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DEPARTMENT *of*
TREASURY *and* FINANCE

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Mr David Boymal
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Dear ~~Mr Boymal~~ David

EXPOSURE DRAFT 155 – FINANCIAL REPORTING BY WHOLE OF GOVERNMENTS

The Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC) welcomes the opportunity to respond to the Australian Accounting Standards Board's (AASB) Exposure Draft 155 *Financial Reporting by Whole of Governments*. The release of ED 155 as a marked-up version of AASB 1049 *Financial Reporting of General Government Sectors by Governments* is a commendable initiative of the AASB.

All jurisdictions have indicated their in-principle support for ED 155 and agree that it is essential for the new standard to be released by October 2007, in time for the commencement of the 2008-09 Budget cycle.

HoTARAC's preferred position is to have separate standards covering General Government Sector (GGS) reporting and whole-of-government reporting (WoG), given the differing objectives and requirements in terms of consolidation, Budget data and sectoral reporting. HoTARAC is also concerned that coverage of GGS reporting and whole-of-government reporting in a single standard may underplay the importance, and compromise the recognition, of separate financial reporting for the GGS.

It is important to note that each Standard serves different objectives. AASB 1049 is a budget and budget outcome reporting framework, presented at the GGS level, while ED 155 serves to harmonise accountability reporting by governments. HoTARAC recommends that ED 155 is not collapsed into AASB 1049 and that GGS and WoG reporting are covered by separate Standards.

HoTARAC is concerned at the number of convergence differences that remain between the Generally Accepted Accounting Principles (GAAP) and Government Finance Statistics (GFS) frameworks. Reconciliations, as required under AASB 1049 and ED 155, increase the complexity of government financial reports and reduce the usefulness, relevance and clarity of the reports. It is in the interests of both users and preparers that, as far as possible, such differences are eliminated to minimise or remove the need for reconciliation information on the face of, or as notes to, the financial statements.

In order to fully harmonise the frameworks, HoTARAC recommends that the remaining convergence differences between GFS and GAAP should be resolved through the AASB mandating the conceptually best treatment in each case, either GAAP or GFS. HoTARAC will continue its practice of making submissions on these differences to both the AASB and the Australian Bureau of Statistics (ABS) as issues emerge. It is noted that both AASB 1049 and ED 155 contain "future-proofing" provisions within their prefaces regarding the identification and review of emerging differences, allowing the Standard to be amended when relevant to resolve those differences.

Finally, HoTARAC recommends the removal of the requirement to present disaggregated functional information about all assets. There is no conceptual basis for comprehensively allocating assets to particular functions nor are there users who require this information. In addition, such a requirement is extremely resource intensive for preparers and auditors, for limited benefit. HoTARAC supports the presentation of information disaggregated by the GFS function for expenses. HoTARAC also supports limiting disaggregated functional information about assets to the net capital investment. This level of information is required by the ABS and the International Monetary Fund.

The attached submission (Appendix 1) provides HoTARAC's specific conclusions and views with regard to ED 155. I trust this will assist the AASB to progress the Harmonisation Project.

Yours sincerely

Don Challen

D W Challen
CHAIR
HEADS OF TREASURIES ACCOUNTING AND REPORTING ADVISORY COMMITTEE

9 August 2007

Encl

APPENDIX 1 - HOTARAC RESPONSE TO ED 155

This submission is presented in four parts:

- **Section A** addresses the specific issues identified for comments by the Australian Accounting Standards Board (AASB) in the order they appear in ED 155 *Financial Reporting by Whole of Governments*;
- **Section B** provides additional commentary on some of HoTARAC's concerns with ED 155;
- **Section C** includes general comments on the text of ED 155; and
- **Section D** provides comments on the Illustrative Example.

Section A - Specific matters for comment

(a) The Board's intention to amend AASB 1049 to reflect its decisions arising out of this Exposure Draft and thereby issue a single integrated Standard that specifies requirements for both whole of government financial reports (incorporating GGS, PNFC sector and PFC sector financial information) and GGS financial report.

The Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC) supports amending AASB 1049 for the purposes of consistency with ED 155.

HoTARAC does not support issuing a single integrated standard. It is HoTARAC's preferred position to have separate standards covering General Government Sector (GGS) reporting and whole-of-government (WoG) reporting, given their differing objectives and requirements in terms of consolidation, Budget data and sectoral reporting. Further, a single standard holds the potential to compromise the recognition of the GGS as a separate financial report. Specific and separate standards are required to address the complexities of the GGS as distinct from the WoG financial statements.

In addition, there is a risk that integrating the two standards may delay the release of a WoG Standard. HoTARAC considers that October 2007 is the critical deadline for the release of the final ED 155 Standard, to ensure it is available in time to accord with each jurisdiction's upcoming Budget cycle.

(b) The Board's intention to base whole of government general purpose financial reporting requirements on the principles adopted in AASB 1049 for GGS financial reporting.

HoTARAC supports the proposal for consistency between GGS and WoG financial reporting, but notes the position of the Heads of Treasuries (HoTs) that both standards should harmonise, rather than reconcile, by mandating the conceptually best treatment. Consistency between the standards also follows the Financial Reporting Council's (FRC's) original direction to the AASB regarding Government Finance Statistics (GFS) and Generally Accepted Accounting Principles (GAAP) convergence (FRC Bulletin 2002/5 18 December 2002, as modified by FRC Bulletin 2003/1 11 April 2003).

Alternative approaches would result in different accounting bases for GGS financial reporting and WoG financial reporting, with the potential to confuse users (eg where the WoG report did not harmonise with GFS; or if the WoG report was based on pure GFS).

(c) The treatment of transactions with owners as owners and movements in reserves (paragraph 15). Such transactions may occur between the GGS and the PNFC/PFC sectors. They may also occur in a whole of government context in relation to partly owned subsidiaries. The Board is particularly interested in views on whether the differential treatment of transactions with owners as owners and movements in reserves is appropriate.

HoTARAC supports the option to present both of these items either in the notes or on the face of the statements, consistent with AASB 101 (paragraph 97) and AASB 1049, although in practice, it is likely that this information would be disclosed in the notes only. This is also consistent with the implication in paragraph 24 of ED 155 that these items may be presented either on the face or in the notes, except where superannuation actuarial gains/losses are recognised in equity. There appears to be no justification for the differential treatment of movements in reserves, compared to transactions with owners as owners.

HoTARAC recommends the inclusion of grey letter discussion to provide the reasoning behind whether transactions with owners as owners are on the face or in the notes.

HoTARAC also notes that the relationship between paragraph 15 of ED 155 and AASB 101 is unclear. The beginning of paragraph 15 provides that the Operating Statement and Statement of Changes in Equity are presented as a single statement. However, the second part of paragraph 15 allows transactions with owners as owners to be disclosed in the notes or a separate statement rather than on the face of the Operating Statement. Given that ED 155 combines the Operating Statement and the Statement of Changes in Equity, it is unclear as to what the term "a separate statement" refers. HoTARAC recommends the AASB expands on this requirement to clarify the matter.

(d) Sector information (paragraphs 41-46). Given the potentially onerous nature of a requirement to disclose the financial statements and reconciliation notes for the GGS, PNFC sector and PFC sector in the whole of government financial report, the Board is particularly interested in views on whether the proposal in this Exposure Draft would provide the most effective way to meet users' needs for sector information.

HoTARAC supports the disclosure of sector information in the WoG financial report, as highlighted as a note in the Illustrative Example. This is preferred over the alternative of separate stand-alone financial reports for the PNFC and PFC sectors. Consequently, HoTARAC supports the AASB's position in paragraph BC17 not to require the disclosure of separate Sector financial statements prepared on a GFS basis. HoTARAC supports the AASB's arguments that such an approach would be inconsistent with AASB 1049 and create the potential for user confusion, where the Sector financial statements are prepared on an inconsistent basis but disclosed within a WoG financial report.

ED 155 requires preparers to disclose a reconciliation between sectoral information and the corresponding information in the WoG report. HoTARAC notes that this may be interpreted to require the disclosure of eliminations between the Sectors. It is questionable whether users would be able to understand these elimination items. Consequently, HoTARAC supports a single elimination column, disclosing eliminations between the Sectors and WoG. HoTARAC does not support the additional elimination columns for eliminations between the Sectors.

HoTARAC regards the requirement to provide reconciliations to ABS GFS for fiscal aggregates for the PNFC and PFC Sectors as both of limited value to users and excessively onerous to preparers. AASB 1049 requires these disclosures for the GGS, where some value, though limited, may be provided to users. The PNFC and PFC Sector reconciliations (Notes S1, S2, S3, T and U in the Illustrative Example) provide little useful information. HoTARAC supports the disclosure of reconciliations to ABS GFS at the WoG and GGS levels only.

(e) Budgetary information (paragraphs 47-53). The Board is particularly interested in views on whether:

(i) Whole of government budgetary information should only be required to be disclosed where whole of government budgeted financial statements are presented to parliament; and

HoTARAC strongly supports this proposal. If Budget information was required for all the detailed notes (such as movements in PPE and financial instruments) as well as for the reconciliations, it is believed that the statements will become very unwieldy, especially if comparatives were also disclosed. HoTARAC recommends it should be clearly stated that this information is not required.

(ii) Sector budgetary information should not be required to be disclosed in the whole of government financial report;

HoTARAC supports this proposal. Such disclosure, if required, would be of limited use, given that these Sectors are not required to prepare stand-alone financial reports.

(f) Transitional requirements (paragraph 54). In particular, the Board is interested in assessments of the costs and benefits of the approach proposed, which is to require the principles in AASB 108 Accounting Policies, Changes in Accounting Estimates and Errors to apply to the first whole of government financial report prepared in accordance with the proposals in this Exposure Draft;

ED 155 is based on the premise that issues relating to first time adoption of AEIFRS do not need to be addressed in a WoG GFS-GAAP Standard, given that AEIFRS has already been adopted at the WoG level, as part of AAS 31 *Financial Reporting by Governments*. However, the AASB's Agenda Paper 6.3 of 6-7 September 2006, implies that the GGS should not apply certain AASB 1 exemptions, as they are not allowed under GFS. Therefore, there is a potential conflict between the GGS treatment (which seems to be prohibited from using some of the AASB 1 exemptions) and the WoG treatment (which has already applied the AASB 1 exemptions).

It is desirable that accounting policies between Sectors and the WoG align for consolidation purposes. However, transitional provisions may be required at the WoG level and for the PNFC and PFC Sectors, as first time adoption decisions may have been made under AASB 1 *First-time Adoption of Australian Equivalents to International Financial Reporting Standards*, at the date of transition, which do not converge with GFS and need to be changed. These include:

- Some financial instruments may be recognised at amortised cost rather than fair value. This may require a change to fair value measurement. However, where this requires designation "at fair value through profit or loss" the ability to reclassify subsequent to initial recognition, is prohibited. That is, AASB 139 *Financial Instruments: Recognition and Measurement* makes clear that an "....entity shall not reclassify a financial instrument into or out of the fair value through profit or loss category while it is held or issued...". Relief was provided from this requirement in AASB 1, which allowed an entity to make this designation at the date of transition.

- A similar issue arises in reclassifying out of the "held to maturity" category. Arguably, under GFS, this category should not be used, because fair value is generally available for "held to maturity" investments. It is unclear, in the absence of transitional provisions, about the ability to reclassify out of this category, other than when there is a change in intention or ability (refer ED 155, paragraph 51).

- If these transitional provisions are not available at the WoG level, then the ability to converge with GFS will be restricted. This is particularly an issue for the PNFC and PFC Sectors, which unlike the GGS (refer AASB 1049, paragraphs 59-62) cannot utilise AASB 1 when preparing the sector information in the first GFS-GAAP harmonised WoG financial report. This also means that the GGS information as part of the WoG financial report (which must be prepared consistently with the policies applied in the WoG financial report) may differ from the AASB 1049 GGS financial report (ie as the AASB 1049 first time adoption decisions in the financial period 2008-09 may differ to the AAS 31 AEIFRS first time adoption decisions which were made as part of the 2005-06 financial report).

HoTARAC recommends the AASB reviews paragraph 54 to ensure that onerous and inconsistent transitional provisions are not required for these or similar issues.

(g) Whether, overall, the proposals would result in financial reports that would be useful to users; and

HoTARAC is concerned that whilst the proposals in ED 155 will be useful to users, the number of users of this report is limited. That is, the general public is unlikely to be able to understand the statements or be able to comment or make informed decisions based on the information, particularly with the current level of reconciliation items. It is for this reason that HoTs and HoTARAC have previously recommended that the best conceptual treatment be adopted, thereby eliminating the need for reconciliation items.

(h) Whether the proposals are in the best interest of the Australian economy.

HoTARAC doubts that reports prepared under ED 155 will have any impact on the Australian economy.

Section B - Additional commentary on concerns with ED 155

HoTARAC has reservations about the reconciliation-based approach to harmonisation in ED 155 because it increases the complexity of government financial reports and thereby reduces their usefulness, relevance and understandability.

In order to fully harmonise GFS and GAAP, HoTARAC reiterates the recommendations of HoTs to Exposure Draft 142 *Financial Reporting of General Government Sectors by Governments*, that remaining convergence differences should be resolved through the AASB mandating the conceptually best treatment for each case, either GAAP or GFS. HoTARAC members have identified two such differences in light of ED 155.

HoTARAC notes that the treatment of borrowing cost was not an issue before AASB 123 *Borrowing Costs* was re-issued in June 2007. As paragraph 14 (a) of AASB 1049 required all borrowing costs to be expensed, there was no difference between GFS and GAAP. When AASB 123 was re-issued, it required borrowing costs to be capitalised under certain circumstances, creating an unnecessary convergence difference. HoTARAC notes that it will be onerous to maintain suitable records across all government entities for items that are expensed for GFS and capitalised for GAAP. There is also the ongoing financial impact on depreciation and asset revaluation. HoTARAC recommends the AASB reviews this requirement, with a view to mandating the conceptually best treatment of expensing the borrowing costs for government controlled assets.

Another convergence issue raised by some HoTARAC members is the recognition of deferred tax assets/liabilities under GAAP by PNFCs and PFCs (in accordance with AASB 112 *Income Taxes*). The Illustrative Example assumes that the mirror to the deferred tax liability recognised by the PNFC and PFC Sectors is not recognised by the GGS. This is also referred to in Reconciliation note r(ii) of the Illustrative Example.

The AASB has indicated in a letter to HoTARAC that the GGS should not recognise the deferred tax balances to the extent the tax-equivalent events associated with the PNFC and PFC deferred tax balances have not occurred. HoTARAC notes that AASB 1049 does not provide guidance on this issue. Under GFS, in the absence of a counter-party, deferred tax is not recognised as either a transaction or other economic flow. Therefore, only the current GFS tax expense/revenue is recognised. However, HoTARAC notes that, in some jurisdictions, the GGS has recognised tax revenue/assets, eliminated on consolidation at the whole-of-government level, to mirror the position reported by PNFCs and PFCs.

HoTARAC considers that when convergence differences are eliminated, the resulting government general purpose financial reports will be more useful to users and will have a less onerous impact on preparers.

Section C - General comments on the text of ED 155

Paragraph 6

1. HoTARAC recommends that changing the wording in paragraph 6 from "in accordance with" to "in a manner consistent with" may resolve the perception that paragraphs 6 and 7 are inconsistent.

2. HoTARAC recommends the inclusion of a statement that ED 155 prevails in the event of an inconsistency with another Standard.

Paragraph 7

3. One Standard in conflict is listed. HoTARAC recommends the inclusion in ED 155 of a list of those Standards that are not to be applied when preparing financial statements under ED 155. This could include AASB 114 *Segment Reporting* and AASB 124 *Related Parties*.

Paragraph 9

4. Paragraph 9 (a) states that historical cost is not characterised as fair value. However, it is often the case that historic cost is deemed as fair value, for example where an active market does not exist. HoTARAC recommends the AASB clarifies the implications of the statement "not characterised".

5. The assumption contained in paragraph 9 (e) "that because of the format of the GFS cash flow statement the direct method must be used for the cash flow statement" may be incorrect. HoTARAC notes that some jurisdictions using the indirect method are not able to use the direct method.

6. HoTARAC recommends the inclusion of the following additional grey letter items in paragraph 9 as a result of AASB 2007-4 *Australian Additions to, and Deletions from IFRSs*, as examples of particular optional treatments that paragraph 8 has the effect of limiting:

   - Classification of dividends paid in the Cash Flow Statement; and
   - Use of the government bond rate in the WoG financial report (even though for-profit entities may use the high quality corporate bond rate).

Paragraph 32

7. As noted earlier in this submission, HoTARAC recommends amendments to AASB 123. If that recommendation is not undertaken, this paragraph should include capitalised interest as an example of an item that needs to be expensed for GFS.

Miscellaneous Comments

8. For many jurisdictions, dividends paid will be a reconciling item disclosed in the Disaggregated Reconciliation to GFS Net Operating Balance. For some jurisdictions, this will be the only reconciling item. HoTARAC notes that the need for reconciliations would be removed if the GFS Disaggregated Income Statement included an Income Tax Equivalents and Dividends line item under Operating Surplus.

Section D - Comments relating to the Illustrative Example

General Matters

1. The use of differing terms in financial statements to describe the same item may confuse users. For example, "distributions" in the Cash Flow Statement and "dividends" in the Operating Statement. HoTARAC recommends that items are consistently referred to throughout the Illustrative Example.

2. The treatment of transactions with an owner, as an owner, are not illustrated. HoTARAC recommends that the inclusion of a transaction to illustrate the differential treatment with an owner, as an owner, would clarify the treatment to be adopted.

3. Where differences in elimination do not cause a difference in measurement of key fiscal aggregates, and are not included in key reconciliation notes, HoTARAC recommends that disclosure on consolidation of these differences should not be required. At best, this information will be an estimate, because at the time of preparing the statements, jurisdictions will not be in a position to know the final GFS numbers finalised by the ABS. Users requiring this information can refer to ABS publications.

4. Note (f) is intended to explain the convergence differences for the Net acquisition of non-financial assets. The inclusion of the tables from the perspective of providing information on how this item is derived is supported. However, the tables do not explain the convergence differences. HoTARAC recommends that the note includes a short narrative component similar to Note k to explain the convergence differences.

Balance Sheet – WoG

5. The illustrated negative net worth may confuse readers. HoTARAC recommends the AASB casts the illustrative example as a positive net worth entity. "Buildings and structures" and/or "land" could be increased to reflect positive net worth.

6. HoTARAC recommends that the reference to "unfunded superannuation liability" should be replaced by "superannuation" or "defined benefit superannuation" since this item is under the heading of liabilities. In addition, these terms are more flexible and accommodate jurisdictions that have partly funded superannuation.

Operating Statement - WoG

7. HoTARAC recommends the inclusion of an additional line item on the face of the Operating Statement: "Transactions with Owners as Owners". For preparers who disclose these movements on the face rather than in the notes, this item would reconcile the full movement in (non-GFS) net worth and be consistent with the purposes of the current statement of changes in equity under AASB 101 paragraph 97(a). Further, this would provide users with a single reference point to review all such movements.

8. It is unclear whether the item "superannuation interest expenses" includes the off-setting actuarial-determined expected return on plan assets or if this component of superannuation is included under the item "employee expenses-superannuation". HoTARAC recommends this should be clarified, with the word "net" being included in the item description.

Cash Flow Statement-WoG

9. HoTARAC recommends that the item "Dividends from associates (part of share of net profit/(loss) from associates)" be shortened to "Dividends from associates" or be included in the item "Other receipts".

10. HoTARAC recommends that the complementary item to "Sales of investments" should be "Purchases of investments" rather than "Increases in investments".

Operating Statement – by sector

11. HoTARAC recommends that the reference to the Operating Statement for the WoG by Sector as Note "R" be extended to all sectoral statements.

PRICEWATERHOUSECOOPERS

ED 155 sub 2

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17 August 2007

Dear David

Exposure Draft ED 155 *Financial Reporting by Whole of Governments*

We write in response to the request for comments contained in the May 2007 Australian Accounting Standards Board (AASB) Exposure Draft 155 *Financial Reporting by Whole of Governments* (ED 155).

We support the general approach taken in the exposure draft. Whole of government financial reports should be prepared using the same accounting principles as are applied in other financial reports. Where there is a conflict between the accounting principles in the accounting standards and the Government Finance Statistics (GFS), the accounting standards should prevail. Additional disclosures may be provided to satisfy the GFS requirements, together with a reconciliation between the two frameworks. In particular, we agree that all controlled entities should be consolidated on a line by line basis.

We support requiring information which is additional to that required by other accounting standards to be included on the face of the financial statements, so that information is presented about key fiscal aggregates in a manner that is consistent with the information presented in GFS financial reports.

We also agree that the requirements of AASB 1049 *Financial Reporting of General Government Sectors by Governments* should be combined with the proposals in ED 155 in due course so that one accounting standard specifies requirements for both whole of government financial reports and General Government Sector (GGS) financial reports.

PRICEWATERHOUSECOOPERS

Professor David Boymal
17 August 2007

We would welcome the opportunity to discuss our views at your convenience. Please contact me on (02) 8266 8099 if you would like to discuss this further.

Yours sincerely

Wayne Andrews

Wayne Andrews
Partner
Assurance

PricewaterhouseCoopers is committed to providing our clients with the very best service. We would appreciate your feedback or suggestions for improvement. You can provide this feedback by talking to your engagement partner, calling us within Australia on 1800 792 111 or visiting our website http://www.pwcfeedback.com.au/

ED 155 sub 3

New South Wales
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17 August 2007

Dear Professor Boymal

Exposure Draft 155 *Financial Reporting by Whole of Government* – Comments on the treatment of deferred tax in the general government sector

I refer to the request for comments on Exposure Draft ED 155 *Financial Reporting by Whole of Government*ent. Please find attached a short comment paper by NSW Treasury regarding the issue of deferred tax, referred to in the Exposure Draft.

The Illustrative Example to ED 155 currently provides that the mirror to the deferred tax liability recognised by the Public Non-Financial Corporation (PNFC) and Public Financial Corporation (PFC) sectors is not recognised by the General Government Sector (GGS). This is also referred to in Reconciliation note r(ii).

NSW Treasury disagrees with this conclusion and believes that deferred tax balances are controlled by the GGS, as a result of its control relationship over the PNFC/PFC sectors. In NSW Treasury's view, the AASB has not given sufficient consideration to the issue of control in its initial deliberations (refer AASB Agenda Paper 11.2). The AASB should revisit this issue, in light of the attached comments, before finalising the Standard.

If NSW Treasury's view is accepted, this would give rise to an additional convergence difference between the Government Finance Statistics (GFS) and Generally Accounted Accounting Principles (GAAP).

Finally, irrespective of the final position on the issue of the GGS mirror deferred tax asset, the AASB needs to consider whether the deferred tax expense is a 'transaction' or 'other economic flow' for the PNFC/PFC.

If you have any queries regarding the attached paper, please contact me on (02) 9228 3019 or Dianne McHugh on (02) 9228 5340.

Yours faithfully

R. Williams

Robert Williams
for Secretary

TREATMENT OF DEFERRED TAX UNDER GFS / GAAP

1. Issue

Under GFS, deferred tax is not recognised as either a transaction or other economic flow. Therefore, only the current tax expense/revenue is recognised.

In contrast, under the GAAP framework, PNFCs and PFCs recognise deferred tax assets / liabilities (in accordance with AASB 112 *Income Taxes*) and in New South Wales the GGS has recognised revenue / assets to mirror the position reported by PNFCs and PFCs. This is then eliminated on consolidation at the whole of government level.

At a minimum, this issue will give rise to a GFS/GAAP convergence difference for the PNFC and PFC sectors (i.e. as deferred tax is recognised under GAAP but not under GFS). The question is, whether there is a similar GFS/GAAP convergence difference for the GGS, in terms of the mirror deferred tax revenue/ asset. Therefore, this paper examines whether:

- the GGS should recognise as revenue / asset the deferred tax of the PNFCs and PFCs.
- deferred tax revenue / expenses are transactions or other economic flows[1].

2. Background

2.1 Accounting Standard requirements

AASB 1049 *Financial Reporting of General Government Sectors by Governments* requires the General Government Sector (GGS) financial report to be prepared in a manner consistent with other Australian Accounting Standards, unless otherwise specified in the Standard. From the GGS perspective, the relevant Standard for the treatment of any revenue / asset relating to the PNFC/PFC deferred tax liability/expense is AASB 1004 *Contributions*. AASB 112 is not applicable to the tax collector.

AASB 1004 states that income from the contribution of an asset to the entity must be recognised when and only when the following conditions have been satisfied (AASB 1004, para 9):

- The entity obtains control of the contribution or the right to receive the contribution;
- It is probable that the economic benefits comprising the contribution will flow to the entity; and
- The amount of the contribution can be measured reliably.

Also, AAS 31 *Financial Reporting by Government* provides that tax revenues should be recognised when the underlying transaction or event which gives rise to the government's right to collect the tax occurs and can be measured reliably (AAS 31, para 15.2.1).

[1] Even if it is not accepted that a mirror deferred tax asset/ revenue is recognised by the GGS, this question arises from the viewpoint of the PNFC/PFC sectors.

2.2 AASB view

Australia's Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC) raised this issue with the AASB. In the AASB's response (letter dated 19 March 2007), they concluded that the GGS should not recognise the deferred tax balances. In coming to this conclusion, they argued that, consistent with the principles in AASB 1004, the GGS should not recognise the deferred tax revenue / asset until the tax equivalent event or transaction has occurred. They argued that from a PNFC/PFC viewpoint, the 'event' is the recognition of the underlying assets / liabilities, but from the GGS's perspective, it is the occurrence of taxable transactions.

Further, the AASB Agenda Paper 11.2, which addressed this issue also stated:

> "We acknowledge that the issue is complicated by the fact that the GGS controls the PNFC/PFC and thereby arguably controls the contribution. That issue starts to get into the consolidation question. Therefore, consistent with the principles that GGS does not consolidate PNFC/PFC, we do not believe that it is appropriate for it to recognise revenue / asset as a counter to the PNFC / PFC deferred tax liability." (Refer 'Staff Response 1', p 2)

The AASB decided that it was not necessary to amend AASB 1049 in response to this issue, but will include it in a list of possible improvements for consideration at a future meeting (refer AASB Minutes of 15 March 2007). However, the Illustrative Example to ED 155 currently assumes that the mirror to the deferred tax liability recognised by the PNFC/PFC sectors is not recognised by the GGS (refer Reconciliation note r(ii)).

3. Analysis

3.1 Recognition of deferred tax asset / revenue

New South Wales recognises revenue / assets in the GGS to mirror the deferred tax position reported by PNFCs and PFCs. NSW Treasury believes that this treatment is permitted by current GAAP and disagrees with the AASB's above conclusion. This is premised on the view that 'control' of the deferred tax contribution is obtained at the same time that the PNFC/PFCs recognise the associated deferred tax expenses/liabilities. This is on the basis:

- The tax equivalents regime is a 'closed system' where the tax collector is the GGS and the PNFC/PFC entities are required to fully comply with the income tax legislation and deferred tax accounting.
- The GGS controls these sectors and as such it controls the mirror deferred tax asset / revenue taken up by the PNFC/PFC sectors.

Further, NSW Treasury argues that the other two criteria of 'probability' and 'reliable measurement' in AASB 1004 are also satisfied on the basis that:

- The probability of the PNFC/PFC paying the tax is the same probability of the GGS receiving it. Therefore, if the PNFC/PFC can recognise the liability based on probability, the GGS can recognise it on the same basis.
- As the GGS sector controls the PNFC/PFC entities, the amounts are reliably measurable.

The AASB staff response in Agenda Paper 11.2, acknowledged that because of this control relationship, the GGS arguably controls the contribution. However, the AASB dismissed this argument as this 'starts to get into the consolidation question', and on the basis that the GGS does not consolidate PNFC/PFC. NSW Treasury believes that this argument is invalid and notes that AASB 1049, para 11(a) "...prohibits the consolidation of controlled entities in other sectors". But that equally explicitly acknowledges that the GGS sector controls the other sectors and also controls the mirror deferred tax asset / revenue.

The other argument advanced by the AASB was that from the GGS perspective, the tax equivalent 'event' that gives rise to control has not occurred. In contrast, the AASB points out that from the viewpoint of the PNFC/PFC, the 'event' is the recognition of the underlying assets/liabilities. However, NSW Treasury argues that, given the control relationship between the sectors, the 'event' is the same for all sectors.

The concept that the relevant 'event' for tax revenue is the 'taxable event' is not included in AASB 1004. Rather, it is part of AAS 31 (para 15.2.1). Also, the AAS 31 reference is clearly in regard to the tax collected external to government, and not the tax equivalents regime operating within jurisdictions. As discussed, the primary difference is that the tax equivalents system is a 'closed system' entirely within government control.

Further, determining the 'event' that gives rise to control and recognition is a question of judgement. That is, the premise of accrual accounting is that items are recognised as incurred or earned, which maybe at an earlier point than the legal liability. In terms of tax equivalents, the 'event' could be argued to occur at various points e.g. the recognition of the underlying asset/liability (or the economic event that gives rise to a future tax asset/liability – per AASB 112, first paragraph under 'Objective') or the taxable event. The choice of the 'event' depends on when control is obtained; when it is probable and when the amount can be measured reliably. Given the nature of the tax equivalent regime, it may be argued that the 'event' that gives rise to the PNFC/PFC deferred tax liabilities/expenses is the same 'event' that gives rise to the GGS's mirror deferred tax asset/revenue.

Finally, if the AASB's argument is accepted, NSW Treasury question the conceptual basis for the recognition of deferred taxes/liabilities under AASB 112. That is, why is it acceptable to recognise deferred taxes/liabilities based on the underlying assets/liabilities of the taxpayer, yet not recognise the asymmetrical treatment for the tax collector, where the tax collector is in a position to control the taxpayer?

3.2 Transaction or other economic flow

Where deferred tax is recognised under GAAP, a question arises as to whether the associated expense/revenue is a 'transaction' or 'other economic flow' under AASB 1049 and GFS/GAAP. Under GFS, deferred tax is not recognised either as a transaction or other economic flow. Even if it is not accepted that a mirror deferred tax asset/ revenue is recognised by the GGS (refer 3.1 above), this question arises from the viewpoint of the PNFC/PFC sectors. This needs to be addressed by the AASB. This is because GAAP prevails over GFS, unless otherwise indicated.

There are a number of different arguments regarding this issue. For example, some argue that, because GFS does not recognise deferred tax assets / liabilities, and because AASB 1049 states that amounts must be classified as transactions or other economic flows in a manner consistent with the principles in the ABS GFS Manual, that the outcome which best aligns with those principles is to treat all deferred tax expenses/revenues as an 'other economic flow'. This is also akin to treating the movement as a revaluation, which is the approach adopted in regard to doubtful debts (refer AASB 1049, para 31(g)).

An alternative argument is that where the deferred tax arises from a movement in an asset or liability that itself is recognised as a transaction, then the associated deferred tax on that movement should also be recognised as a transaction (but not otherwise). This would mean that deferred tax would need to be dissected between transactions and other economic flows, depending on treatment of the underlying asset / liability.

Finally, some argue that if a mirror deferred asset/revenue is recognised by the GGS to reflect the PNFC/PFC treatment, then the entire deferred tax expense/revenue is a transaction, because in a 'closed' tax equivalent system within government, it is a 'mutually agreed interaction' which satisfies the definition of a 'transaction'.

4. Conclusion

NSW Treasury is of the view that because of the nature of the tax equivalent system in the public sector and the control relationship between the GGS and PNFC/PFC sectors, a mirror revenue/ asset should be recognised by the GGS to counter the PNFC/PFC tax balances. This would give rise to an additional GFS/GAAP convergence difference.

However, irrespective of the outcome on the above issue, the AASB will need to examine whether deferred tax expenses/revenue are 'transactions' or 'other economic flows' under GFS/GAAP convergence.

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20 August 2007

Mr David Boymal
Chairman
Australian Accounting Standards Board
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By email: standards@aasb.com.au

Dear David

Exposure Draft 155: Financial Reporting by Whole-of-Governments

Thank you for the opportunity to comment on Exposure Draft 155: *Financial Reporting by Whole-of-Governments.*

CPA Australia supports the FRC's objective of harmonising GFS and GAAP *"to achieve an Australian accounting standard for a single set of Government reports which are auditable, comparable between jurisdictions, and in which the outcome statements are directly comparable with the relevant budget statements"*. CPA Australia believes strongly that this objective be observed in all GFS and GAAP harmonisation initiatives.

As the ASSB has also issued ED 156 *Short Term Review of AAS 27, 29 and* 31, CPA Australia believes that it is important that the AASB considers the implications of, and response to, ED 156 prior to issuing the standard arising out of ED155.

Our detailed comments on the specific matters raised in the Exposure Draft are attached to this letter. Should you have any queries on our comments, please contact Chee Ng our Public Sector Policy Adviser at cheemin.ng@cpaaustralia.com.au.

Yours sincerely

Geoff Rankin FCPA
Chief Executive Officer

cc: C Ng

CPA Australia's Response to ED 155 Financial Reporting by Whole of Governments

(a) the Board's intention to amend AASB 1049 to reflect its decisions arising out of this Exposure Draft and thereby issue a single integrated Standard that specifies requirements for both whole of government financial reports (incorporating GGS, PNFC sector and PFC sector financial information) and GGS financial reports;

CPA Australia supports a single integrated standard given the close relationship between the sectors and the whole-of-government.

CPA Australia does recognise that, while this is an onerous task, it is a necessary one.

(b) the Board's intention to base whole of government general purpose financial reporting requirements on the principles adopted in AASB 1049 for GGS financial reporting;

CPA Australia supports this approach as it results in consistency in reporting and avoids any confusion had separate basis been followed.

c) the treatment of transactions with owners as owners and between the GGS and the PNFC/PFC sectors. They may also occur in a whole of government context in relation to partly owned subsidiaries. The Board is particularly interested in views on whether the differential treatment of transactions with owners as owners and movements in reserves is appropriate;

CPA Australia considers the approach proposed in the Exposure Draft appropriate.

(d) sector information (paragraphs 41-46). Given the potentially onerous nature of a requirement to disclose the financial statements and reconciliation notes for the GGS, PNFC sector and PFC sector in the whole of government financial report, the Board is particularly interested in views on whether the proposal in this Exposure Draft would provide the most effective way to meet users' needs for sector information;

CPA Australia believes that this is a presentation issue and considers the disclosures necessary.

(e) budgetary information (paragraphs 47-53). The Board is particularly interested in interested in views on whether:

(i) whole of government budgetary information should only be required to be disclosed where whole of government budgeted financial statements are presented to parliament; and

(ii) sector budgetary information should not be required to be disclosed in the whole of government financial report;

CPA Australia supports:

- that the whole of government budgetary information should only be required to be disclosed where whole of government budgeted financial statements are presented to Parliament; and
- that sector budgetary information should not be required to be disclosed in the whole of government financial report.

(f) transitional requirements (paragraph 54). In particular, the Board is proposed, which is to require the principles in AASB 108 Accounting Policies, Changes in Accounting Estimates and Errors to apply to the first whole of government financial report prepared in accordance with the proposals in this Exposure Draft;

CPA Australia the transitional requirements proposed in the Exposure Draft.

(g) whether, overall, the proposals would result in financial reports that would be useful to users; and

CPA Australia believes that the real test is the increasing use of the financial statements proposed by users and the phasing out of reports produced under the Uniform Reporting Format.

(h) whether the proposals are in the best interest of the Australian economy.

CPA Australia believes that this will only be achieved:

- when the FRC's objective of harmonising GFS and GAAP "to achieve an Australian accounting standard for a single set of Government reports which are auditable, comparable between jurisdictions, and in which the outcome statements are directly comparable with the relevant budget statements" is realised; and
- increasing use of the financial reports and data produced proposed by the Exposure Draft by the users including the Australian Loan Council.

AUSTRALASIAN COUNCIL OF AUDITORS-GENERAL

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21 August 2007

Mr David Boymal
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AUSTRALIA

Dear Mr Boymal

ED 155 – FINANCIAL REPORTING BY WHOLE OF GOVERNMENTS

Members of the Australasian Council of Auditors-General (ACAG) have been canvassed and submit the attachment in response to the Exposure Draft referred to above.

The views expressed in this submission represent those of all Australian members of ACAG with the exception of the Auditor-General for South Australia, who reserves his right to respond separately to auditing and accounting Exposure Drafts where he deems it appropriate, rather than as a member of ACAG.

ACAG supports the release of a standard based on ED 155 and believes that the requirements proposed for whole-of-government in ED 155 will be an improvement on current reporting practice and will enhance Government Finance Statistics (GFS) information.

ACAG also supports the desire of the Financial Reporting Council (FRC) to see concurrent preparation of harmonised financial statements for the General Government Sector (GGS) and Whole of Government in 2008-09.

The attachment to this letter details ACAG's specific comments to the matters raised in the Exposure Draft.

The opportunity to comment is appreciated and I trust you will find the attached comments useful.

Yours sincerely

Frank McGuiness
Chairman
ACAG Financial Reporting and Auditing Committee

ATTACHMENT

SUBMISSION BY THE AUSTRALIAN MEMBERS (EXCEPT FOR THE AUDITOR-GENERAL FOR SOUTH AUSTRALIA) OF THE AUSTRALASIAN COUNCIL OF AUDITORS-GENERAL ON ACCOUNTING EXPOSURE DRAFT –

ED 155 Financial Reporting by Whole of Governments

Note – references below to ACAG are limited to the Australian members of ACAG, excluding the Auditor-General for South Australia.

Specific comments

a) request for comment on the Board's intention to amend AASB 1049 to reflect decisions arising out of ED 155 and issue a single integrated Standard that specifies requirements for both Whole of Government financial reports (incorporating GGS, Public Non-financial Corporations (PNFC) sector and Public Financial Corporations (PFC) sector financial information) and GGS financial reports

We support the Board's stated intention to issue a single integrated Standard that specifies requirements for both GGS and Whole of Government financial reports.

An integrated Standard should help to minimise the potential for accounting policy and presentation differences between the GGS report and the reporting of GGS within the Whole of Government Report.

b) request for comment on the Board's intention to base Whole of Government general purpose financial reporting requirements on the principles adopted in AASB 1049 for GGS financial reporting

We agree that the Whole of Government financial reporting requirements should be based on the principles adopted in AASB 1049. This will help to ensure consistency in reporting of GGS and Whole of Government.

c) request for comment on the treatment of transactions with owners as owners and movements in reserves (paragraph 15). Such transactions may occur between the GGS and the PNFC/PFC sectors. They may also occur in a Whole of Government context in relation to partly owned subsidiaries. The Board is particularly interested in views on whether the differential treatment of transactions with owners as owners and movements in reserves is appropriate

We support the differential proposal to incorporate, in a single operating statement, information usually presented in the income statement and the statement of changes in equity under AASB 101 *Presentation of Financial Statements*.

We agree that transactions with owners as owners are different in nature from other movements in reserves and should not be recognised on the face of the operating statement because such transactions do not represent revenue or gains to the entity concerned.

Accordingly, we agree that transactions with owners as owners should be disclosed in the notes or a separate statement.

The Board might consider specifying a form of presentation to achieve consistency for disclosing owner transactions and movements in reserves.

d) Sector information (paragraphs 41-46). The Board has acknowledged the potentially onerous nature of the proposed requirement to disclose the financial statements and reconciliation notes for GGS, PNFC and PFC sectors in the Whole of Government Financial Report. The Board requests views on whether the proposal in ED 155 would provide the most effective way to meet users' needs for sector information.

ACAG supports the presentation of sector information and the reconciliation of sector fiscal aggregates to the equivalent GFS numbers. We believe that the credibility that attaches to this information will be enhanced by being subject to audit. The requirement also promotes comparison between jurisdictions.

Sector information needs to be prepared to produce consolidated financial statements for Whole of Government. The additional burden is in the information being published and the extra work in checking that the presentation of the information is accurate.

On balance we think the advantages of including sector information and reconciliation notes justify these disclosures.

ACAG supports the Board's proposal to present sector information in the form of a table comprising all sectors, Whole of Government and an adjustments column as proposed in the "Illustrative Example" (Supplement to ED 155). We note that the "Illustrative Example" does not show comparative information as required by AASB 101 and believe it would be useful to indicate whether a separate table showing comparatives would be acceptable.

e) request for comment on whether:
(i) Whole of Government budgetary information should only be required to be disclosed where Whole of Government budgeted financial statements are presented to parliament; and
(ii) Sector budgetary information should not be required to be disclosed in the Whole of Government financial report

ACAG agrees that Whole of Government budgetary information should be required to be disclosed where Whole of Government budgeted financial statements are presented to parliament.

ACAG also agrees that sector budgetary information should not be required in the Whole of Government Report. Where the main Budget focus is on the general government sector, the budget to actual comparison is catered for by the financial reports proposed for that sector, through existing AASB 1049.

f) request for comment on whether transitional requirements, in particular assessments of the costs and benefits of the approach proposed, which is to require the principles in AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* to apply to

the first Whole of Government financial report prepared in accordance with the proposals in this Exposure draft

ACAG does not foresee any issues with application of the principles in AASB 108 to the first Whole of Government financial report prepared in accordance with the proposals in ED 155.

Given that AASB 1049 requires AASB 1 *First-time Adoption of Australian Equivalents to International Financial Reporting Standards* to be applied, an explanation of the requirement to apply AASB 108 instead of AASB 1, possibly in the Basis for Conclusions, would be useful.

g) request for comment on whether, overall, the proposals would result in financial reports that would be useful to users

We agree that the proposals in this exposure draft to apply to preparation of the Whole of Government financial report would result in a financial report that would be inherently useful to users of GAAP/GFS information.

h) request for comment on whether the proposals are in the best interest of the Australian economy.

We believe that audited GFS/GAAP information will be in the best interests of the Australian economy.