

Explanatory Statement

AASB 2005-9 Amendments to Australian Accounting Standards

September 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 4 *Insurance Contracts* and AASB 139 *Financial Instruments: Recognition and Measurement* was issued at this time and are the Australian equivalent of IFRS 4 *Insurance Contracts* and IAS 39 *Financial Instruments: Recognition and Measurement*.

Reasons for Issuing AASB 2005-9

AASB 2005-9 makes amendments to AASB 4, AASB 1023 *General Insurance Contracts* and AASB 139 as well as consequential amendments to AASB 132 *Financial Instruments: Disclosure and Presentation*.

Under AASB 4 (issued July 2004) and AASB 1023 (issued July 2004) a contract that requires specified payments to be made to reimburse the holder for a loss it incurs if a specified debtor fails to make payments when due under the original or modified terms of a debt instrument meets the definition of an insurance contract. Such a contract could be a financial guarantee contract, credit insurance contract, letter of credit or credit derivative default contract.

AASB 4 is not consistent with the proposals articulated in the June 2002 *Invitation to Comment of Proposed Improvements to IAS 39 Financial Instrument: Recognition and Measurement*, which proposed that AASB 139 deal with all financial guarantees.

Some contracts which might be financial guarantee contracts, credit insurance contracts, letters of credit or credit derivative default contracts may meet both the definition of an insurance contract, under AASB 4 and the definition of a financial guarantee contract under AASB 139.

Where a contract meets the definition of a financial guarantee contract, it is within the scope of AASB 139 and AASB 132, and not within the scope of AASB 1023. However, if the issuer of financial guarantee contracts has previously asserted explicitly that it regards such contracts as insurance contracts, and has used accounting applicable to insurance contracts, the issuer may elect to apply either AASB 139 and AASB 132 or AASB 1023.

In July 2004, the AASB issued Exposure Draft ED 134 *Request for Comment on IASB ED of Proposed Amendments to IAS 39 Financial Instruments: Recognition and Measurement and IFRS 4 Insurance Contracts – Financial Guarantee Contracts and Credit Insurance*, which proposed that AASB 139 deal with all financial guarantees. ED 134 replicated the IASB's ED.

In August 2005, the IASB issued *Amendments to International Financial Reporting Standards IAS 39 Financial Instruments: Recognition and Measurement IFRS 4 Insurance Contracts – Financial Guarantee Contracts* with the objective to ensure that liabilities for financial guarantee contracts are not omitted from the financial reports of issuers. In this amendment, the

IASB modified their ED's original proposals in response to comments received, so that credit insurers can retain most aspects of their existing accounting. The IASB expects to review accounting for credit insurance contracts and other forms of financial guarantee contract in more detail in phase II of the project on insurance contracts.

The amendments define a financial guarantee contract as a 'contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument'. These contracts could have various legal forms, including a guarantee, some types of letter of credit, or a credit insurance contract. Issuers must apply the amendments for annual periods beginning on or after 1 January 2006. Earlier application is encouraged.

Main Features of this Standard

This Standard was made by the AASB on 6th September 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 4 (July 2004) and AASB 1023 (July 2004)

If the issuer of financial guarantee contracts has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts, the issuer may elect to apply either AASB 139 or AASB 1023 to such financial guarantee contracts.

In all other cases, the issuer of a financial guarantee contract applies AASB 139.

Main Changes from AASB 139 (July 2004)

Issuers of financial guarantee contracts apply AASB 139 and not AASB 1023 if they have not previously asserted explicitly that it regards financial guarantee contracts as insurance contracts.

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 to amend the existing version of AASB 139 (issued July 2004). An Exposure Draft (ED) containing proposed revisions, ED 134 was issued in July 2004. Two submissions to ED 134 were received and the AASB considered these submissions in the process of developing this Standard.