

**GAAP/GFS Harmonisation for Not-for-Profit Entities within the GGS:
Facilitating orderly adoption of future amendments to the ABS GFS Manual**

1 Introduction

1.1 The minutes of the 30 July 2010 AASB meeting's discussion of the post-implementation review of AASB 1049 *Whole of Government and General Government Sector Financial Reporting* record [under agenda item 11, attachment A, item (y)(i) and (ii)] – emphasis added:

- (i) ... the Board decided that it should write to the ABS formally advising it of the concerns identified during the post-implementation review of AASB 1049 relating to the scope of the ABS GFS Manual and the process for change. The letter should encourage the ABS to clarify the scope of the ABS GFS Manual and establish an agreed process for amending and/or interpreting the Manual.
- (ii) ... The Board considered whether to amend the definition of the ABS GFS Manual in AASB 1049 to be a static reference rather than an ambulatory reference. Rather than amend the definition, the Board decided that further **consideration should be given to amending AASB 1049 in other ways to help facilitate orderly adoption of any future amendments to the ABS GFS Manual.** The Board noted that the nature of the amendment would depend on the outcome of the consultation with the ABS (see decision (y)(i) immediately above). **Alternative ways to amend AASB 1049 for this issue to be considered by the Board at a future meeting include giving the same kind of transitional relief that is given in relation to changes in GAAP to changes to GFS (e.g. mandatory after 2 years but allowing early adoption in the interim); or require adoption of the ABS GFS Manual as at the beginning of the previous financial year.** The principle should be to continue to require reconciliation of GAAP to GFS 'dynamically' unless there is a change to GFS (and therefore accounting) that would preclude its orderly adoption ...

The bolded text provides the focus for this paper.

1.2 Although the above decisions were made in the context of the Post-Implementation Review of AASB 1049 project, they are also pertinent to the GAAP/GFS Harmonisation for Not-for-Profit Entities within the GGS project. Accordingly, the Board's decisions on the issues in this paper will be relevant to both projects.

1.3 A copy of the letter to the ABS referred to in minute item (y)(i) [dated 13 August 2010] is attached as Appendix I to this paper for the information of Board members.

2 The issue

2.1 As concluded by the Board at its July 2010 meeting, neither the ABS GFS Manual nor AASB 1049 currently contain requirements that would adequately facilitate the orderly adoption of GFS amendments for the purposes of AASB 1049 financial reporting. This paper presumes that the ABS might amend the ABS GFS Manual in the future in a way that might not facilitate orderly adoption of the amendments for the purposes of GAAP/GFS harmonised financial reporting purposes. The issue is how best to draft requirements into GAAP/GFS harmonisation standards¹ that would facilitate the orderly adoption of unknown future GFS amendments for the purposes

1 References to 'GAAP/GFS harmonisation standards' in this paper are to both AASB 1049 and the standard expected to be developed out of the Board's GAAP/GFS Harmonisation for Not-for-Profit Entities within the GGS project.

of GAAP/GFS harmonised financial reporting. There are potentially two broad aspects to this issue:

- (a) the extent to which a change to the ABS GFS Manual should be applied retrospectively in the GAAP/GFS harmonised financial statements; and
- (b) the time lag to allow between the change being issued and it becoming mandatory for the GAAP/GFS harmonised financial statements.

2.2 In relation to aspect (a), it is relevant to note that GAAP typically adopts one of four different types of transitional arrangements, on a case-by-case basis:

- (a) fully retrospective – as if the new/revised policy had always been applied. This results in the adjustment of opening retained earnings for the earliest period presented;
- (b) retrospective to the earliest period presented, accepting opening balances despite them not being prepared using the new/revised policy;
- (c) conditional retrospectivity, eg subject to practicability; and
- (d) prospective from opening balance of current period – accepting opening balance of current period.

2.3 At the time the ABS GFS Manual is amended, the ABS may decide to adopt any one of a number of possible transitional arrangements for GFS purposes. Staff understand that in the absence of specific transitional arrangements, the amendments would be retrospective, due to the emphasis GFS places on the time series.

2.4 If GAAP/GFS harmonisation accounting standards were to override or even merely clarify GFS transitional arrangements relating to retrospectivity, they would arguably go beyond the Board's role, and potentially result in the Board interpreting or effectively modifying the ABS GFS Manual. To avoid this, consistent with the approach in AASB 1049, GAAP/GFS harmonisation accounting standards would need to accept the ABS GFS Manual as it is. Accordingly, *the staff view* is that the Board should not address issues relating to retrospectivity in facilitating the orderly adoption of changes to the ABS GFS Manual for GAAP/GFS harmonised financial reporting purposes. This is consistent with the view that the Board does not have the authority to amend the ABS GFS Manual, and to modify it through GAAP/GFS harmonisation accounting standards would be fundamentally inconsistent with the Board's role in facilitating the harmonisation of GAAP (over which the Board has control) with GFS (over which the Board has no control). To do otherwise would create the potential for there to be a permanent difference between the amounts presented as GFS in the financial statements and amounts published by the ABS.

Question 1 for the Board: Do you agree that GAAP/GFS harmonisation standards should not modify ABS GFS Manual requirements in relation to retrospectivity?

2.5 The remainder of this paper assumes that the staff view expressed above is accepted. Accordingly, the focus of the remainder of this paper is on the question of how to give an effective time lag between the issue of an amendment to the ABS GFS Manual and when it becomes mandatory for GAAP/GFS harmonised financial reporting purposes. Unlike the potential permanent GAAP/GFS difference noted above in relation to retrospectivity, contemplating 'time lag' relief has the potential to give rise to a temporary difference between the amounts presented as GFS in the financial statements and amounts published by the ABS.

3 Alternative possible solutions

- 3.1 At its 30 July 2010 meeting, the Board decided that the definition of the ABS GFS Manual in AASB 1049 should not be amended. Accordingly, the following definition from AASB 1049 is retained:

DEFINED TERMS

ABS GFS Manual The Australian Bureau of Statistics (ABS) publication *Australian System of Government Finance Statistics: Concepts, Sources and Methods* as updated from time to time.

The Board rejected an approach that would amend this definition by making a static reference to the ABS GFS Manual, in part because of the amount of work that could be involved in keeping such a static reference up to date.

The following outlines alternative possible solutions, including those explicitly referred to during the Board's discussion in July 2010 [see paragraph 1.1 above – (y)(ii)] that retain the existing definition of the ABS GFS Manual.

- 3.2 **Approach A: leave it to each preparer's assessment of undue cost and effort² to decide whether to adopt ABS GFS Manual changes made after a certain date.** In relation to the Board's approach to providing a lag between issue and mandatory dates, under the heading 'Implementation of Standards', paragraph 18 of the draft *AASB Policies and Processes* [see agenda paper 13.2 of the 1-2 September 2010 AASB meeting] states:

When determining the effective date of Standards the AASB seeks to ensure that constituents have adequate time to prepare for their implementation. In normal circumstances the AASB will issue a Standard a significant time before its effective date, say, during the previous annual reporting period and generally permits entities to apply those requirements early should they wish to do so.

This approach could be adapted for specifying the effective date of changes to the ABS GFS Manual for GAAP/GFS harmonisation financial reporting purposes as follows:

BODY OF GAAP/GFS HARMONISATION STANDARD

Paragraph X Subject to paragraph Y, for the purpose of this Standard, the entity shall apply the ABS GFS Manual as at the reporting date.

² We have borrowed the phrase 'undue cost and effort' from the IASB's *IFRS for SMEs*. Although we are not aware of any material developed by the IASB to clarify its meaning, we interpret it as providing a lower hurdle than 'impracticable', given the way we understand the latter is interpreted in practice. 'Impracticable' is defined in paragraph 5 of AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* as:

Applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so. For a particular prior period, it is impracticable to apply a change in an accounting policy retrospectively or to make a retrospective restatement to correct an error if:

- (a) the effects of the retrospective application or retrospective restatement are not determinable;
 - (b) the retrospective application or retrospective restatement requires assumptions about what management's intent would have been in that period; or
 - (c) the retrospective application or retrospective restatement requires significant estimates of amounts and it is impossible to distinguish objectively information about those estimates that:
 - (i) provides evidence of circumstances that existed on the date(s) as at which those amounts are to be recognised, measured or disclosed; and
 - (ii) would have been available when the financial report for that prior period were authorised for issue;
- from other information.

Paragraph Y An entity may elect not to adopt a change to the ABS GFS Manual made since the beginning of the previous [*note to Board: alternatively this could refer to current*] annual reporting period when, and only when, implementation of the change would give rise to undue cost or effort in preparing the current or previous reporting period's financial statements.

This approach would introduce the phrase 'undue cost or effort' into Australian Accounting Standards. As noted in footnote 2 above, the phrase is consistent with the fact the IASB has adopted it in its *IFRS for SMEs*. Some argue that the phrase is difficult to operationalise, and we are not aware of any material developed by the IASB to clarify its meaning.

An advantage of Approach A is that it is relatively 'principles-based' and effectively deals with the fact that the future timing of changes to the ABS GFS Manual relative to reporting dates is unknown. However, the approach is heavily reliant on the judgement of preparers as to when GFS changes should be implemented in the GAAP/GFS harmonised financial statements.

3.3 **Approach B: specify that references to the ABS GFS Manual are to that Manual as at the beginning of the previous [or current] annual reporting period.** This approach could be implemented as follows:

BODY OF GAAP/GFS HARMONISATION STANDARD

Paragraph X For the purpose of this Standard, the entity shall apply the ABS GFS Manual as at the beginning of the previous [*note to Board: alternatively this could refer to current*] annual reporting period.

A consequence of this approach is that the GFS information incorporated into the financial statements would be based on an ABS GFS Manual that is consistently either one or two reporting periods out of date. An advantage of this approach is its simplicity and potential for greater consistency in financial reporting, thus enhancing comparability among entities. However, unlike the Board's normal approach to facilitating transition to GAAP changes, it mandates relief for all kinds of GFS changes, even those that would not be onerous or those that an entity would prefer to adopt.

A benefit of referring to 'the previous annual reporting period' rather than 'the current annual reporting period' is that it facilitates more orderly adoption of changes that affect comparative information. However, it means that the GFS information included in the financial statements is based on an ABS GFS Manual that is two years out-of-date rather than one year out-of-date.

3.4 **Approach C: specify that references to the ABS GFS Manual are to that Manual as at the beginning of the previous [or current] annual reporting period or later.** This approach modifies Approach B by allowing entities to elect to adopt recent changes made to the Manual. It could be implemented as follows:

BODY OF GAAP/GFS HARMONISATION STANDARD

Paragraph X For the purpose of this Standard, the entity shall apply the ABS GFS Manual updated as at the beginning of the previous [*note to Board: alternatively this could refer to current*] annual reporting period or a later version.

This approach is broadly aligned with the Board's normal approach to specifying transitional requirements for changes to GAAP because it:

- (a) specifies, albeit in an ambulatory one or two year lagged way, a mandatory operative date for changes to the ABS GFS Manual;
- (b) could be drafted in a way that provides a reasonable time for entities to implement changes to the ABS GFS Manual that could affect comparative information; and
- (b) allows, but does not require, entities to adopt changes to the ABS GFS Manual prior to mandatory operative dates, and even changes made subsequent to the reporting date.

3.5 **Other conceivable approaches:** There are conceivably other approaches that could be adopted. For example, an approach dependent on the nature of a change to the ABS GFS Manual could be adopted – such as immediate adoption of changes that remove an existing GAAP/GFS convergence difference and delayed adoption of other changes. However, these types of approaches are more complex, and could be onerous.³

4 Staff view

4.1 In principle, staff prefer Approach A, because it is relatively ‘principles-based’. However, from a more pragmatic perspective and consistent with the way the Board normally specifies a lag between issue and mandatory operative dates for changes to GAAP, we favour Approach C, with a reference to ‘the previous annual reporting period’ – to provide appropriate relief for comparative information. Accordingly, we think the Exposure Draft proposing GAAP/GFS harmonisation requirements for not-for-profit entities within the GGS and the Exposure Draft proposing amendments to AASB 1049 arising from the post-implementation review of that Standard should include the following paragraph:

Paragraph X For the purpose of this Standard, the entity shall apply the ABS GFS Manual updated as at the beginning of the previous annual reporting period or a later version.

Question 2 for the Board: Do you agree that an approach based on Approach C should be incorporated into GAAP/GFS harmonisation standards?

3 For example, one of the practical issues that has given rise to this paper is the new GFS requirement to recognise defence weapons platforms as assets measured at fair value. This change removes an existing GAAP/GFS convergence difference but would still arguably warrant relief, to allow preparers time to capture the relevant information.

Appendix I
Letter from AASB Chairman to the Australian Statistician

13 August 2010

Mr Brian Pink
Australian Statistician
Australian Bureau of Statistics
Locked Bag 10
Belconnen ACT 2617

Dear Mr Pink

GAAP/GFS harmonisation

As you may be aware, the AASB has commenced a post-implementation review of AASB 1049 *Whole of Government and General Government Sector Financial Reporting* (October 2007) with a view to identifying aspects of AASB 1049 that could be improved. As a means of identifying potential improvements, in addition to meeting with Bernard Williams and other ABS staff, AASB staff consulted staff responsible for implementing AASB 1049 at an operational level in each jurisdiction's department of treasury/finance and audit office. At its 30 July 2010 meeting, the AASB considered a comprehensive list of implementation issues relating to AASB 1049 and noted that the work to date had not identified any major flaws in the Standard. However, the AASB identified some areas where it believes improvements can be made to clarify the requirements in AASB 1049.

One aspect of AASB 1049 that was identified as an area for improvement is the current way in which AASB 1049 deals with the ABS GFS Manual. This issue mainly arose from uncertainty expressed about the scope of the Manual (for example, the extent to which ABS information papers and interpretations are part of the Manual) and the process for changing the Manual. The Board asked me to write to formally advise you of these concerns and encourage the ABS's work of clarifying the scope of the Manual and establishing an agreed process for amending and/or interpreting the Manual that I understand is currently underway.

A related issue is the consequence of defining the ABS GFS Manual in Appendix A of AASB 1049 as "The Australian Bureau of Statistics (ABS) publication *Australian System of Government Finance Statistics: Concepts, Sources and Methods* **as updated from time to time**" (emphasis added). Concern was expressed that unless the Manual allows for the orderly adoption of changes to GFS, compliance with the Manual 'as updated from time to time' would be too onerous from a GAAP perspective.

The Board noted that, when it effects any change to an accounting standard, it explicitly considers whether any transitional provisions (such as a delay in mandatory operative dates) are warranted, to allow sufficient time for entities affected by the change to become familiar with the requirements and introduce any new systems that might be needed.

The Board decided that consideration should be given to amending AASB 1049 to help ensure that orderly adoption of any future amendments to the Manual is facilitated, perhaps in a way similar to that used by the Board to help facilitate orderly adoption of amendments to accounting standards. The Board noted that the nature of such an amendment would depend on the actions the ABS intends to take in relation to the issue. The Board agreed on the principle that AASB 1049 should continue to require reconciliation of GAAP to GFS as it changes, unless the nature of the change to GFS (and therefore accounting) would preclude its orderly adoption.

The Board's aim, subject to other priorities, is to issue any amendments to AASB 1049 arising from the post-implementation review before the end of 2010, after undertaking its full due process, which will involve an Exposure Draft being issued for public comment. Accordingly, because any Board proposals relating to orderly adoption of changes to the Manual are dependent on how the ABS intends to deal with such issues, I would appreciate an indication from you as to whether, and if so how and when, the ABS intends to address concerns about transitional requirements for changes to the ABS GFS Manual.

Yours sincerely

Kevin M Stevenson
Chairman & CEO