

EXTRACT FROM MINUTES: AASB 15-16 OCTOBER 2003 MEETING

GAAP/GFS CONVERGENCE

Agenda Item 9

The Board had before it:

- (a) a memorandum from Robert Keys and Parveen Dhaliwal dated 1 October 2003, providing a background to the AASB's deliberations at its 2-3 September meeting concerning its draft Consultation Paper to Project Advisory Panel members, an update on the matters discussed at the HoTARAC GFS/GAAP Convergence Working Group meeting on 24 September 2003, and international activities concerning GAAP/GFS convergence (Agenda paper 9.1);
- (b) a draft Consultation Paper containing preliminary views that is intended to be provided to Project Advisory Panel members as an accompaniment to the HOT's submission on GAAP/GFS convergence (Agenda paper 9.2);
- (c) an issues paper (unamended from the September 2003 AASB meeting) "Which basis of distinguishing between two broad components of a comprehensive performance report should be adopted:
 - 'results from transactions' and 'results from other events'; or
 - 'results from remeasurements' and 'results from other events'" (Agenda paper 9.3);
- (d) the issues paper (unamended from the September 2003 AASB meeting, which in turn was from the December 2002 AASB meeting) "The implications of acknowledging that a General Government Sector (GGS) is Analogous to a Parent Entity" (Agenda paper 9.4A);
- (e) an extract from AARF Discussion Paper 21 (unamended from the September 2003 AASB meeting) *Financial Reporting by Governments* (November 1994) relating to the reporting entity issue (Agenda paper 9.4B);
- (f) a covering letter dated 6 August 2003 from the Acting Chair of HOTARAC to the Acting Chair of the AASB, together with the HOT's endorsed papers containing the HOTARAC Working Group report and conclusions, conceptual papers, technical papers and logistical papers (Agenda papers 9.5, 9.5A and 9.5B – unamended¹ from the papers provided to the September 2003 AASB meeting);
- (g) an issues paper (unamended from the September 2003 AASB meeting) "Examples of issues that may affect the Project Advisory Panel's (PAP) perception of the GAAP/GFS convergence project" (Agenda paper 9.6);
- (h) a report on the HOTARAC GFS/GAAP Convergence Working Group meeting on 24 September 2003 (Agenda paper 9.7);
- (i) an excerpt from the draft minutes from the 2-3 September 2003 AASB meeting (Agenda paper 9.8);
- (j) comments from Brett Kaufmann and Wayne Cameron on an earlier (September 2003) draft of the Consultation Paper referred to in (b) above (Agenda papers 9.9 and 9.10);
- (k) a draft agenda for the PSC/IMF/OECD Working Group on GFS, ESA95, and IPSAS Convergence and Steering Committee of the OECD Taskforce on Harmonisation of Public Sector Standards meeting on 3 October 2003, and a draft report on the meeting (Agenda papers 9.11 and 9.11A); and
- (l) an illustration of a possible format of a "Statement of Financial Performance and Fiscal Impact" (Agenda paper 9.12 – tabled).

Preliminary Board Views on GAAP/GFS Convergence (Agenda paper 9.2)

¹ The "Identification of the Users and Their Uses of Public Sector Financial Statements" paper included as part of agenda paper 9.5A replaced the original version of that paper. (The original version was provided as part of agenda paper 7.5A in September and an update was provided under cover of a separate memo at the September meeting).

The Board reviewed the draft Consultation Paper in Agenda paper 9.2 decided that:

- (a) footnote 1 should be retained, noting that the views in the Consultation Paper will outline the Board's preliminary views, and that the attached Heads of Treasuries (HOT's) papers will be presented as additional background papers that contain the views of HOTs;
- (b) as an underlying general principle, consistent with its policy of issuing sector neutral standards, unless there are compelling reasons to do otherwise, GAAP definition, recognition and measurement principles should be adopted (with note disclosure where necessary to satisfy Government Finance Statistics (GFS) requirements where they differ from GAAP requirements). Consistent with the Board's decisions relating to particular technical issues noted below, the Board agreed to include in the Consultation Paper a preliminary view that, in relation to performance reporting, the broad GFS principles (distinguishing between the results of transactions and other economic flows) should be adopted, although "transactions" should be defined in a manner that aligns with the GAAP notion of transactions. The Board noted the view that "degree of control" is the basis for distinguishing between the two components of performance in GFS, and also noted that ABS staff did not necessarily agree with characterising the transactions/other economic flows dichotomy in such a way. The Board agreed that the approach reflected in the draft Consultation Paper is suitable for the purposes of seeking comment from Panel members;
- (c) to help clarify the scope of the issues, the Consultation Paper should include a flowchart in the introductory section, depicting the inter-relationship between the GGS and other public sub-sectors. Several examples of entities within each sub-sector should also be provided. There should also be an explanation of terminology used in the paper. The Board also decided that flowcharts, or other techniques, should be included at the beginning of each of sections 2 to 4 to give Panel members an overview and guide to the issues being addressed in each section;
- (d) because the FRC's strategic direction has been interpreted as applying the GAAP/GFS Convergence project to all public sector entities and because some constituents have expressed concern at the extension of the scope of the project beyond whole of government (including sector) reporting, Panel members' views and comments should be sought on the implications for Phase 2 and Phase 3 entities if the decisions on Phase 1 entities ultimately flow-through to those other entities;
- (e) *Question 1.1 relating to the HOT's conclusion on the overlap between GAAP and GFS frameworks:* The Board agreed that convergence is a worthwhile objective, and decided that the preliminary AASB view should mention the fact that the Board was given a directive, by the FRC, to pursue this project as an urgent priority;
- (f) *Question 2.1 relating to whether General Government Sector (GGS) is a reporting entity.* The Board agreed with the draft preliminary AASB view and, in addition, decided to reinstate the following two struck-through sentences:

"It is acknowledged in relation to government financial reporting that the political and analytical focus is often directed to the GGS (rather than the whole of government) and in practice it is not possible for users of GGS financial information to command the preparation of GGS-focused financial reports. Therefore, it is appropriate that GGS financial information is made available to users with an interest in such information, and that accounting standards specify the form and content of that financial information.";

- (g) *Question 2.2 relating to reasons to exempt the GGS from full consolidation:* The Board agreed with the draft preliminary AASB view and, in addition, decided to include the additional paragraph (described as a preliminary staff view in the draft Consultation Paper) as part of the preliminary AASB view. That paragraph addresses the view held by some that GGS does not control the entities in the other sectors;
- (h) *Question 2.3 relating to measurement of investments in controlled entities.* The Board agreed with the draft preliminary AASB view, noting the interrelationship of this question with question 3.3 (relating to sector reporting);
- (i) *Question 2.4 relating to the disclosures necessary where GGS is regarded as a reporting entity:* The Board agreed with the draft preliminary AASB view. To facilitate user understanding, the Board decided to include in its preliminary view that general purpose financial reports should include disclosures explaining the meaning of each GFS analytical balance (such as net lending/borrowing) disclosed;
- (j) *Question 2.5 relating to whether the scope of the budget should determine the scope of ex-post reports.* The Board agreed with the draft preliminary AASB view;
- (k) *Question 3.1 relating to the GGS as a sector of the Whole of Government (WOG):* The Board decided that its preliminary view should include the view that, irrespective of whether the GGS is regarded as a reporting entity, the GGS is a sector of whole of government. Panel members should be asked whether or not the GGS is a sector of WOG (even if the GGS is not a reporting entity) and if the GGS is a reporting entity, whether it can also be a sector of WOG;
- (l) *Question 3.2 relating to the prominence of GGS information in WOG reports.* The Board decided in relation to the first sentence in question 3.2 to delete “(partially consolidated)”, to avoid pre-empting the question (question 3.3) of whether sector reports should be prepared on a “partially consolidated” basis, and to add “relative to WOG information” after “financial information”, to provide a context to the question;
- (m) *Question 3.3 relating to the treatment of inter sector investments by the GGS sector.* The Board agreed with the draft preliminary AASB view;
- (n) *Question 3.4 relating to the disclosure of information about other sectors.* The Board agreed with the draft preliminary AASB view;
- (o) *Question 3.5 relating to the need for a GGS standalone general purpose financial report where GGS is a sector of WOG:* The Board agreed with the preliminary staff view as reflected in the text box, subject to rewording the initial sentence to clarify that if an exemption is granted from full consolidation (as an outcome of question 2.2) it would be appropriate to publish a separate stand alone GPFR for the GGS. Furthermore, the question should be amended to insert “potentially” in the bracketed text as follows: “(that potentially does not consolidate entities in the other sectors)” – to avoid pre-empting views on partial consolidations;
- (p) *Question 4 relating to the format and presentation of financial statements:* Consistent with item (c) above, the Board decided that there should be an introductory paragraph to question 4 identifying the issues, and the structure of the issues, involved;
- (q) *Question 4.1 relating to two broad components of the statement of financial performance.* The Board agreed with the draft preliminary AASB view. It decided that the first sentence

of the question should be amended to clarify that the issue relates to the components of the net operating result only. It decided that footnote 7 should provide a cross-reference to question 4.2 and be expanded to make it clear that the GFS notion of “net lending/borrowing” is not contemplated in an IASB Performance Reporting project context. Another footnote should also acknowledge that it may be difficult to adopt certain GFS terminology under GAAP reporting to the extent that GFS uses balance sheet type language (such as “net operating balance” and “net lending/borrowing”) in a statement of financial performance context;

- (r) *Question 4.1.1 relating to the basis for componentising the statement of financial performance.* The Board agreed with the question (although noting that it should be amended to clarify that it is referring to the net operating result) and the preliminary view as drafted in the text box (although see item (b) above). Board decisions regarding examples of particular issues relating to the definition of “transactions” included in the text box are noted below (see for example item (w));
- (s) *Question 4.1.2 relating to the presentation of the components of the statement of financial performance.* The Board agreed with the question (although noting that it should be amended to clarify that it is referring to the net operating result) and the preliminary view in the text box; and
- (t) *Question 4.2 relating to where GFS analytical balances (such as “net lending/borrowing”) relating to financial performance/fiscal impact should be disclosed in a financial report:* The Board decided that the first sentence “To avoid undermining the primary focus of the statement of financial performance from a GAAP perspective...” should be amended to avoid a negative context in asking Panel members for their comments on how such balances could be included in a financial report. The Board also decided that Panel members should be asked to identify which approach to presenting GFS analytical balances would best achieve the objectives of both frameworks and is sufficiently clear to avoid user misunderstanding of the bottom-lines disclosed.

The Board agreed that the preliminary AASB view conveyed to Panel members should contemplate a “Statement of Financial Performance and Fiscal Impact” (which may be perceived by some as being two statements on one piece of paper) that would display both “operating result/balance” and “net lending/borrowing”, together with a reconciliation from a converged net operating result/balance to the GFS net operating balance. The Board considered an example of such a Statement prepared by staff. The Board agreed, in concept, with the format of the example, noting that differing views are held by some constituents as to whether the reconciliation from converged net operating result/balance to GFS net operating balance should be presented on the face of the Statement, and also whether net lending/borrowing should be presented for columns other than the GGS column. The Board decided to include the example, unamended, as an attachment to the Consultation document and to leave specific format issues to be considered later in the project.

Consistent with the above, the Board decided that the preliminary view to be included in the Consultation Paper should be amended to support the option of a Statement of Financial Performance and Fiscal Impact and include the discussion contained in the italicised text under “preliminary staff view”;

- (u) *Question 4.3 relating to the disclosure of transactions with owners:* The Board decided to move the first sentence in the preliminary view: “The IASB has not yet resolved how owner movements in equity should be presented/disclosed in the context of its Performance Reporting project” to a footnote. In accordance with the Board’s decisions in point (t)

above, the second paragraph in the preliminary view should be replaced with the third (italicised) paragraph;

- (v) *Question 4.4 relating to where GFS analytical balances relating to cash flows should be disclosed in a financial report:* Consistent with the view in (t) above, the Board decided that the question should contemplate a “Statement of Cash Flows and Fiscal Impact”, and that the preliminary view should be amended along the lines contained in italicised text in the preliminary staff view text box;
- (w) *Question 5 relating to specific technical issues where HOTs recommends the adoption of GAAP treatments with disclosure to satisfy GFS requirements:* The Board considered in particular the more significant issues so far as they affect performance reporting (swap interest, allowances for bad and doubtful debts, amortisation of intangible assets, distributions receivable and investments in associates) and agreed that all the preliminary staff views in relation to question 5.1 should be included in the Consultation Paper as preliminary AASB views. The Board noted that dividends (particularly dividends from controlled entities) could arguably be classified as transactions (rather than other economic flows) if “degree of control” is adopted as the basis for classifying components of performance. In relation to the amortisation of intangible assets, the Board decided that the text “consistent with the preliminary view to question 6.2 item (f)” should be deleted to remove a potentially confusing cross-reference;
- (x) *Question 6 relating to specific technical issues categorised in agenda paper 9.2 as those where HOTs recommends the adoption of GFS treatments in the short term (future GAAP treatment is broadly expected by HOTs to align with the GFS treatment):* The Board considered in particular the more significant issues (revisions relating to prior periods [correction of errors and changes in accounting policies], actuarial adjustments for government defined benefit superannuation schemes, self-generating and regenerating assets, initial recognition of assets and financial instruments) and agreed that all the preliminary staff views in relation to question 6.2 should be included in the Consultation Paper as preliminary AASB views;
- (y) *Question 7 relating to other specific technical issues:* The Board considered in particular the more significant issues (revisions relating to prior periods [changes in estimates], constructive obligations, investment properties, valuation of inventory and negative goodwill) and except for valuation of inventories, agreed that all the relevant preliminary staff views in relation to question 7.1 should be included in the Consultation Paper as preliminary AASB views. The Board’s preliminary view on valuation of inventory is that rather than provide an option for inventory to be measured at current replacement cost, consideration should be given to requiring all inventory to be measured at current replacement cost. Accordingly, the last sentence of sub-paragraph (h) in the preliminary view should be amended by deleting “be given the option to” and adding “all” after “measure”;
- (z) *Question 8 relating to unidentified technical issues:* the Board decided to omit the text “Not aware of any such differences. However,” from the preliminary view and agreed with the rest of the preliminary staff view;
- (aa) *Question 9 relating to the timing of making a converged framework mandatory.* The Board decided that the question should be described as “Timetable for Completion” rather than “Operative Date”. In addition, to avoid Panel members forming a false impression about the extent to which convergence will be achieved in a limited time frame, the preliminary view

expressed should also note that there are many issues to be resolved and that future research is required on some of the issues before a convergence solution can be achieved; and

- (ab) *Questions 10 to 16 relating to vehicle for convergence, interpretation of GFS in relation to identified technical issues, subsequently identified technical issues, international convergence, convergence of private sector and public sector accounting standards, users and uses of public sector financial information, and other comments:* the Board agreed with the preliminary staff views on these matters.

The Board decided to amend the draft Consultation Paper to reflect the above decisions and retain the current drafting of the remaining sections prior to review by a subcommittee of the AASB (comprising Ms Picker, Mr Appleyard, Mr Cameron and Mr Kaufmann) before it is sent to Project Advisory Panel members for comment (and posted on the AASB's website). PAP members will be requested to provide their comments to the AASB by the end of January 2004.

Action:

Staff
Board Sub-Committee