

Explanatory Statement

AASB 2005-1 Amendments to Australian Accounting Standard

May 2005



Australian Government

**Australian Accounting
Standards Board**

EXPLANATORY STATEMENT

Adoption of Australian equivalents to IFRSs

The Australian Accounting Standards Board (AASB) is implementing the directive of the Financial Reporting Council (FRC) to adopt the Standards of the International Accounting Standards Board (IASB), for application to reporting periods beginning on or after 1 January 2005.

The IASB defines International Financial Reporting Standards (IFRSs) as comprising:

- (a) International Financial Reporting Standards;
- (b) International Accounting Standards (IAS); and
- (c) Interpretations originated by the International Financial Reporting Interpretations Committee (IFRIC) or the former Standing Interpretations Committee (SIC).

The Australian equivalents to IFRSs are:

- (a) Accounting Standards issued by the AASB that are equivalent to Standards issued by the IASB, being AASBs 1 – 99 corresponding to the IFRS series and AASBs 101 – 199 corresponding to the IAS series; and
- (b) Urgent Issues Group (UIG) Interpretations issued by the AASB corresponding to the Interpretations adopted by the IASB, as listed in AASB 1048 *Interpretation and Application of Standards*.

In implementing the FRC's directive, the AASB is replacing relevant existing AASB Standards with Australian Standards equivalent to those of the IASB. The AASB has decided it will continue to issue sector-neutral Standards, that is, Standards applicable to both for-profit and not-for-profit entities, including public sector entities. Except for Standards that are specific to the not-for-profit or public sectors or that are of a purely domestic nature, the AASB uses the IASB Standards as the "foundation" Standards to which it adds material detailing the scope and applicability of a Standard in the Australian environment. Additions are made, where necessary, to broaden the content to cover sectors not addressed by an IASB Standard and domestic, regulatory or other issues.

On 15 July 2004, the AASB made the set of Australian Standards equivalent to IFRSs, together with several associated Australian Standards, effective for annual reporting periods beginning on or after 1 January 2005.

AASB 139 *Financial Instruments: Recognition and Measurement* was issued at this time and is based on IAS 39 *Financial Instruments: Recognition and Measurement*

Reasons for Issuing AASB 2005-1

AASB 2005-1 is an amending standard which makes amendments to AASB 139. AASB 139 was initially issued in July 2004, (based on a revised version of IAS 39). However, under the existing AASB 139, entities can use hedge accounting only for transactions with an external entity. The one exception to the hedge accounting requirements of the Standard is to allow the foreign currency risk in an intragroup monetary item to be designated as the hedged item in the consolidated financial statements. This exception is only available if the exposure to foreign rate gains or losses is not fully eliminated upon consolidation under AASB 121 *The Effects of Changes in Foreign Exchange Rates*. However, both AASB 121 and AASB 139 do not allow a forecast intragroup transaction to be designated as a hedged item in consolidated financial statements in a foreign currency cash flow hedge.

Since the release of the revised IAS 39, some IASB constituents raised with the IASB some concerns about its decision not to allow a forecast intragroup transaction to be designated as a hedged item in consolidated financial statements in a foreign currency cash flow hedge, namely:

- it is common practice to hedge in this manner, and it was allowed under the previous IAS 39;
- some future IFRS adopters are known to use hedge accounting in such a way, and have already entered into derivatives to hedge related exposures; and
- these new requirements diverge from US GAAP.

In response to these concerns, the IASB issued an Exposure Draft (ED) and subsequent amendment to *IAS 39 – Cash Flow Hedge Accounting of Forecast Intragroup Transactions*. The amendment permits the foreign currency risk of a highly probable intragroup forecast transaction to qualify as the hedged item in consolidated financial statements provided that the transaction is denominated in a currency other than the functional currency of the entity entering into that transaction and the foreign currency risk will affect consolidated financial statements. Further, the amendment also specifies that if the hedge of a forecast intragroup transaction qualifies for hedge accounting, any gain or loss that is recognised directly in equity in accordance with the hedge accounting rules in IAS 39 must be reclassified into profit or loss in the same period or periods during which the foreign currency risk of the hedged transaction affects consolidated profit or loss.

Main Features of this Standard

This Standard was made by the AASB on 5 May 2005 under section 334 of the *Corporations Act 2001*.

Application Date

This Standard is applicable to annual reporting periods beginning on or after 1 January 2006 with early adoption permitted for annual reporting periods beginning on or after 1 January 2005.

Main Changes from AASB 139 (July 2004)

The main changes from AASB 139 (issued July 2004) are identified below [showing the relevant paragraph numbers in the Standard in square brackets].

1. The foreign currency risk of a highly probable forecast intragroup transaction may qualify as a hedged item in consolidated financial statements provided that the transaction is denominated in a currency other than the functional currency of the entity entering into that transaction and the foreign currency risk will affect consolidated profit or loss. [Paragraph 80]
2. If the hedge of a forecast intragroup transaction qualifies for hedge accounting, any gain or loss that is recognised directly in equity in accordance with the hedge accounting rules in AASB 139 must be reclassified into profit or loss in the same period or periods during which the foreign currency risk of the hedged transaction affects consolidated profit or loss. [Paragraph AG99B]
3. An entity need not apply paragraph AG99B to comparative information relating to periods before the date of application. [Paragraph 108B]

Consultation prior to Issuing this Standard

Public consultation was part of the process undertaken by the AASB prior to its decision to issue this Standard, amending the existing version of AASB 139 (issued July 2004). An ED containing proposed revisions, ED 135 Request for Comment on IASB ED of Proposed Amendments to IAS 39 *Financial Instruments: Recognition and Measurement – Cash Flow Hedge Accounting of Forecast Intra-group Transactions* was issued for public comment in July 2004, with a comment period ending on 8 October 2004.

Four submissions to ED 135 were received, supporting the proposed changes and the AASB considered these submissions and approved, out of session, in October 2004, a submission to the IASB which also conveyed the AASB's support for the proposed amendments.

The IASB then issued the final proposed amendments to IAS 39 in April 2005. These amendments were considered and approved by the AASB in its April 2005 meeting. The AASB also approved facilitating these amendments through an amending standard (this Standard). The amending standard was made at the AASB's May 2005 meeting.

A Regulatory Impact Statement has not been prepared in connection with the revision of this Standard as the amendments it makes do not have a direct, or substantial indirect, effect on business or restrict competition, are of a minor or machinery nature and do not substantially alter existing arrangements.