

Extract from Collation and Analysis of Submissions on ED 142

[ED 142 *Financial Reporting of General Government Sectors by Governments* was issued in July 2005 for comment by 21 October 2005.]

This paper is a modified extract from a Collation that was presented to the Board on its 8-10 February 2006 meeting, updated to take into account a late Submission. Text boxes have been added where applicable to record the Board's decisions made at the February 2006 meeting. The included Issues have been shaded.

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This paper deals with responses to ED 142. Although ED 142 did not specifically ask for comments on whether the proposals satisfy the FRC strategic direction, some respondents made comment on these issues. For the purpose of this paper, this issue is described as a 'Threshold Issue' and is considered ahead of the responses to the specific matters for comment identified in ED 142.

The following structure is used for each of the specific matters for comment:

- numerical analysis of responses by view; and
- summary of main arguments in submissions.

In the preparation of this paper, staff have used judgment in interpreting the responses and attributing them to a particular view where required. Therefore, the collation is not intended to be a substitute for reading the full text of the submissions.

Classification and Listing of Submissions

| Class | Description | Number of Submissions |
|--------------|----------------------------|-----------------------|
| Acc/Aud | Accounting and Auditing | 7 |
| Pers/Aca | Personal/Academic | 2 |
| Gov | Governmental Organisations | 9 |
| Total | | 18 |

| ID | Respondent | Class |
|----------------|--|----------|
| 1 – Alfred | Keith Alfredson | Pers/Aca |
| 2 – PwC | PricewaterhouseCoopers | Acc/Aud |
| 3 – NIA | National Institute of Accountants | Acc/Aud |
| 4 – ICAA | Institute of Chartered Accountants in Australia | Acc/Aud |
| 5 – Deloitte | Deloitte Touche Tohmatsu | Acc/Aud |
| 6 – CPAA | CPA Australia | Acc/Aud |
| 7 – Barton | Professor Allan Barton, Australian National University | Pers/Aca |
| 8 – ABS | Australian Bureau of Statistics | Gov |
| 9 – AGV | Auditor General of Victoria | Acc/Aud |
| *10 – HoTs | Heads of Treasuries | Gov |
| *11 – DFA&TT | Department of Finance & Administration and The Treasury, Australian Government | Gov |
| *12 – VicDTF | Department of Treasury and Finance (Victoria) | Gov |
| *13 – TasDTF | Department of Treasury and Finance (Tasmania) | Gov |
| *14 – WADTF | Department of Treasury and Finance (Western Australia) | Gov |
| *15 – TasTreas | Treasurer (Tasmania) | Gov |
| #16 – ACAG | Australasian Council of Auditors General | Acc/Aud |
| *17 – SADTF | Department of Treasury and Finance (South Australia) | Gov |
| 18 – VicPAEC | Victorian Public Accounts and Estimates Committee | Gov |

* The responses from these ID numbers use essentially identical arguments and ID numbers 11 to 15 and 17 effectively cross-reference to the HoTs' submission and therefore, to avoid repetition, these seven submissions are presented together, where appropriate.

The submission from ID number 16 includes the views of seven of its nine Australian members. The exceptions are the Auditor-General of South Australia, who reserves the right to respond separately where he deems appropriate, and the Auditor-General of Victoria, who lodged a separate submission (ID number 9).

Threshold Issues

Issue (1) FRC strategic direction

Do the proposals in ED 142 satisfy the FRC's strategic direction to harmonise GAAP with GFS? If not, can the FRC strategic direction be satisfied?

| Threshold Issue (1) | | | |
|---------------------|---|--|----|
| 1 | The FRC strategic direction is not satisfied | PwC, ICAA, CPAA, Barton, HoTs, DFA&TT, VicDTF, TasDTF, WADTF, TasTreas, ACAG, SADTF, VicPAEC | 13 |
| 2 | The FRC strategic direction cannot be satisfied | Deloitte, AGV | 2 |
| 3 | No explicit comment provided (except general views expressed by some) | Alfred, NIA, ABS | 3 |

Summary of main arguments in submissions

Arguments indicating the FRC's strategic direction is not satisfied by ED 142

- HoTs state that it is the consensus view of Australia's Treasuries that ED 142 fails to harmonise GAAP and GFS to any meaningful degree. The failure is a fundamental concern to HoTs and it clearly means that ED 142 does not comply with the FRC's directive.
- The FRC's apparent objective is to increase the transparency and accountability of governments by removing the confusion associated with the publication of two sets of financial statements. The proposals would result in a significant reduction in the understandability and comparability of the government reports, and accordingly would not meet the objective. (HoTs)
- The proposals do not harmonise the two frameworks to a single conceptual accounting framework, and therefore will not deliver comparable, understandable and relevant or reliable reports. For example, the operating surplus, buried in an 'overwhelmed' operating statement, will have two different measures attached to it. (HoTs)
- The reconciliation approach would increase the complexity of the reports and reduce users' understandings. Therefore, HoTs strongly disagree with ED 142 and would not support it becoming a standard. In order to progress this high priority project, HoTs believe that, in light of its comments, the AASB should undertake a major review of the Exposure Draft, and then issue a new Exposure Draft for stakeholder comment. HoTs recognise that this would necessitate deferral of mandatory application of the GAAP-GFS reporting standard until 2007-08.
- True harmonisation has not been achieved as ED 142 merely facilitates a presentation of both GAAP & GFS on the financial statements and because some convergence differences still remain. Harmonisation can only be achieved where there is a single set of financial statements and where only irreconcilable differences are permitted on the financial statements. (AGV)
- It is disappointing that full convergence has not been achieved and that the proposed GGS financial report has to proceed on a reconciliation basis. As a result, there is a need to minimise any possible confusion to the users. (ACAG)

- It is a concern that Australia is insisting on leading the way with GAAP/GFS harmonization (ICAA and CPAA). CPAA's users group suggest Australia wait for the outcome of the IPSASB and the IMF review of the System of National Accounts, which is due in 2008.
- It is questionable whether it is appropriate for the AASB to mandate the preparation of GPFs for Australian GGSs, if this will not be mandated under the proposed international requirements (eg IPSASB ED 28 *Disclosure of Financial Information about the General Government Sector*). The AASB's broad strategic direction to implement GAAP/GFS convergence requires it to have regard to international activities, including the work undertaken by the IPSASB. (PwC)
- CPAA consultation with its users group (comprising four Public Accounts Committees, a Finance and Estimates Committee, a Ratings Agency, GFS and GAAP academics and Access Economics) indicates that the reports will not meet many of their needs and they would still consult with preparers on other specific requirements, and that the converged statements would benefit the preparers more than the users.
- It is questionable whether it is appropriate to converge with the existing GAAP framework. GAAP requirements for government reporting should be investigated first before converging with GFS. (CPAA)
- A fundamental concern is that GAAP reports are given pre-eminence over the GFS reports in ED 142. The presumed superiority of the GAAP system cannot be accepted in the context of the public sector. GAAP is fundamentally designed for the business for-profit sector, and its objectives, concepts and standards are designed accordingly. However, the nature and methods of government operations are fundamentally different. The GFS system is the appropriate one for government rather than GAAP. It provides useful information which is relevant for the information needs of government, and which can satisfy the reliability, comparability and understandability requirements. However, it suffers from a few problems such as the expensing of all expenditures on military equipment, and it needs enhancement for its application at the micro level of government resource management. (Barton)
- In accordance with the FRC's strategic direction, the AASB's objective was to achieve an accounting standard for a single set of Government reports which are auditable, comparable, and in which the outcome statements are directly comparable with related budgets. ED 142 has partially achieved this objective because, although GGS financial reports, if produced based on ED 142 proposals, will be auditable, comparable, and outcome statements will be comparable with related budgets, the proposals do not achieve convergence between GFS and GAAP. Consequently, the proposals do not enable governments to prepare a single GGS financial report that will satisfy both GFS and GAAP requirements. Additionally, the report may not provide users with relevant and useful information. (Deloitte)
- GGS financial aggregates should be based on conceptually best treatments, either GFS or GAAP. This will ensure that the FRC's strategic direction is satisfied and that financial statements are clear and understandable. (HoTs)
- ED 142 is a step in the right direction although it tends to be based on reconciliation rather than convergence, and therefore it leads to complexity. One

set of converged financial statements is likely to increase transparency and accountability. (ICAA)

- ED 142 does not achieve harmonisation. The proposed format for financial reports is merely a reconciliation between GFS and GAAP, rendering it less relevant to the users' needs. (VicPAEC)

Arguments indicating the FRC's strategic direction cannot be satisfied

- The fundamental premise underlying the FRC's direction is questionable because of the different sets of data, with GAAP being based on an accounting framework, while GFS is based on economic statistics following a framework established by the IMF. Each framework serves different but related objectives. The GAAP framework focuses on the 'reporting entity' for the purposes of reporting performance and discharging responsibility whereas the GFS framework focuses on the economic impact the government has on the economy. (AGV)
- The AASB has no authority with respect to the formulation of GFS and was only prepared to depart from GAAP in limited circumstances. This being the case, the 'reconciliation' approach proposed by the Exposure Draft is arguably the only solution to presenting both GFS and GAAP information in the same financial report. (Deloitte)

Other general comments

- The AASB has shown considerable leadership in developing an Exposure Draft in which both GFS and GAAP co-exist within the same framework. This is a world-first and it has received considerable attention from the international statistical community. We thank the Board for providing such strong leadership in this field. (ABS)
- ABS state that anything purporting to be on a GFS basis should in fact be on a bona-fide GFS basis, as users should rightfully be given the opportunity to have confidence in both 'views' of the underlying information. Mandating GFS for GFS-based information would be helpful in this regard.
- NIA comment that the GAAP-GFS project is one to 'harmonise' the two frameworks underlying accounting practice in the public sector and that to 'harmonise' does not mean grant or guarantee supremacy to any single ideal. The AASB is encouraged to further consider its proposed framework for public sector reporting (see NIA's submission).
- ACAG members are disappointed that full convergence has not been possible at this time but regard the work done to date as useful, given that it provides audited GAAP, GFS and reconciliations between the two.

Outcome of the 8-10 February 2006 AASB meeting:

"The Board decided ...to continue developing a Standard for the General Government Sector (GGS) of a federal, state or territory government based on the proposals in ED 142 amended, where appropriate, to take account of respondents' comments."

(AASB 8-10 Feb 2006 Draft Minutes of Meeting, Agenda Item 6, first (a));

"The Board also decided that the Chairman should update the FRC on the status of the project and convey the main messages reflected in the submissions, including the different views on what is meant by the word 'harmonisation' in the FRC's directive and the view of some that the so-called reconciliation-approach is not true harmonisation."

(AASB 8-10 Feb 2006 Draft Minutes of Meeting, Agenda Item 6).

Specific Matters for Comment

Issue (a) Is GGS a reporting entity?

The proposal in paragraph 5 that the GGS (as defined in GFSM 2001) of a government is a reporting entity.

| Issue A | | | |
|---------|----------------------------|---|----|
| 1 | Agree with the proposal | ICAA, Deloitte, CPAA, Barton, ABS, HoTs, DFA&TT, VicDTF, TasDTF, WADTF, TasTreas, ACAG, SADTF | 13 |
| 2 | Disagree with the proposal | PwC, NIA, AGV, VicPAEC | 4 |
| 3 | No comment provided | Alfred | 1 |

Summary of main arguments in submissions

Issue (a) is inextricably linked to the ‘partial consolidation’ issue addressed in issue (b). Some respondents effectively commented on the two issues as if they were one, whereas others considered the two issues as if they are independent of each other.

The supporters of the proposal commented that:

- The GGS meets the key criteria for being regarded as a reporting entity in accordance with SACs 1 and 2. The GGS is the ‘budget sector’ with a large number of key users who are interested in comparable, accountable and transparent GPFs and are unable to command the preparation of such reports.
- There is extensive user interest in the GGS, which arises mainly due to the non-market characteristics of the GGS being economically different from the market-oriented government-controlled corporations. The market and non-market proportions in each of the nine jurisdictions are individually significant. Hence, there is a user need for their separate identification and reporting.
- In acknowledging that there is disagreement over this proposal, the AASB should finalise the remaining parts of Phase 1 of the GAAP/GFS Convergence Project as soon as possible. This would place the GGS financial reports explicitly within the context of the harmonised WoG GPFs.

The opponents of the proposal commented that:

- The GGS neither meets the definition of an ‘entity’ nor an ‘economic entity’ under SAC 1 and thereby fails to meet the definition of ‘reporting entity’.
- A government is a reporting entity that is involved in a wide range of activities and GGS is only a subset of it. Therefore, if GGS is recognised as a reporting entity, and as such GPFs are prepared, then it fails to recognise that government is involved in other activities. From an accountability perspective, it is not appropriate for the government to present a partial picture of its activities to parliament. There are also transactions between various sectors of the government (eg. GGS, PNFC, and PFC) that could lead to misleading results if each sector is reporting and viewed in isolation.
- The principal entities dependent on information relating to GGS are statistical agencies such as the ABS, which currently command the preparation of reports tailored to satisfy their information needs.

- If AASB revises the definition of ‘reporting entity’ and ‘GPFRs’ in the Conceptual Framework, this may open up a floodgate for entities, including private sector entities, to present segmental information as GPFRs, thus providing users with incomplete information.
- Since the reporting entity is the government and the GGS is a part of it and not a reporting entity in itself, the AASB should consider requiring the issue of a suite of reports, rather than the single financial report, making up the GPFR for the reporting entity that is government.
- Treating the GGS as a reporting entity, and consequently applying a special treatment to it (that is, ‘partial consolidation’, see Issue (b)), is not consistent with the AASB’s broad strategy of sector neutrality.

CPAA identified that the AASB has the following options:

- a) Amend ED 142 to require a full application of all accounting standards – including consolidating by GGS of its controlled entities in the PNFC and PFC sectors;
- b) Call the GGS financial reports special purpose financial reports (SPFRs); and
- c) Call the GGS financial reports something between GPFRs and SPFRs (eg Government-produced financial reports).

Some respondents recommended the AASB provide explanations on the rationale for its conclusion that the GGS is a reporting entity.

Outcome of the 8-10 February 2006 AASB meeting:

[Staff note: The decision is also relevant to Issue (b).]

“... the GGS should be required to prepare a GPFR that does not consolidate on a line-by-line basis, the controlled entities that are part of other sectors. Given the controversial nature of this decision, the Board decided to articulate its rationale in a Basis for Conclusions that will accompany the Standard. Mr Appleyard, Ms Peach and Ms Perry agreed to assist staff in drafting the Basis for Conclusions”
(AASB 8-10 Feb 2006 Draft Minutes of Meeting, Attachment A, Item (a)).

Issue (b) *Partial-consolidation in a GPFR*

The proposal, implicit in paragraph 5, that a GGS financial report prepared on a partial consolidation basis is a GPFR together with the proposal in paragraph 18 that the GGS should be prohibited from consolidating controlled entities in the PNFC sector and the PFC sector.

| Issue B | | | |
|---------|--|---|----|
| 1 | Agree with the proposals | Deloitte, Barton, ABS, HoTs, DFA&TT, VicDTF, TasDTF, WADTF, TasTreas, ACAG, SADTF | 11 |
| 2 | Disagree and express concerns with the proposals | Alfred, PwC, NIA, ICAA, CPAA, AGV, VicPAEC | 7 |

Summary of main arguments in submissions

Arguments in favour of the proposals

- As users are interested in knowing how effectively government policies for the allocation of public funds have been delivered, the GGS is more relevant than WoG as a general purpose reporting entity of the government.
- The concept of consolidation, as it applies to the for-profit sector, is not readily applicable to the public sector, when determining whether a reporting entity is relevant to the activities of the Executive Government.
- It is not meaningful to recognise the stand-alone existence of the GGS and then undertake a line-by-line consolidation. This would in turn defeat the purpose of separate identification of the GGS.
- The proposed standard will identify a clear framework and consistent basis for the preparation of the financial reports on the GGS, even though it may not comply with all aspects of other accounting standards.
- The proposals result in useful information and do not ‘offend’ WoG financial reports because:
 - a) Expressions such as ‘partial consolidation’ and ‘prohibit from consolidation’ seem to carry the connotation that GGS’s finances are somehow misrepresented. In fact, the method of consolidation is different in form rather than in substance because the GGS is, in effect, consolidating its controlled entities in a single line, rather than on the traditional line-by-line basis.
 - b) The single-line consolidation preserves details that relate exclusively to GGS and thus satisfy the users’ needs. In any case, the total controlled asset and liabilities, on a line-by-line basis, would still be available in WoG financial reports.
 - c) If the single-line consolidation is of concern, the AASB could consider requiring the GGS to provide a note disclosure showing the names of the controlled entities, opening and closing balances of their assets and liabilities.

Arguments against the proposals

- If GGS financial reports are labelled GPFRs, they should comply with all accounting standards. This means that, the GGS should consolidate its controlled entities in the PNFC and PFC sectors in accordance with AASBs 3 *Business Combinations* and 127 *Consolidated and Separate Financial Statements*.

- Proposing to issue a standard that supports the concept of partial consolidation has broken GAAP, as no existing standards support it
- The current proposals reduce comparability to other GPFRs and undermine the concept of control.
- A suite of reports, rather than a single GPFR, should be presented for the reporting entity that is the government. GGS is only a subset of the government.
- CPAA consulted the following key stakeholders: four Public Accounts Committees, a Finance and Estimates Committee, a Ratings Agency, GFS and GAAP academics and Access Economics. The results indicated that partial consolidation does not meet their needs. Therefore, the usefulness of the GGS reports may be questionable and ED 142 will not meet its desired objectives.
- It would be better to define the notion of control in the public sector, rather than abandoning the concept and adopting a different concept because it is easier to apply.
- If the public sector follows a framework that is different from the private sector, it is a step away from the commitment for sector neutral standards.
- A GGS GPFR is very much akin to a parent entity financial report and therefore should only be presented in conjunction with a WoG's consolidated set of accounts.
- The proposals are akin to promoting "Enron" type accounting with all the difficulties of unconsolidated controlled entities.
- The proposal to require the preparation of GPFRs for the GGS is a significant divergence from the approach proposed in IPSASB ED 28 *Disclosure of Financial Information about the General Government Sector*. IPSASB ED 28 proposes requirements for the disclosure of GGS information within WoG GPFRs, where a government elects to make such disclosures.
- Regarding the GGS as a reporting entity that prepares GPFRs ignores the equity of government in the PNFC and the PFC sectors. Not recognising the government control of these corporations (by adopting a 'partial-consolidation' basis) is contrary to the fundamental concept of control under Australian Accounting Standards. This would invariably lead to qualification by the Auditor-General.
- One of the practical difficulties with the proposal is the government may draw dividends from these corporations. The impact of such drawings would not be apparent unless the WoG financial reports were produced concurrently with the GGS reports.
- The GGS reports should be regarded as SPFRs and should provide the same level of information as is provided in the government's financial report.

Outcome of the 8-10 February 2006 AASB meeting:

[Staff note: The decision is also relevant to Issue (a).]

"... the GGS should be required to prepare a GPFR that does not consolidate on a line-by-line basis, the controlled entities that are part of other sectors. Given the controversial nature of this decision, the Board decided to articulate its rationale in a Basis for Conclusions that will accompany the Standard.

Mr Appleyard, Ms Peach and Ms Perry agreed to assist staff in drafting the Basis for Conclusions"

(AASB 8-10 Feb 2006 Draft Minutes of Meeting, Attachment A, Item (a)).

Issue (e) Treatment of GGS investment in PNFC & PFC sectors

The proposals in paragraphs 19 to 23 that:

- (i) the GGS's equity investment in non-consolidated controlled entities should be measured at fair value where fair value is reliably measurable and at the government's proportional interest in the net assets of the controlled entities where fair value is not reliably measurable;
- (ii) where net assets is used as the basis of measurement, it is determined in a manner consistent with the net assets that are consolidated into the whole of government GPFs;
- (iii) changes in the carrying amount of the GGS's equity investment in non-consolidated controlled entities during a reporting period are treated in a manner consistent with the treatment of a change in fair value under AASB 139 even if the carrying amount is not fair value; and
- (iv) specify the treatment of jointly controlled entities and associates.

| Issue E: Treatment of GGS's equity investment in non-consolidated controlled entities | | | |
|--|---|--|----|
| 1 | As proposed by the ED | NIA, Barton, ABS, HoTs, DFA&TT, VicDTF, TasDTF, WADTF, TasTreas, ACAG, SADTF | 11 |
| 2 | Should be fully consolidated | ICAA, CPAA | 2 |
| 3 | Measure at proportional share of net assets | Deloitte | 1 |
| 4 | Measure at cost | Alfred | 1 |
| 5 | Should not be recognised on balance sheet | AGV | 1 |
| 6 | No comment provided | PwC, VicPAEC | 2 |

Summary of main arguments in submissions

Core Issue

On the question of the treatment of the GGS's equity investment in non-consolidated controlled entities, the respondents are divided on the following five methods of recognition of non-consolidated controlled entities:

- As proposed in ED 142
The majority of the respondents agree with the proposal, although the support of some of them appear reluctant as they might have presumed that they had lost their argument to oppose the 'partial consolidation' treatment referred to in Issue (b).
- Full Consolidation
Consistent with the views expressed under Issue (b), two respondents advocated a full consolidation of the controlled entities in the PNFC and PFC sectors in accordance with all Australian Accounting Standards, without exception, given that the GGS financial reports are GPFs.
- Proportional Share of Net Assets
Deloitte comments that the fair value measurement method proposed for the controlled entities is impractical and potentially onerous. It suggests measurement at the proportional share of the assets as this would be more consistent with the measurement basis of controlled entities in the WoG reports.

- At Cost
Alfredson disagrees with the proposal and comments that the fair value treatment would be anomalous and irrelevant to objectives of GGS reports, which are to report the results of the activities dependent on taxes and revenues rather than to report the results of the controlled entities. Additionally, he believes that there are no benefits in merely recording fair value in GGS reports and not in WoG reports. He suggests the cost method of valuation for these assets.
- No Recognition in the Balance Sheet
AGV claims that the proposed treatment of controlled entities and associates is an example of “cherry-picking” as on the one hand, the ED proposes partial consolidation for the controlled entities in the PNFC and PFC sectors, and on the other hand, it proposes full consolidation for other types of investments. As both scenarios are to be treated as investments, AGV does not support the proposed inconsistency in accounting treatments.

AGV also expressed the view that the GGS is only a segment of the WoG and not a reporting entity, and that the GGS does not control the PNFC and PFC sectors, as the controlling entity is the government. Accordingly, AGV does not believe that GGS can have an equity investment in the other sectors.

Outcome of the 8-10 February 2006 AASB meeting:

“... the investment of a GGS in non-consolidated controlled entities should be recognised and measured in accordance with the proposals in ED 142 (that is fair value or, if fair value is not available, net assets)”
(AASB 8-10 Feb 2006 Draft Minutes of Meeting, Attachment A, Item (c)).

Issue (i) Additional information in accounting policy note

The proposals in paragraphs 44 and 45 relating to additional information to be provided in the note containing the summary of significant accounting policies, illustrated in Appendix C. In particular, the Board is interested in comments on whether the proposed disclosures provide sufficient information to minimise the risk that users might perceive the GGS financial report as being a substitute for the whole of government GPFRs.

| Issue I | | | |
|---------|-----------------------------------|--|----|
| 1 | Proposed disclosures are adequate | NIA, ICAA, Deloitte, Barton, ABS, HoTs, DFA&TT, VicDTF, TasDTF, WADTF, TasTreas, SADTF | 12 |
| 2 | Concerns expressed | CPAA, AGV, ACAG, VicPAEC | 4 |
| 3 | No comment provided | Alfred, PwC | 2 |

Summary of main arguments in submissions

Additional information illustrated in Appendix C

Most respondents support the proposals and the notes illustrated in Appendix C. They believe the notes are sufficiently clear and comprehensive and that they clearly distinguish between the GGS and the WoG reports. HoTs commented that many jurisdictions currently produce budget outcome reports that are restricted to GGS, in addition to the WoG GPFRs. Therefore, the proposals provide an opportunity for greater linkages between the budget outcome reports and the WoG GPFRs.

CPAA agrees the additional disclosures would be useful to users in reading the context in which the GGS reports are prepared. However, CPAA is concerned that the users might be misled by inconsistent treatments of certain items included in the GGS and the WoG financial reports, eg. the GGS's partial consolidation of controlled entities within the PNFC and the PFC sectors, and the WoG's full consolidation of these same entities.

GGS reports being perceived as substitutes for WoG reports

The following concerns are expressed by respondents:

- There is the danger that the focus on WoG reporting will be de-emphasised, particularly where work on ED 142 for the WoG reporting under the GAAP/GFS convergence framework is yet to be seen. [Staff Note: refer to Threshold Issue 2]
- It is questionable whether the cross reference to the WoG reports is sufficient to ensure the users get the full picture and overall context of the reports being produced.
- There is a potential for the development of a practice for the GGS results to be audited and published before the finalisation of the WoG reports. This will further diminish the focus of the WoG reports.
- Having a harmonised standard that deals only with GGS may result in divergence between GFS reporting for the GGS and GFS reporting for the PNFC and PFC sectors of government under the Uniform Presentation Framework. [Staff Note: refer to Threshold Issue 2]
- Users might be misled by inconsistent treatments of certain items included in the GGS and WoG financial reports, eg the GGS's partial consolidation of controlled entities within the PNFC and PFC sectors, and the WoG's full consolidation of these same entities. [Staff Note: refer to Issue (b)]

In light of their concerns, AGV and ACAG recommend the following actions:

- An urgent completion of Phase 1 and therefore of ED 142 on WoG under GAAP/GFS convergence framework. [*Staff Note: refer to Threshold Issue 2*]
- Governments to move towards concurrent financial reporting of both GGS and WoG.

The VicPAEC supports GGS financial reports being produced concurrently with those of the government, as this would minimise the potential impact of the dividend drawings made by the government (discussed at Issue (b)).

ABS encourages the Board to adopt a more neutral expression by avoiding words such as ‘minimise the risk that users might perceive’.

Outcome of the 8-10 February 2006 AASB meeting:

“... consistent with the proposals in ED 142, the Standard should require the GPFR of a GGS to include a cross-reference to the related WoG GPFR but that the Standard should not imply that it is necessary for the WoG GPFR to exist or to be publicly available at the time the GPFR of a GGS is finalised. The other proposed disclosure requirements in paragraph 44 of ED 142 and the illustration in Appendix C should be retained unamended”

(AASB 8-10 Feb 2006 Draft Minutes of Meeting, Attachment A, Item (e)).

Issue (m) Budgetary information

The proposals in paragraphs 57 to 62 to require disclosure of:

- (i) the original budget, restated if necessary so that it is presented on a basis that aligns with the basis on which the financial statements and notes have been prepared (in accordance with the Standard); and
- (ii) an explanation of major variances between the original GGS budget and actual amounts.

| Issue M(i) – which budget should be disclosed? | | | |
|---|---|---|---|
| 1 | Original budget (as adopted) – as proposed | NIA, Deloitte, ABS, AGV, ACAG | 5 |
| 2 | Revised budget | CPAA | 1 |
| 3 | Original budget (as adopted) and final revised budget (but can accept view 2) | ICAA | 1 |
| 4 | Original or mid-year budget | Barton | 1 |
| 5 | Original budget (as presented) or revised budget, at discretion of jurisdiction | HoT, DFA&TT, VicDTF, TasDTF, WADTF, TasTreas, SADTF | 7 |
| 6 | No specific comment | Alfred, PwC, VicPAEC | 3 |

| Issue M(ii) – explanation of major variances | | | |
|---|-----------------------------|--|---|
| 1 | Support the proposal | NIA, ICAA, Deloitte, CPAA, Barton, ABS, AGV | 7 |
| 2 | Do not support the proposal | HoT, DFA&TT, VicDTF, TasDTF, WADTF, TasTreas, ACAG, SADTF, VicPAEC | 9 |
| 3 | No specific comment | Alfred, PwC | 2 |

Summary of main arguments in submissions

Overall

All respondents commenting on the Issue agree that budget information should be presented, and that it should be on a basis that aligns with the basis on which the financial statements have been prepared. AGV note that there are risks involved in restatement of budgets where they were originally prepared on a GFS basis. ICAA expresses concern that the proposal will trigger Auditors-General to seek to audit the budget documents. It would not support changes to current practice in this area. Some express concern if notes are also required to be presented.

M(i) Which budget should be disclosed?

Arguments in favour of the original adopted budget only

- Useful information for users

Arguments in favour of the revised budget only

- Unless amendments to the original budget are taken into account, the basis on which variances occur will be distorted

Arguments in favour of requiring either original or mid-year budgets

- Variances are normally substantial due to the inherently inaccurate nature of budgeting. Mid-year budgets are prepared some 9 months later than the original budget and forecasts are more accurate

Arguments in favour of requiring either original (as presented) or revised budgets

- It is a matter for individual jurisdictions to determine according to circumstances
- It is consistent with the FRC's requirement that outcome statements should be comparable with relevant budget statements
- Revised budgets contain explanations of changes between the revised budget and the original or previously revised budget
- Reporting of only variances since the previous published budget revision allows for the provision of more detailed explanations of movements
- Reporting against the most recent published budget allows users to focus on the most recent variances, rather than on movements that may have occurred earlier in the year and that have been previously reported
- The revised budget information is available in public documents such as the Mid-Year Report or the Budget Papers
- The budget as first presented to Parliament provides greater understandability and accountability [*Staff note: see the HoTs' submission for expansion of this argument*].

Respondents' suggestions for drafting amendments

- The revised budget should be defined as the most recently revised published budget
- The original budget is the first budget "presented" to parliament (and not "adopted" as per paragraph 59 of the ED)
- The disclosure of budget information in the notes should be at the discretion of each jurisdiction.

M(ii) Explanation of major variances

Arguments in favour of an explanation of major variances

- Provides useful information and a basis for a better understanding of the information
- Assists users in assessing the discharge of a government's accountability in relation to its activities

Arguments against an explanation of major variances

- Explanation of variances between budget and outcomes is considered to be management information, which does not generally form part of the GPFRs
- Explanations of variances can be compared to statements by company directors in the private sector, which are not subject to audit
- The reasons for the variation may be verifiable, but not auditable, or may not fall within the expertise of the auditor. While disclosure of such variances is to be encouraged, the appropriate place is in a management discussion and analysis or similar reporting of performance by management outside of the financial report
- Explanations of revisions to original budget numbers would be given as revisions are published during the year

- Practical difficulties for both the presentation and auditing of the explanations are envisaged
- The matter should be considered further in the context of the IPSASB's Budget Reporting Project
- It is questionable whether budget variances should be included in the audited financial reports for the GGS, particularly where the information has not been to-date included in the private sector's financial reports. The budget variances and explanations for them should continue to be recorded in the budget documents, in the report of operations, etc but not in the GGS's audited financial reports
- Inclusion of variances in GPFR may make the audit process unnecessarily complicated and extended as all budget information would need to be audited
- Budget variations can occur for a range of reasons and can be open to interpretation as to their cause

Outcome of the 8-10 February 2006 AASB meeting:

"... the Standard should:

- (i) require budget information (being the original budget that relates only to the financial statements themselves that was presented to parliament) to be presented in the GPFR of a GGS on a comparable basis to the GGS financial statements;
- (ii) require explanations of major variances between the actual amounts and the budgeted amounts to be disclosed in the GPFR of a GGS; and
- (iii) explicitly allow the disclosure of a revised budget in the GPFR of a GGS in addition to the original budget"

(AASB 8-10 Feb 2006 Draft Minutes of Meeting, Attachment A, Item (g)).

Issue (o) Illustrated formats of financial statements

The illustrated acceptable format for the financial statements and notes related to convergence differences in Appendix B. The Board is particularly interested in comments on:

- (i) the columnar approach illustrated for the balance sheet and operating statement. In addition to any criticisms of the columnar approach, respondents are invited to provide an alternative that is consistent with the Exposure Draft's proposals for the Board's consideration; and
- (ii) whether the illustration provides guidance that is helpful in implementing the proposals in the Exposure Draft, particularly those that adopt the requirements in AASB 101 as effectively amended by the proposals.

| Issue O(i) – Multi-column approach | | | |
|---|---|--|----|
| 1 | Support multi-column approach | CPAA, ABS | 2 |
| 2 | Do not support multi-column approach. Prefer convergence differences in notes to financial statements | ICAA, Barton, AGV, HoTs, DFA&TT, VicDTF, TasDTF, WADTF, TasTreas, ACAG, SADTF, VicPAEC | 12 |
| 3 | Indifferent to multi-column approach | Deloitte | 1 |
| 4 | No comment provided | Alfred, PwC, NIA | 3 |

| Issue O(ii) – Illustration provides helpful guidance | | | |
|---|--|--|----|
| 1 | Illustration provides helpful guidance | ICAA, Deloitte, CPAA, Barton, ABS, AGV, HoTs, DFA&TT, VicDTF, TasDTF, WADTF, TasTreas, ACAG, SADTF | 14 |
| 2 | No comment provided | Alfred, PwC, NIA, VicPAEC | 4 |

Summary of main arguments in submissions

Issue O(i) – Multi-column approach

Arguments for the multi-column approach and suggestions for improvement

- ABS supports the multi-column approach, as it is considered helpful in presenting the key elements of both GFS and GAAP in close proximity and the information relating to a particular year is less likely to be spread over multiple pages. ABS would prefer the key GFS Aggregates to remain on the face of the statements.
- The user group consulted by CPAA likes the multi-column format presented in Appendix B as it provides a streamlined approach in presenting most information.
- It would be beneficial for the report preparers if Appendix B includes narrative explanations of some other equally acceptable presentation methods.
- All columns, including disaggregated information should be totalled.

Arguments against the multi-column approach

- The multi-column approach is extremely unwieldy and impractical. It in turn may seriously impair the usefulness of the GGS financial reports. This would be exacerbated when comparatives to the estimates of the previous year, of the current budget year and of the three forward years are included, which would take up to 20 columns across the page.

- The budget presentation adopted in the Budget Papers rightly should be consistent with the format used for financial reports. However, adopting the multi-column format as illustrated would make it impossible to use the same format for the presentation of the budget in the Budget Papers.
- Presentation of two different balance sheets which are to be audited is likely to place the Auditor General in a difficult situation in attesting to the truth and fairness of balance sheets for the same entity and balance date (notwithstanding the qualifying statement concerning preparation of the reports in accordance with AAS and GFS standards etc). Any major company publishing two sets of very different financial statements would arouse great suspicion in the minds of investors and the public.
- The presentation of budgetary information on a separate page, as proposed by paragraph 62 of ED 142 is not considered to be a suitable alternative. This is because it does not facilitate the comparison of the budget and outcome information in a form that is readily understandable by users. Similar problems apply to the presentation of historical information for a number of years for trend analysis.
- A down the page approach is more practical and could usefully also be illustrated, picking up perhaps on some of the other mandatory information proposed by the standard that is not readily accommodated by the columnar approach eg budget information and comparatives.
- The column shown in Appendix B for convergence differences should be removed. Such removal would shift focus of the financial statements to the key results achieved by the GGS, rather than the convergence differences between GAAP and GFS.
- The single-column format as shown at Attachment B of the HoTs' submission is recommended to be an endorsed format for inclusion in the Standard. If this recommendation is not adopted by the Board, HoTs seek explicit confirmation from the Board that this format is acceptable.

Issue O(ii) – Illustration Provides Helpful Guidance

Almost all respondents believe that the illustration contained in Appendix B provides helpful guidance in implementing the proposals of ED 142.

Outcome of the 8-10 February 2006 AASB meeting:

[Staff note: The decision is also relevant to issue (r).]

“... the principles as proposed in ED 142 should be adopted. However, the Board decided that:

- (i) the format of the illustrative financial statements included in Appendix B of ED 142 should be replaced with an illustration of a single-column format, with GAAP presented on the face of the financial statements, GFS aggregates presented in a box at the bottom of the statements, reconciliation of any remaining convergence differences presented in the notes to the statements, and other GFS information presented either on the face or in the notes as appropriate. The illustration should accommodate the GFS notion of distinguishing transactions from other economic flows; and
- (ii) to undertake further consultation with constituents, including users, to develop the illustration. A sub-committee including Mr O’Grady, Mr Kaufmann and Mr Keys, a representative from HoTs and CPA Australia, is to be formed to assist with the reformatting of the illustrative financial statements”
(AASB 8-10 Feb 2006 Draft Minutes of Meeting, Attachment A, Item (d)).

Issue (r) Do the proposals result in useful information for users?

Whether, overall, the proposals result in financial reports that are useful to users.

| Issue R | | | |
|---------|--------------------------------|--|----|
| 1 | Significant concerns expressed | ICAA, Deloitte, CPAA, Barton, AGV, HoTs, DFA&TT, VicDTF, TasDTF, WADTF, TasTreas, ACAG, SADTF, VicPAEC | 14 |
| 2 | Useful to users | ABS | 1 |
| 3 | No comment provided | Alfred, PwC, NIA | 3 |

Summary of main arguments in submissions

In general, the respondents consider the proposals useful to users as this is a step in the right direction in trying to achieve one set of converged financial statements rather than the current regime of two sets. Most said that one set of converged financial statements would be more likely to increase transparency and accountability of governments.

Some respondents note the information produced will be useful because the disclosure of GAAP/GFS measures would satisfy the information needs of users. For example, ABS notes that the use of the GFS basis of distinguishing ‘transactions’ and ‘other economic flows’, as per the illustrated format of the operating statement, will result in financial reports that are useful to users. Additionally, reporting the actual performance against budget would provide useful information to users in assessing the discharge of a government’s accountability.

However, most respondents express the following concerns, including those of the CPAA consultative user group:

- The FRC’s strategic direction has only been achieved partly. This is because ED 142 does not achieve a convergence between GAAP and GFS and therefore does not enable governments to prepare a single GGS financial report that will satisfy both GAAP and GFS requirements. The AASB has no authority with respect to the formulation of GFS, as it applies to Australia, and ED 142 indicates that the AASB is only prepared to depart from the AASB Accounting Standards in limited circumstances. Consequently, the reconciliation approach proposed by ED 142 is arguably the only solution to presenting both GFS and GAAP information in the same financial report.
- The ED is based on a reconciliation rather than convergence approach, and leads to some complex accounting disclosures and reconciliation.
- The presentation of both GAAP and GFS data on the face of financial statements creates too many bottom lines, which may confuse users.
- The issue of partial consolidation is a major concern. The users consulted by CPAA believe that the proposed approach would exclude relevant information about the effects of all controlled entities. They are also concerned about the issue of the reports being prepared on the basis contrary to the conceptual framework but held out to be GPFs.
- Reports are prepared on a different basis from the private sector, thus it is seen as a move away from the sector neutral standard principle.

- The removal of AAS 27 *Financial Reporting on Local Government*, AAS 29 *Financial Reporting by Government Departments* and AAS 31 *Financial Reporting by Governments* before the finalisation of ED 142, would leave the GGS report preparers with no specific guidance, and a potential for incomparable reports.
- The AASB should investigate the GAAP requirements for government reporting first, before converging with GFS.
- It is not evident from ED 142 that its proposals will provide users with relevant and useful information. Accordingly, it is suggested that the Board gives due consideration to the views expressed by the preparers and users of government financial reports in this regard.
- Although considerable progress has been made, a full convergence has not been achieved, and a number of significant issues remain to be resolved. Therefore, the AASB is encouraged to undertake a major review of ED 142 and to issue a new ED.
- Australia should await the completion of the IPSASB and IMF review of the System of National Accountants in 2008.

Staff Recommendation – Issue (r)

Staff believe that, in combination, the staff recommendations made throughout this collation would result in GGS financial reports that are useful to users who require both GAAP and GFS information.

Outcome of the 8-10 February 2006 AASB meeting:

[*Staff note: The decision is also relevant to issue (o).*]

“... the principles as proposed in ED 142 should be adopted. However, the Board decided that:

- (i) the format of the illustrative financial statements included in Appendix B of ED 142 should be replaced with an illustration of a single-column format, with GAAP presented on the face of the financial statements, GFS aggregates presented in a box at the bottom of the statements, reconciliation of any remaining convergence differences presented in the notes to the statements, and other GFS information presented either on the face or in the notes as appropriate. The illustration should accommodate the GFS notion of distinguishing transactions from other economic flows; and
- (ii) to undertake further consultation with constituents, including users, to develop the illustration.

A sub-committee including Mr O’Grady, Mr Kaufmann and Mr Keys, a representative from HoTs and CPA Australia, is to be formed to assist with the reformatting of the illustrative financial statements.”

(AASB 8-10 Feb 2006 Draft Minutes of Meeting, Attachment A, Item (d)).