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Accounting Alert

Analysis of the latest accounting developments delivered to you via e-mail

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Second Tranche of Convergence Exposure Drafts Released

The Australian Accounting Standards Board (AASB) has released two further Exposure Drafts (EDs) and an Invitation To Comment (ITC) as part of the convergence process with International Financial Reporting Standards (IFRS).

This *Accounting Alert* provides an outline of the proposals in these documents.

Overview

The two EDs and ITC propose some potentially radical changes to current Australian accounting practices, most significantly:

Recognition of assets/liabilities in relation to funding of defined benefit plans, free choice of presentation currency and changes in accounting for inventories

- Introduction of a requirement to recognise and measure an asset or liability in relation to defined benefit plans;
- Possible introduction of the ability for entities to have a free choice in presentation currency for their financial reports; and
- Changes to the treatment of inventory in the agricultural and extractive industries, and for not-for-profit entities.

In these documents, the AASB continues to propose differences between IFRS and the equivalent converged AASB Standards, by mandating one particular option available under IFRS, or changing other IFRS requirements. Whilst the reasons for these changes are supportable, the Australian business community needs to communicate to the AASB whether it would prefer 100% 'word for word' harmonisation with IFRS so as to ensure that the playing field is levelled with entities reporting under IFRS in other jurisdictions.

ED 115 'Request for Comment on IAS 19 Employee Benefits'

Australian Standards Affected

- AASB 1028 'Employee Benefits'.

Major Changes to Existing Practice

- Recognition of assets and liabilities related to the timing of funding of defined benefit plans versus accrual of the service cost.
- Treatment of unwinding of discounts associated with employee benefits measured on the present value basis as interest, which may then be capitalised as a borrowing cost in certain circumstances.
- Revisions to disclosure requirements, particularly in relation to equity-based compensation benefits and defined benefit superannuation plans.

Proposed Departures from IFRS

Choice of using the 'corridor' approach would not be permitted in Australia

- Elimination of the choice of using the so-called 'corridor' approach for the recognition of actuarial gains and losses (elimination of the 'corridor' approach from IFRS is being considered by the IASB, but any change is not expected to be effective until at least 2006).

Other Points to Note

- If it were permitted under the Australian converged Standards, IFRS 1 would permit the resetting of the 'corridor' to zero on first-time adoption (note that the Australian Standard converged with IFRS 1 is yet to be issued – see *Accounting Alert 2003/06* for more information).

Requirements of IAS 19 could be early adopted

- The AASB has issued a Media Release regarding the disclosures surrounding defined benefit plans under the existing AASB 1028 – this release does not suggest that entities adopt IAS 19 before 2005, but strongly encourages any entity with a defined benefit superannuation plan to disclose sufficient information to enable users of its financial report to determine the extent of any under-funding of the plan as at reporting date. However, as there are no equivalent requirements in Australia regarding defined benefit plans, the requirements of IAS 19 could be applied prior to the adoption of IFRS converged AASB Standards, but would be treated as a voluntary change in accounting policy that would be retrospectively applied (unless impracticable), with the cumulative effect recognised in net profit or loss, rather than through retained earnings.

ASIC's view is that liabilities should be recognised under current Standards

- ASIC has also expressed the view that entities should recognise a liability for defined benefit plans with a net deficiency, even under current accounting pronouncements.

IAS 19 is a Major Convergence Impact Area

Accounting for defined benefit plans is a major convergence impact area

The recognition and measurement of amounts related to defined benefit plans (associated with both medical and retirement obligations) is one of the major impact areas of the IFRS convergence process, and is complex due to the nature of these types of arrangements.

Actuarial Valuations

Affected entities should consider the need for actuarial valuations close to their date of transition

IAS 19 has many detailed requirements in relation to defined benefit plans, requiring the use of actuarial techniques, discounting and fair values. Entities will need to address the convergence issues related to defined benefit plans on a timely and proactive manner, as it will be more efficient to obtain any necessary actuarial valuations close to the actual valuation date. For entities adopting IFRS converged Standards for the first time in 30 June 2006 financial reports, the first actuarial valuation would be effectively required at 1 July 2004.

'Corridor' Approach

The choice available under IAS 19 of using the 'corridor' approach further complicates accounting for defined benefit plans, but does lessen the volatility in reported profits arising from immediately recognising actuarial gains and losses in the net profit or loss.

Even if permitted, the benefits of adopting the 'corridor' approach might be short-lived and potentially outweighed by the costs involved

However, even if the AASB converged Standard ultimately permits this treatment, many entities would find it very difficult to fully retrospectively apply the 'corridor' approach, and would therefore be expected to opt to reset the 'corridor' to zero in accordance with the forthcoming AASB Standard that is converged with IFRS 1. If the IASB's expected proposals to eliminate the 'corridor' approach are implemented, the use of the 'corridor' approach would be limited to perhaps one or two financial years, and the substantial implementation costs may therefore outweigh any short-term financial reporting benefit.

Providing further details on this topic is beyond the scope of this *Accounting Alert*. However, Deloitte will release an in-depth *Discussion Paper* on the requirements once the proposals are finalised by the AASB.

ED 116 'Request for Comment on IAS 2 and IPSAS 12 Inventories'

Australian Standards Affected

- AASB 1019 'Inventories'.

Major Changes to Existing Practice

Some inventories can be measured at net realisable value, even if NRV is greater than cost

- Inventories of agricultural, forest products and mineral ores can be optionally measured at net realisable value in some circumstances.
- Some differences in the application of the retail inventory method, determination of net realisable value and the concept of normal operating capacity.
- Introduction of special treatments for not-for-profit entities in the following areas:

New requirements for not for profit entities

  – scope inclusion for inventories held for distribution for no or nominal consideration, measured at the lower of cost and current replacement cost, and recognised as expenses when distributed; and

  – scope exclusion for work in progress of services to be provided for no or nominal consideration directly in return from the recipients.

Proposed Departures from IFRS

- Inclusion of IPSAS 12 requirements for not for profit entities (as not addressed under IAS 2).

Invitation to Comment 'Presentation Currency of Australian Financial Reports'

Australian Standards Affected

- AASB 1034 'Financial Report Presentation and Disclosure'.

Options on Which AASB is Seeking Comments

In this Invitation to Comment, the AASB is requesting feedback as to which of the following options on presentation currency should be implemented in the Australian context:

1. Adopt the 'free choice' model proposed by the IASB for IAS 21;
2. Mandating Australian currency as the only presentation currency (as is currently required by AASB 1034); or
3. Allowing a free choice of which presentation currency to use, but mandating that the Australian currency also be used as one of the presentation currencies.

The maximum benefits of convergence might arise if free choice in presentation currency is permitted

If the objectives and maximum benefits of IFRS convergence are to be achieved, it might be expected that full convergence with the 'improved' IAS 21 to allow a 'free choice' of presentation currency may be the preferable treatment in the Australian context. Mandating a choice of Australian currency may potentially disadvantage certain Australian reporting entities, such as those with a functional currency other than Australian dollars.

Feedback and Assistance

We welcome your feedback on the matters covered in this *Accounting Alert* – please email your comments to **accounting_alerts@deloitte.com.au**.

For assistance in applying the requirements outlined in your organisation, please contact your local Deloitte office or contact our Lead National Technical Partner, Bruce Porter on (03) 9208 7490, or by email to **bruporter@deloitte.com.au**.

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