

## Issues paper: Exemption for whole of governments and GGSs from disclosing the information required by paragraphs 134-136 of AASB 101

### 1 INTRODUCTION

1.1 The minutes of the 24 September 2008 AASB meeting's discussion of amendments to AASB 1049 *Whole of Government and General Government Sector Financial Reporting* for consistency with AASB 101 *Presentation of Financial Statements* record [under agenda item 4, attachment B, item g]:

“consistent with staff view 5, the exemption from disclosing certain information that enables financial statement users to evaluate the entity's objectives, policies and processes for managing capital as per paragraph Aus1.7 of AASB 101 should not be reviewed as part of this project. Instead, the issue should be considered as part of the post-implementation review of AASB 1049”.

1.2 Paragraph Aus1.7 of AASB 101 states:

**“Notwithstanding paragraphs Aus1.1 and Aus1.6, a not-for-profit entity need not present the disclosures required by paragraphs 134-136.”**

1.3 Paragraphs 134-136 of AASB 101 state:

**134 An entity shall disclose information that enables users of its financial statements to evaluate the entity's objectives, policies and processes for managing capital.**

135 To comply with paragraph 134, the entity discloses the following:

- (a) qualitative information about its objectives, policies and processes for managing capital, including:
  - (i) a description of what it manages as capital;
  - (ii) when an entity is subject to externally imposed capital requirements, the nature of those requirements and how those requirements are incorporated into the management of capital; and
  - (iii) how it is meeting its objectives for managing capital;
- (b) summary quantitative data about what it manages as capital. Some entities regard some financial liabilities (e.g. some forms of subordinated debt) as part of capital. Other entities regard capital as excluding some components of equity (e.g. components arising from cash flow hedges);
- (c) any changes in (a) and (b) from the previous period;
- (d) whether during the period it complied with any externally imposed capital requirements to which it is subject; and
- (e) when the entity has not complied with such externally imposed capital requirements, the consequences of such non-compliance.

The entity bases these disclosures on the information provided internally to key management personnel.

136 An entity may manage capital in a number of ways and be subject to a number of different capital requirements. For example, a conglomerate may include entities that undertake insurance activities and banking activities and those entities may operate in several jurisdictions. When an aggregate disclosure of capital requirements and how capital is managed would not provide useful information or distorts a financial statement user's understanding of an entity's capital resources, the entity shall disclose separate information for each capital requirement to which the entity is subject.

1.4 The issue of whether to retain or remove the exemption provided by paragraph Aus1.7 was first raised by the Australasian Council of Auditors-General (ACAG) in its

submission on AASB ED 163 *Proposed Amendments to AASB 1049 for Consistency with AASB 101* back in July 2008. In its submission, ACAG recommended the AASB reconsider the exemption provided by paragraph Aus1.7 to whole of government financial statements, on the basis that the information required by paragraphs 134-136 provides useful information for users of whole of government financial statements.

- 1.5 Other standard setting bodies have dealt with this issue in ways that differ from the AASB’s approach:
- (a) IPSAS 1 *Presentation of Financial Statements* does not currently require entities to disclose information about capital management. However, IPSAS 30 *Financial Instruments: Disclosures* recently amended IPSAS 1 to require entities to make the same disclosures required by paragraphs 134-136 for annual reporting periods beginning on or after 1 January 2013; and
  - (b) The New Zealand Financial Reporting Standards Board (FRSB) does not exempt whole of governments (or other not-for-profit entities that are not qualifying entities) from the disclosure requirements, although it does provide partial relief for qualifying entities as part of its differential reporting regime. (The FRSB standards do not explicitly address GGS financial reporting.)
- 1.6 The intention of this paper is to address the issue of whether AASB 1049 should be amended to remove or retain the current relief in paragraph Aus1.7 of AASB 101 as it applies to whole of governments and GGSs.

## **2 OVERVIEW OF OUTCOME OF STAFF’S CONSULTATION TO DATE**

- 2.1 Staff consulted through email and phone with personnel with AASB 1049 implementation experience from each jurisdiction’s Department of Treasury and Finance and Auditor-General’s Office to seek their views on this issue. We have received responses from most jurisdictions. Table 1 provides a high level summary of these responses.

**Table 1**

<b>Summary of responses</b>		<b>Related section of this paper</b>
Number consulted	18	
Number of responses	15	
Number of respondents who think the exemption should be retained	11	4
Number of respondents who think the exemption should be retained, but if the Board decides to review the exemption, it should be reviewed as part of NFP reporting requirements rather than as part of the post-implementation review of AASB 1049	1	4
Number of respondents who think the exemption should be removed	1	3
Number of respondents who have no preference to remove or retain the exemption, but if the Board decides to remove the exemption, the requirements should be amended to address public sector specific issues	2	5

- 2.2 The remainder of this paper details the arguments for and against removing the exemption in light of respondents' comments, outlines alternative approaches, notes some public sector specific issues, and concludes with a staff view on how to best deal with the issue.

### **3 ARGUMENTS FOR REMOVING THE EXEMPTION**

- 3.1 The one respondent who supported removing the exemption argues that removing the exemption would enhance the usefulness of the whole of government financial report. They did not express a view on whether the exemption should be removed for GGSs.

They acknowledge the argument that it would be burdensome to present the disclosures required by paragraphs 134-136 of AASB 101 at the whole of government level if the entities included in the consolidation have a variety of policies and processes for managing capital. However, they note that this argument could be used to argue against the qualitative disclosures required by AASB 7 *Financial Instruments: Disclosures* in relation to management of risks at the whole of government level, for which there is currently no exemption.

### **4 RETAIN THE EXEMPTION**

- 4.1 Most respondents support retaining the exemption on the basis that:

- (a) the concept of 'capital' as referred to in AASB 101 is not relevant to whole of government and GGS financial statements because:
  - (i) governments have coercive fund raising capabilities;
  - (ii) governments do not rely on the market for capital. The information about capital required by AASB 101 is intended to inform how an entity will avoid losses to remain solvent and pay dividends (as explained in the basis for conclusions of IAS 1), which is more relevant to entities that depend on the market to raise capital (i.e. banks and insurance companies);
  - (iii) governments' primary objective is not earning a return on capital or earning a profit; and
  - (iv) not-for-profit entities within the public sector do not have share capital or other formal capital structures;
- (b) 'capital management' in the public sector context is not the same as in the private sector context. Some of the differences between the public sector and private sector include:
  - (i) governments do not issue securities;
  - (ii) governments do not pay dividends;
  - (iii) financial risks resulting from good/bad capital management are not the same for governments as they are for private firms;

- (iv) the main 'users' of the information provided under paragraphs 134-136 of AASB 101 are shareholders, lenders, analysts and rating agencies and these users have established their own method to obtain such information; and
- (v) for-profit elements are not a major part of the whole-of-government;
- (c) respondents are not aware of any government being subject to externally imposed capital requirements;
- (d) the information is already disclosed as part of the Budget Papers. The capital management strategy for government is a simple one inherent in the budget strategy – how to determine an appropriate level of revenue and an appropriate level of expenditure, with the balance affecting the level of borrowings;
- (e) some of the information is already disclosed under AASB 7 *Financial Instruments: Disclosure*;
- (f) whole of government is a combination of not-for-profit and for-profit entities. This combination is a reason for retaining the exemption. For-profit entities within the whole of government already disclose information required by AASB 101.134-136 and such disclosures are more relevant in those entities' individual audited financial statements rather than at a consolidated level. Therefore users are not disadvantaged by the exemption at the whole of government level because entities disclose information required by AASB 101.134-136. Such entities run themselves, with their own boards;
- (g) all public corporations are owned by the government. If these corporations require additional capital contribution, this is provided by the State in the form of equity contributions or borrowings. This information is already disclosed in the State's annual report;
- (h) the entities that comprise the whole of government and GGS in most jurisdictions are generally separately managed and subject to very specific legislative requirements. For instance, in Tasmania, the financial management of a government department is the responsibility of the Head of Agency and is governed by the financial management provisions of the *Financial Management and Audit Act 1990* and by *Treasurer's Instructions* issued in accordance with that Act. There are, however, distinctly different financial management responsibilities for other entities such as State-owned Corporations, Government Business Enterprises and Statutory Authorities. These requirements are contained in enabling legislation that is specific to either each individual entity or, as in the case of Government Business Enterprises, to entities of a similar type;
- (i) differing entities within the whole of government sector would have distinctly inconsistent policies and objectives in relation to capital management. The capital management disclosures would generally not apply to GGS entities, as capital management is undertaken by the Government at a whole-of-government level rather than at a specific departmental entity level. Therefore,

removing the exemption would not provide any benefit to users but would provide additional costs to preparers;

- (j) the management of net debt and its impact on credit ratings is more important for governments than the information required by AASB 101 – and the annual report on State Finances (which is publicly available) contains adequate disclosures on debt management; and
- (k) IPSAS 1 *Presentation of Financial Statements* does not currently contain a similar requirement.

4.2 One respondent questions why the Board would consider removing this exemption for one type of not-for-profit only, when other not-for-profit entities could be in similar situations. The same respondent notes the majority of the whole of government and nearly all of the GGS comprise NFP entities. Therefore, disclosing information required by AASB 101.134-136 is not appropriate on consolidation on the basis that the majority of entities are not required to make such disclosures. This respondent suggests that if the exemption is to be revisited, it is more appropriate to review the exemption at the time all NFP Aus paragraphs are reviewed, rather than as part of a review of AASB 1049, which is only addressing one type of NFP entity.

## **5 SOME POSSIBLE PUBLIC SECTOR SPECIFIC ISSUES IF THE EXEMPTION IS REMOVED**

5.1 Some respondents are of the view that if the exemption in paragraph Aus1.7 is removed, the concept of capital in AASB 101.134 – 136 should be revised to be relevant in the public sector context, on the basis of paragraph 4.1(a) above. They note that if the concept is not revised, there is a risk of either non-disclosure on the grounds that there is no capital as such, or disclosures are lengthy and not useful. These respondents provided their comments on how to revise the concept of ‘capital’ in the public sector context, which is summarised as follows:

- (a) some think the concept of ‘capital’ should be limited to the primary measures that governments employ in managing their capital requirements. This would encompass the principles and targets outlined in the current fiscal strategy, for example a government’s objective to reduce debt. They note that this information is already publicly available as it is outlined in detail in jurisdictions’ Budget and Annual Budget Outcomes statements; and
- (b) others think the concept of ‘capital’ should focus on three key fiscal aggregates: net debt, net financial worth and net worth. Any disclosure associated with the management of capital should require the whole of government financial statements or GGS financial statements to indicate which measure has primacy and how the fiscal strategy that is in place is intended to manage the outcomes associated with that aggregate. The disclosure should indicate whether that aggregate is expected to have primacy indefinitely or whether it is expected that emphasis would shift to one of the other measures in the short to medium term and the reasons for the shift. This information would be useful considering where a new government changes the focus of fiscal strategy. Also, this information would give an insight into the linkage

between the fiscal strategy that is usually dealt with in budget papers and the expected outcome in terms of the aggregate in question.

## **6 ALTERNATIVE APPROACHES TO ADDRESS THE ISSUE**

- 6.1 After noting respondents' views, staff note there are a number of possible ways to address the issue relating to the exemption. These alternative approaches include:
- (a) retain the exemption;
  - (b) retain the exemption for now but revisit later in the context of all NFP entities;
  - (c) remove the exemption only for whole of governments;
  - (d) remove the exemption for whole of governments (and GGSs), consistent with the requirements in NZ IAS 1; or
  - (e) remove the exemption, but revise the requirements to address public sector specific issues along the lines of paragraph 5.1 above.

## **7 STAFF VIEW**

- 7.1 Staff note the significant support from respondents to retain the exemption. We think that the needs of users would be best met through approach (e) – remove the exemption, but revise the requirements to address public sector specific issues along the lines of paragraph 5.1 above. However, we also note the view in paragraph 4.2 that consideration should be given to other NFP entities. Accordingly, on balance, we think the issue would be best addressed as part of the second phase (public benefit entities/NFP entities) of the Australian/New Zealand Convergence project, which is scheduled to commence once the first phase (for-profit entities) is complete. As such, we do not think that it would be appropriate to address the question of removing the exemption as part of the AASB's Post-Implementation Review of AASB 1049 project.

### **Question for the Board:**

Do you agree with the staff view to deal with the issue of the exemption in paragraph Aus1.7 of AASB 101 to whole of governments as part of the second phase of the Australian/New Zealand Convergence project rather than the post-implementation review of AASB 1049?