

EXTRACT FROM MINUTES: AASB 5-6 APRIL 2006 MEETING

GAAP/GFS CONVERGENCE

Agenda item 6

The Board had before it:

- (a) a memorandum from Robert Keys, Anne Vuong and Sabine Schührer dated 28 March 2006 (Agenda paper 6.1);
- (b) a copy of the Collation and Analysis of Submissions on ED 142 *Financial Reporting of General Government Sectors by Governments* highlighting issues that had not been addressed at the 8-10 February 2006 meeting (Agenda paper 6.2);
- (c) a package of material sent out to selected constituents seeking input on single-column illustrative financial statements (Agenda paper 6.3);
- (d) a staff analysis of responses to the package of material in Agenda paper 6.3 and an illustration incorporating various suggestions made by constituents (Agenda paper 6.4);
- (e) responses from constituents on the package of material in Agenda paper 6.3 (Agenda paper 6.5), comprising responses from:
 - (i) Mr Tulsi Ram, Australian Bureau of Statistics (Agenda paper 6.5.1);
 - (ii) Mr Kaufmann (Agenda paper 6.5.2);
 - (iii) Mr Don Challen, Heads of Treasuries Accounting and Reporting Advisory Committee (Agenda paper 6.5.3);
 - (iv) Dr Mark Shying, CPA Australia (Agenda paper 6.5.4); and
 - (v) Mr O'Grady (Agenda paper 6.5.5 – tabled);
- (f) a staff issues paper: How to progress ED 142 to a Standard given the controversy surrounding the GPFR/SPFR issue (Agenda paper 6.6);
- (g) a supplementary submission on ED 142 from the National Institute of Accountants (Agenda paper 6.7);
- (h) a supplementary submission on ED 142 from Heads of Treasuries (Agenda paper 6.8 – updated, tabled as a replacement for an earlier version of Agenda paper 6.8);
- (i) an email from Don Challen to David Boymal, Chairman, AASB, dated 21 March 2006 re timing of project (Agenda paper 6.9);
- (j) a letter from the David Boymal, Chairman, AASB, to Charles Macek, FRC Chairman, dated 17 February 2006 providing a progress report on the AASB's GAAP/GFS Convergence Project (Agenda paper 6.10);
- (k) extract from approved February and draft March 2006 AASB meeting minutes (Agenda paper 6.11);

- (l) ED 142 *Financial Reporting of General Government Sectors by Governments* (Agenda Paper 6.12);
- (m) articles from the Australian Financial Review: “Treasury Chiefs Revolt Over Budget Rules”, dated 3 April 2006; and “Accounting Debate Divides Profession”, dated 4 April 2006 (Agenda paper 6.13 – tabled);
- (n) a letter from Mr Ian Gaudion to David Boymal, Chairman, AASB, dated 4 April 2006 re the articles in the Australian Financial Review (Agenda paper 6.14 – tabled); and
- (o) the ABS GFS Manual “Australian System of Government Finance Statistics: Concepts, Sources and Methods 2005”.

The Board revisited the question of the relationship between General Government Sector (GGS) and Whole-of-Government (WoG) financial reports and decided that the Standard to be developed from ED 142 should explicitly specify that:

- (a) a government is required to prepare both a GGS financial report, which excludes entities in the Public Non-financial Corporations (PNFC) and Public Financial Corporations (PFC) sectors, and a WoG financial report, which consolidates all controlled entities, and that the WoG report should be available at the same time as the GGS report. Given the current processes adopted for the preparation of WoG reports, the Board decided that it is appropriate to provide a transitional period before the requirement for the two reports to be available at the same time becomes mandatory. The Board will consult with constituents before determining the length of the transitional period; and
- (b) if the WoG and GGS financial reports are presented separately, the two reports should include cross-references to each other.

The Board also decided that it is not necessary for the Standard to specify whether the GGS is a reporting entity and whether the financial report is a general purpose financial report (GPFR), given that the Standard itself will prescribe the particular requirements for the form and content of the financial report. Consistent with this decision, the requirement in AASB 101 *Presentation of Financial Statements* to specify whether a financial report is a GPFR or a special purpose financial report (SPFR) will not be imposed on the GGS financial report.

The Board continued its review of the submissions on ED 142 and considered issues relevant to finalising an illustration of an acceptable single-column format of the financial statements to be included in material accompanying the Standard.

Specific decisions made by the Board on these matters are noted in Attachment B.

The Board directed staff to proceed to develop a draft Standard [marked up from ED 142] to reflect its decisions for consideration by the Board at a future meeting.

Action:

Staff
Mr Kaufmann
Mr O’Grady

ATTACHMENT B

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The Board continued its review of the Collation of Analysis of Submissions on ED 142 that was commenced at its February 2006 meeting and decided that, in respect of:

- (a) the view expressed by some respondents that the AASB should await the outcomes of international activities being undertaken in relation to GAAP/GFS convergence issues, recorded in the collation under Issue (a) [concerning whether the GGS of a government is a reporting entity and whether a partial consolidation basis is to be adopted in a GPFR] and under Issue (r) [concerning whether the proposals in ED 142 overall result in useful information for users]: consistent with the FRC directive the AASB should continue to progress its own project, but should also continue to monitor, and influence where possible and appropriate, the international work;
- (b) concerns expressed by the Australasian Council of Auditors General (ACAG) about the practical difficulties of determining fair values in certain circumstances to satisfy the GFS measurement principles, recorded in the collation under Issue (c), concerning the alignment of GAAP optional treatments with GFS: the Standard should clarify that it does not override GAAP measurement requirements and therefore if the fair value of an asset cannot be reliably measured then it should be measured at cost. The Board noted paragraphs 2.89 and 2.91 of the ABS GFS Manual and the fact they take a pragmatic approach to the application of the GFS measurement principles. The Board also noted that it would not be appropriate to characterise cost as fair value in circumstances where an asset is measured at cost in the absence of a reliable measure of fair value, even though GFS may accept cost as a proxy of fair value;
- (c) comments made by Deloitte about whether the Board intended that ED 142 override the active market precondition in AASB 138 *Intangible Assets* for revaluing intangible assets and limit the option under AASB 139 *Financial Instruments: Recognition and Measurement* for classifying certain financial assets as either 'fair value through profit or loss' or 'available-for-sale' [also recorded in the collation under Issue (c):] the Standard to be developed from ED 142 should clarify that it does not override the active market precondition and that it does not limit GAAP options to the extent they are allowable under GFS. The Board also decided that, in relation to the option under AASB 139, that the illustration of acceptable single-column format financial statements to be included in material accompanying the GGS Standard should be amended to illustrate the circumstance where certain financial assets, such as the GGS investment in public non-financial corporations (PNFC) or public financial corporations (PFC) entities, addressed under Issue (e) of the collation, may be classified as 'available-for-sale';
- (d) Issue (e), concerning the treatment of GGS investments in PNFC and PFC sectors:
 - (i) in regard to the suggestion by The Institute of Chartered Accountants in Australia (ICAA) that the GGS financial report should include disclosure of the valuation basis adopted for non-consolidated controlled entities have been valued, such a disclosure should be required;
 - (ii) on the question of whether the impact of the valuation of PNFC and PFC sectors on the GGS should also be disclosed as a compensating factor for the absence of full consolidation, the Board noted that the issue is related to its decision on the relationship of GGS to WoG reporting (see the main body of minutes above); and

- (iii) on the ACAG suggestion that the Standard should clarify whether related balances between the GGS and PNFC/PFC entities should be eliminated for the purposes of determining net assets of PNFC/PFC entities, the Standard should clarify that such eliminations are not made;
- (e) Issue (f), concerning the balance sheet:
- (i) to retain the title of ‘balance sheet’, on the basis that it is consistent with the terminology used in the current AASB 101. The Board noted that if AASB 101 were to be amended prior to the issue of the GGS Standard, the GGS Standard should reflect the terminology adopted in the revised AASB 101; and
 - (ii) consistent with AASB 101, the GGS Standard should not specify that the balance sheet should be presented in liquidity order. However, the illustration of an acceptable single-column balance sheet to be included in material accompanying the Standard should adopt a liquidity order presentation;
- (f) Issue (g), concerning the operating statement:
- (i) in regard to Issue G(i), concerning the classification of income/expenses by nature, consistent with decision (e)(ii) immediately above, the GGS Standard should not specify that the income statement be presented by nature. However, the illustration of an acceptable single-column operating statement to be included in material accompanying the Standard should illustrate a presentation by nature on the face;
 - (ii) to proceed with the proposal in regards to Issue G(ii) to recognise all non-owner movements in equity in a single operating statement;
 - (iii) in regard to Issue G(iii) regarding the treatment of actuarial gains and losses, consistent with decision (c) above, the corridor approach should not be allowed, but the other AASB 119 *Employee Benefits* options (recognising actuarial gains and losses in either the operating result or in other non-owner movements in equity) should be retained;
 - (iv) to change the phrase ‘other non-owner movements in equity’ to ‘other movements in equity’, as suggested by HoTs, given the absence of owners in the GGS;
 - (v) in regards to the suggestion to require disclosure of a breakdown of taxation revenue, it is not necessary to specify such a requirement given the requirements in AASB 101;
- (g) Issue (h), concerning the cash flow statement:
- (i) a distinction between cash flows relating to investing in financial assets for ‘policy’ and ‘liquidity management’ purposes should be required to be presented either on the face or in the notes to the cash flow statement. The Board decided that there is sufficient rigour for drawing the distinction and that the distinction provides useful information. The illustration of an acceptable single-column cash flow statement should present the information on the face; and
 - (ii) in response to ACAG’s concern that providing certain GFS information may detract from other information required to be disclosed by the GGS Standard, paragraph 17 of ED 142 should be amended to clarify that if an entity elects to disclose additional information, it should be made in such a way that it does not detract from the information that is required to be disclosed;

- (h) Issue (j), concerning additional disclosures:
- (i) not to explicitly require the GGS to disclose its exposure to any net asset shortfall in PNFC or PFC entities as contingent liabilities, noting that the requirements in *AASB 137 Provisions, Contingent Liabilities and Contingent Assets* adequately address the issue. Furthermore, *AASB 139* adequately addresses requirements relating to financial guarantees;
 - (ii) to include the term ‘net debt’ in the list of examples of key technical terms in the GGS Standard (from paragraph 47 of ED 142), on the basis that ‘net debt’ is a key fiscal aggregate under ABS GFS;
 - (iii) to clarify that the Standard requires disclosure of the financial effects of changes in the list of entities within the GGS, by amending paragraph 46(b)(ii) of ED 142 to make it clear that this information is required in accordance with paragraph 42 of *AASB 127 Consolidated and Separate Financial Statements*. The Board noted that paragraph 42 of *AASB 127* requires disclosure of an entity’s significant investments in subsidiaries and that such information is disclosed on a comparative basis. The Board also noted that *AASB 5 Non-current Assets Held for Sale and Discontinued Operations* requires disclosures relating to subsidiaries leaving the GGS;
 - (iv) to require the disclosure of information about dividends and distributions from PNFC and PFC entities to the GGS, given that the amount of dividends and other distributions is determined by the GGS management and may affect the operating result of the GGS; and
 - (v) it is not necessary to insert a global catch-all clause in the Standard that would require that the GGS report any information that would be relevant to the users’ understanding of the financial reports, because this is already adequately covered in *AASB 101* paragraphs 13, 15(c) and 116;
- (i) Issue (k), concerning disaggregated information: to incorporate the ED 142 proposals in the Standard, and include a note in the Standard that acknowledges that in due course the outcome of the AASB’s segment reporting project may lead to an amendment to the requirements;
- (j) Issue (q), concerning whether any aspects of GFS should be prohibited from forming part of the basis upon which the GGS’s financial report is prepared, and after considering the HoTs’ view that the AASB should select the conceptually best treatment, whether GAAP or GFS, on an item-by-item basis: the GGS financial report should adopt GAAP definition, recognition and measurement principles for all items (with GAAP options limited to the extent they are consistent with GFS – see for example decisions (c) and (f)(iii) above). Recognised amounts determined in this way should be presented in the operating statement in a manner that reflects the GFS notions of transactions and other economic flows. The face of the financial statements should include key fiscal aggregates, such as net lending/borrowing, measured in a manner that is consistent with other amounts recognised on the face. To the extent these key fiscal aggregate amounts differ from the corresponding amounts determined in accordance with ABS GFS principles, a reconciliation should be provided in the notes to the financial statements; and
- (k) outstanding issues recorded in the collation under Issues (n) concerning transitional provisions, (p) concerning ABS GFS vs IMF GFS, and other issues raised by respondents: staff should consider these issues out-of-session and, consistent with the principles reflected in the Board’s decisions noted above and in February 2006, reflect its views into a draft Standard to be considered by the Board at a future meeting.

In relation to the illustration of an acceptable single-column format of the financial statements, the Board decided that it should continue to be developed in a manner that is consistent with the decisions made to-date. In this regard, the Board commenced its review of an illustrative format labelled Version X (in Agenda Paper 6.4) prepared by staff based on the limited out-of-session consultation on a format labelled Version 2 (in Agenda Paper 6.3). The Board decided that Version X provides an appropriate basis on which to continue to develop the illustration. It should be refined further through out-of-session consultation with an AASB sub-committee comprising Brett Kaufmann and John O'Grady prior to being sent to selected constituents for further comment.

To facilitate discussions with the sub-committee, staff should also prepare examples that illustrate the implications of the transactions/other economic flows split for particular items, including its implications for recycling in the operating statement. The examples should include:

- (a) provision for doubtful debts and its relationship to the write-off of mutually agreed bad debts;
- (b) recognition of an unrealised gain on an equity investment in a PNFC or PFC entity and its relationship to the recognition of dividends or other distributions from those entities; and
- (c) employee benefit expenses relating to defined benefit obligations.

Those examples should also be provided to the Board at the future meeting at which it will review the illustrative financial statements that are refined from the out-of-session consultation.