.

Further, NSW Treasury agrees with the proposal as we understand it; ie that it permits long-term leases of land to be classified as finance leases. To explain our view, we note that a recent staff paper for the IASB meeting on 18 July 2007 explains the issue more fully. It notes that many constituents would view paragraph 14 as requiring a ***long-term*** lease of land to be classified as an operating lease, despite the economics of the transaction (and the general guidance in paragraphs 8-12) suggesting a finance lease. However, this inconsistency is not explained in the exposure draft or the accompanying basis for conclusions.

The general and specific guidance on classifying land leases has been authoritatively reconciled in the past in the following ways. The Board's basis for conclusions on IAS 17 explicitly rejects classifying land leases as finance leases in view of the (normally) indefinite economic life of land and the lessor's retention of significant risks and rewards of ownership at the end of the lease term (paragraph BC8). In addition, IFRIC, in considering the

appropriate classification for a 500-year land lease, noted in passing that, irrespective of the lease term, it would be classified as an operating lease unless title or significant risks and rewards of ownership pass to the lessee (*IFRIC Update*, March 2006).

Some constituents are therefore likely to view the proposed change as having no impact as they do not presently perceive any inconsistency between the general guidance in paragraphs 8-12 and the specific guidance in paragraphs 14-15 of the standard. They are likely to continue to classify land leases as operating leases.

However, other constituents, including NSW Treasury, are likely to view the proposed change as permitting a reclassification of some existing operating leases as finance leases.

The proposed change, as currently presented, may therefore create more inconsistency than it removes and may lead to diversity of practice.

If it is intended to require or permit long-term land leases to be classified as finance leases, it would be preferable for the standard to be clear on this point and to explain the rationale for such classification.

The proposal may therefore represent a substantive change to the standard rather than a minor amendment. It could have a significant impact. Because we believe this is the case, we recommend that it be articulated more fully and exposed for greater understanding.

Importantly, we consider that paragraphs 14 and 15 are particularly relevant to a long-term lease of land. We argue that the economic substance of such a transaction is akin to a sale. NSW Treasury supports classifying such arrangements as finance leases. In a long-term lease of land, the significant risks and rewards of ownership are in substance transferred to the lessee. The lessor's reversionary right in the title has minimal value and is therefore of no economic significance for most of the lease term.

In addition, we recommend that the residue of paragraph 14, proposed to be retained as paragraph 19A, be relocated to a more appropriate part of IAS 17 as it deals with operating lease payments rather than classification of leases.

Question 16: Do you agree with the proposal to replace in IAS 19 the term 'fall due' with the notion of employee entitlement in the definition of short-term employee benefits and other long-term employee benefits? If not, why?

Consistent with HoTARAC, NSW Treasury strongly disagrees with the proposal to replace the term 'fall due' with the term 'to which the employee becomes entitled'. Instead, NSW Treasury prefers the term 'expected to be settled', as was originally proposed (refer International Accounting Standards Board IASB Update March 2007).

The classification between 'short term' and 'long term' is for the purpose of determining the measurement basis. Short term employee benefits are calculated without discounting while other long term employee benefits are accounted for at the present value of the obligation. In NSW Treasury's view, classification based on entitlement (i.e. whether or not an obligation is current or non current) is a separate issue.

The concept of discounting relates to the expected timing of cash flows i.e. relevant to cash outflows expected to occur in more than 12 months. Therefore, while a liability such as annual leave may be due (i.e. an employee may be entitled to the leave) within 12 months, it may not be settled for a substantially longer period. It is relatively common for employees to accumulate more than 12 months' annual leave. However, under the proposed amendment, such annual leave would be classified as short term and would not be discounted, even though the cash outflow is not expected until sometime more than 12 months. This may be misleading.

In NSW Treasury's view, calculation of liabilities and discounting based on the timing of estimated cash flows is consistent with IAS 39 and IAS 37 (refer IAS 39, Implementation Guidance, B.26).

Also, the proposed amendments do not address the treatment of employee benefits that are not "wholly" due or entitled to be taken within 12 months. For example, for long service leave, a legal liability does not arise until after a qualifying period of service. This means that for a particular employee that has satisfied the qualifying period of service for long service leave, 'the employee becomes entitled' to that benefit within 12 months. As currently drafted, it could be argued that the portion of the total long service leave liability that is entitled to be taken within 12 months could satisfy the 'short term employee benefit' definition and be required to be measured on an undiscounted basis, even though there is no expectation for this liability to be settled within 12 months.

Previously, the use of the word "wholly" in the definition seemed to address this issue i.e. benefits that "do not fall due wholly within twelve months". This was also consistent with paragraph 66 of IAS 19, which required that the whole of a post employment obligation be discounted, even if part of the obligation 'falls due' within twelve months of the reporting date.

Therefore, NSW Treasury supports the retention of the word "wholly" in the definitions. This is necessary to ensure that the whole of the long service leave liability is treated as an 'other long term benefit' and discounted, irrespective of whether particular employees have satisfied the qualifying period of service and are entitled to the benefit within 12 months.

Further, if the proposed amendments proceed, paragraph 66 needs to be amended to remove the "falls due" terminology, to be consistent with any revised definitions of 'short term employee benefits' and 'other long term employee benefits'.

Question 19 – Do you agree with the proposed amendments to IAS 20 to clarify that the benefit of a loan received from a government with a below market rate of interest should be quantified by the imputation of interest in accordance with IAS 39? If not, why?

NSW Treasury agrees with the proposed amendment. In contrast, HoTARAC agrees, with reservations regarding measurement practicalities. Although there are practical measurement difficulties, NSW Treasury's view is that any loan below the government's bond rate includes a grant component that must be recognised..

Question 35: The exposure draft proposes to include property under construction or development for future use as an investment property within the scope of IAS 40. Do you agree with the proposal? If not, why?

NSW Treasury agrees with the proposed amendment for the following reasons:

- Whether the property falls within the scope of IAS 16 or IAS 40, it should be recognised at fair value; and
- In practice there should be no material difference between cost and fair value during the first few years of the life of the asset.

In contrast, HoTARAC disagrees with the proposal.

Request for Confirmation from the AASB

Question 4 proposes to require an entity that cannot make an unreserved statement of compliance with IFRSs to describe how its financial statements would have been different if prepared in full compliance with IFRSs.

NSW Treasury would like the AASB to confirm that the requirement to state compliance with IFRSs would continue to be not applicable to not-for-profit entities per AASB 101.Aus16.3 which states that not-for-profit entities are not required to make an explicit/unreserved statement of compliance with IFRSs.