

## **PUBLIC SECTOR ACCOUNTING: GAAP/GFS HARMONISATION**

### **Issue**

There have been developments on the completion of Phase 2 of the GAAP/GFS Harmonisation Project. The AASB has, after its consultation process on ED 174, decided not to mandate GAAP/GFS harmonisation requirements on entities within the General Government Sector (GGS), and instead develop non-mandatory guidance that could be used if a jurisdiction or GGS entity elects to present harmonised financial reports.

### **Recommendations**

It is recommended that Council Members:

- recognise the considerable effort and resources the AASB has devoted to this project to date;
- discuss the FRC strategic direction, the AASB proposal for completion of the project (Accompanying Paper 4(a)(i)) and Don Challen's response (Accompanying Paper 4(a)(ii)); and
- make a decision on ways forward for completion of the GAAP/GFS Project. Possible options include:

#### *Accept AASB proposal*

- (i) accept the AASB proposal as an adequate solution to phase 2 of the project, albeit one not meeting the original direction;

#### *New Strategic Direction*

- (ii) issue another strategic direction or clarification to the AASB to ensure that the Council's strategic goals for public sector accounting are achieved;

#### *Request Ministerial Direction*

- (iii) write to the Ministers for Financial Services, Superannuation & Corporate Law and Finance & Deregulation, requesting they re-affirm the priority the Government gives to this policy; or

#### *Legal Advice*

- (iv) engage in (joint) legal consultations to ascertain the status of the original FRC strategic directions and AASB responses.

### **Background**

In December 2002 the FRC issued its initial strategic direction calling for the AASB to:

*“pursue as an urgent priority the harmonisation of Government Finance Statistics (GFS) and Generally Accepted Accounting Principles (GAAP) reporting. The objective should be 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.*

*The strategic direction agreed by the FRC involves including within Australian GAAP applicable to the public sector, the key features of the GFS framework. This will enable comparability across the public sector within Australia, without sacrificing the high level of international comparability which currently exists through GFS reporting.”*

In April 2003, the strategic direction was modified by deleting the second paragraph of the direction. It was felt that this deletion would help ensure that the strategic direction was seen to be fully consistent with the respective roles of the FRC and AASB as specified in the *Australian Securities and Investments Commission Act 2001*.

At its December 2006 meeting, the (then) AASB Chairman sought clarification of the strategic direction and the FRC agreed that, with the completion of Phase 1 (whole of government and government financial corporations) and Phase 2 (GGS), the requirements of the public sector strategic direction would be met.

Phase 1 was largely completed by the AASB with the issuing of AASB 1049.

At its February 2008 meeting, the FRC discussed the AASB’s GAAP/GFS Harmonisation Project and noted that: following decisions taken by the FRC at its December 2006 meeting, there is an expectation amongst public sector stakeholders that the final stages of the GAAP/GFS Harmonisation project covering GGS will be completed by February 2010 as then proposed by the AASB; reaffirmed its December 2006 decision that, Stage 1 of the project (covering the GGS and Whole of Government reporting) having been completed, it remained to complete Stage 2 (covering entities within the GGS) to fulfil the requirements of the strategic direction; and requested the AASB maintain its priorities to ensure Stage 2 of the GAAP/GFS Harmonisation project is completed no later than the previously agreed date of February 2010.

#### *Phase 2*

At its May 2008 meeting, the AASB commenced consideration of specific issues relating to the extension of GAAP/GFS harmonisation to entities within the GGS of the Australian Government and the State and Territory Governments. The AASB approved ED 163 *Proposed Amendments to AASB 1049 for Consistency with AASB 101* for a Standard to update AASB 1049 for the changes in AASB 101 *Presentation of Financial Statements* (issued September 2007). The changes relate primarily to new terminology and to the requirement to prepare a ‘statement of changes in equity’.

At its September 2008 meeting, the AASB reconsidered its May 2008 decisions in the light of a letter from Heads of Treasuries. The letter further identified some of the practical implications of applying AASB 1049 to entities within the GGS.

In October 2008, the FRC hosted a public sector accounting workshop. The GAAP/GFS harmonisation issue was highlighted in the DoFD papers *Public Sector Issues Paper* and *Development of Public Sector Reporting in Australia* and both assumed the AASB would be proceeding with the completion of Phase 2.

At its December 2008 meeting, the AASB considered a draft Exposure Draft and approved the ED for issue, subject to it being amended to reflect the Board’s decisions. Exposure Draft [ED 174 \*Amendments to Australian Accounting Standards to facilitate GAAP/GFS Harmonisation for Entities within the GGS \[AASBs 101, 107 and 1052\]\*](#) was issued for public comment in January 2009 with a four-month comment period. A draft illustrative example, developed with the

assistance of the HoTARAC GFS/GAAP Harmonisation Working Group, was also issued which reflected a possible format of financial statements for entities within the GGS under ED 174 proposals. The AASB held Roundtables in Melbourne and Canberra to discuss the specific matters for comment included in ED 174 and the Supplement. The AASB reports that it received thirteen written submissions on ED 174 and the Supplement.

At its June 2009 meeting, the AASB discussed the responses to ED 174 and the Board expressed a preference not to proceed with Phase 2 of the project on the grounds that imposing GAAP/GFS harmonisation requirements in the manner proposed in ED 174 on the general purpose financial statements of entities within the GGS would not meet the needs of a broad range of users. The Board decided that its view and the rationale for its view should be outlined in a paper to be provided to FRC members.

A draft progress report paper for the FRC was considered by the AASB at its July 2009 meeting. The AASB decided that the paper should ask the FRC to reconsider its broad strategic direction in relation to Phase 2 of the GAAP/GFS Harmonisation project, on the basis that the majority of the AASB had reservations about the usefulness of the proposed incorporation of GFS presentation and classifications into the general purpose financial statements of entities within the GGS. A dissenting paper highlighting peak body views in favour of Phase 2 was circulated to the meeting. The AASB Chairman raised the prospect of an AASB request to alter Phase 2 at the 21 September 2009 FRC meeting.

Following the 21 September 2009 FRC meeting, there was further discussion in September between the FRC, the AASB, the Department of Finance and Deregulation (DOFD) and Treasury in order to develop ways forward.

At the September AASB meeting, Mr Tim Youngberry, Acting General Manager, Finance Management Group, DoFD outlined the Department's view of the benefits users of the general purpose financial statements of entities within the GGS might derive if the Board were to issue GAAP/GFS harmonisation requirements based on the proposals in ED 174. The AASB session was for information purposes, and no decisions were made. The AASB also noted that, on 24 September 2009 the Minister for Finance and Deregulation wrote to the Chair of the AASB reaffirming the Government's and Parliament's desire for completion of Phase 2.

At the 30 October 2009 AASB meeting, the AASB reconsidered proceeding with GAAP/GFS harmonisation for entities within the GGS based on the proposals in ED 174 *Amendments to Australian Accounting Standards to facilitate GAAP/GFS Harmonisation for Entities within the GGS*, and discussed alternative ways to proceed. The AASB decided to issue non-mandatory guidance, which would include material based on the proposals in ED 174 and an illustrative example that could be used if a jurisdiction/entity elects to present GAAP/GFS harmonised general purpose financial statements. The Board's decisions made in June 2009, when the Board originally reviewed constituents' comments on the ED, and subsequent staff work, will be taken into account in finalising the guidance.

On 2 November 2009 the AASB Chairman wrote to the FRC Chairman with a progress report on GAAP/GFS harmonisation, and this letter was circulated to FRC members on 23 November 2009 by the FRC Secretary.

### *Options*

*Accept AASB proposal*

If the FRC were to accept the AASB proposal as an adequate solution to Phase 2 of the project, albeit one not meeting the original direction, it is likely to cause considerable disquiet in the public sector. HoTARAC, Treasuries and the DoFD support the imposition of Phase 2 to GGS entities as a means of supplying appropriate and comparable information from the public sector; however it could be accepted that Phase 2 is less critical than Phase 1.

#### *New Strategic Direction*

If the FRC were to issue another strategic direction or clarification to the AASB to ensure that the strategic goals for public sector accounting of the Council and Government were achieved, this would place the AASB in a difficult situation given its decision not to fully implement the FRC's direction. However if the FRC does not do this users of public sector financial reports may find that they do not have comparability of reports from different entities and be unable to compare GGS entities reports with those reported in Budgets (the primary source of public sector financial reporting). Given that GAAP/GFS harmonisation has been introduced for whole of government reports, eliminating this incomparability problem can only be eliminated by a decision to rescind the harmonisation process or to require compliance throughout the public sector. This requires a decision by the FRC that non-mandatory guidance will not achieve what a standard would, and is insufficient.

#### *Request Ministerial Direction*

The FRC could write to the Ministers for Financial Services, Superannuation & Corporate Law and Finance & Deregulation, requesting they re-affirm the priority the Government gives to this policy. This could be seen as an interim step to clarify that the issue is currently an important one to the Government, and thus worth being pursued by the FRC. Parliaments, Departments of Finance and Treasuries are major users of public sector financial reports and the scrutiny they apply to public sector accounts can be seen as the equivalent of the market scrutiny given to those in the private sector. The authority granted to the AASB to legislate accounting standards is delegated from Parliament, and if in the end an AASB standard were in conflict with the wishes of Government and Parliament, it could be disallowed by Parliament. In this case, however, because the AASB is proposing to issue non-mandatory guidance it is not clear that it could be disallowed.

#### *Legal Advice*

The FRC could engage in (joint) legal consultations with the AASB to ascertain the status of the original FRC strategic directions and AASB responses. Given that it is inappropriate to resolve disputes between different Australian Government entities in legal proceedings, advice on the options would best be pursued jointly. Legal issues that might be explored in these consultations include how far a strategic direction can be taken before it becomes a question of technical direction, and the relevance of AASB processes if they lead to outcomes in contradiction to an FRC strategic direction. It is clear that the goals of the AASB can be set by government, while their processes should be independent. In between the role of the FRC and its strategic directions is less straightforward. The issue of the weight given to formal as opposed to informal submissions might also be a topic of discussion.