

13 August 2020

Dr Keith Kendall  
Chair  
Australian Accounting Standards Board  
PO Box 204  
Collins St West Victoria 8007  
AUSTRALIA

Dear Dr Kendall

### **ED 298 General Presentation and Disclosures**

The Australasian Council of Auditors-General (ACAG) welcomes the opportunity to comment on Exposure Draft 298 *General Presentation and Disclosures* (the ED). The views expressed in this submission represent those of all Australian members of ACAG.

While ACAG supports the objective of the ED to improve how performance information is communicated in the statement of profit or loss, we have reservations about whether the proposals will result in public sector financial statements being more useful for users. We acknowledge that this ED was developed to address investors' concerns about comparability and transparency of entities' financial statements, including the reporting of performance measures. As such, the proposals are heavily focused on the disclosure needs of private sector investors which have different needs to public sector users.

While ACAG acknowledges the reasoning behind the inclusion of "unusual income and expenses" and management performance measures (MPMs), we question the value they will have to users of public sector financial statements. As such, ACAG does not support the inclusion of "unusual income and expenses" in their current form as the proposals and definition in paragraph 100 of the ED are vague and therefore open to interpretation. We have also identified possible challenges in auditing this information which are highlighted in the attachment to this letter.

In addition, ACAG questions whether it is necessary to make MPM disclosures mandatory in financial statements as entities can provide value-added additional information as appropriate without it being mandated. ACAG has identified various issues including the ability for auditors to obtain sufficient appropriate audit evidence over MPM disclosures that might make the implementation of the proposals impractical. These concerns are detailed in the attachment to this letter.

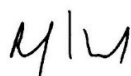
For the proposals to be useful and relevant for the public sector, ACAG believes guidance is needed, particularly in relation to the structure of the statement of profit or loss and determining integral and non-integral associates and joint ventures; details of which are highlighted in the attachment to this letter.

In addition to the issues highlighted above, ACAG also does not agree with income and expenses from cash and cash equivalents being classified in the financing category.

The attachment to this letter addresses the AASB's specific matters for comment outlined in the ED. Also attached is ACAG's response to the International Accounting Standards Board (IASB) Exposure Draft ED/2019/7 General Presentation and Disclosures.

ACAG appreciates the opportunity to comment and trusts the attached comments are useful.

Yours sincerely



Rod Whitehead  
**Chairman**  
**ACAG Financial Reporting and Accounting Committee**

## AASB Specific Matters for Comment

1. **Whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, particularly any issues relating to:**
  - a) **not-for-profit entities; and**
  - b) **public sector entities, including GAAP/GFS implications**

ACAG has identified the following issues which may affect the implementation of the proposals in the ED by public sector entities.

### Structure of the statement of profit or loss

In the statement of profit or loss, the ED requires income and expenses to be classified into specific categories with defined subtotals. ACAG has identified the following issues which may affect the implementation of these proposals.

1. The Australian Government Financial Statistics (GFS manual) and AASB 1049 *Whole of Government and General Government Sector Financial Reporting* contain specific presentation requirements for Whole of Government and General Government Sector financial reports. For example, income and expenses from transactions are presented separately from other economic flows in the statement of profit or loss.

As such, ACAG recommends guidance be developed to specify how the required presentation from the GFS Manual and AASB 1049 will be impacted - that is, how and where these existing requirements will be presented alongside the proposed defined sub totals.

2. It is not clear whether the defined subtotals can be modified or adapted to suit the particular circumstances of the public sector. For example:
  - “operating” may not be the most appropriate term to encompass the transactions relevant to the public sector
  - some State treasuries require agencies to report a “Net cost of services” subtotal which is before Income from State Government, and therefore will not be consistent with the proposed requirement.

In addition to clarity on the above sub-totals, ACAG believes that the AASB should permit public sector and not-for-profit entities to have a separate sub-total that excludes non-operating items, such as capital grants. Capital grants can vary significantly from one year to the next and are not directly related to underlying operations presented in the statement of profit or loss. Many not-for-profit entities, including some public sector jurisdictions, want to exclude these amounts from operating profit as they regard its inclusion as potentially misrepresenting the results.

### Integral and non-integral associates and joint ventures (JVs)

The definition and examples of significant interdependency in paragraph 20D of IAS 12 is private sector specific and does not incorporate factors that a public and not-for-profit (NFP) entity should consider.

In the public sector, the determination of whether a significant interdependency exists between the public sector agency and the associate and/or JV may be open to interpretation and inconsistent application. For example, would a public sector agency, with the main objective of delivering public services, conclude that a significant interdependency exists if the associate and/or JV delivers a subset of those public services?

To appropriately apply this requirement by the public and NFP sectors, ACAG recommends the AASB develop guidance on the application of examples in paragraph 20D of IFRS 12 to help public and NFP sector entities determine whether a significant interdependency exists between the public or NFP sector entity and the associate and/or JV.

## **Management performance measures (MPMs)**

ACAG questions the inclusion of MPMs in the financial statements. In the public sector context, some jurisdictions already require the disclosure of performance, either within the financial statements or as part of the annual reports. As such, it may not be necessary to require these disclosures in financial statements as entities can provide value-added additional information as appropriate without it being mandated. ACAG has identified various issues in question 5 below that may make the implementation of the proposals impractical.

If the proposals are mandated, ACAG believes it would be beneficial for the AASB to provide additional guidance on applying the principles of MPM in the public sector context to aid in transparency and comparability.

ACAG has identified that additional columns currently disclosed by some public sector entities in compliance with AASB 1055 *Budgetary reporting* and AASB 1052 *Disaggregated disclosures* may be considered MPMs under the proposals. By extension, these additional columns would need to be removed from the face of the income statement. ACAG suggest the AASB provide guidance on how the proposals on MPMs interact with the current requirements within AASB 1055 and AASB 1052.

## **Financing activities**

ACAG does not agree with the proposal to classify income and expenses from cash and cash equivalents in the financing category. ACAG believes income and expenses from cash and cash equivalents should be classified in the investing category as these are investing in nature. This is particularly the case for public sector entities where excess cash is not used as part of their financing and government Treasuries fund agencies on a cash needs basis. ACAG suggests the AASB consider whether classifying cash and cash equivalents as financing activities is appropriate in the public sector.

ACAG recommends the AASB updates the definition of investing and financing activities if they agree with ACAG's view that it is more appropriate for public sector entities to classify income and expenses from cash and cash equivalents in the investing category.

## **Definition of borrowings in IAS 7**

The proposed definition of borrowings in paragraph 6 of IAS 7 requires the provider of the finance to be "appropriately compensated". It is not clear what "appropriately compensated" means? Is this meant to be a market rate?

This definition does not appear to consider situations in the NFP and public sectors where low interest or interest free loans may be given, or the fact that public sector entities may be able to access borrowings at lower than market rates compared to their private sector counterparts. This means that cashflows from these types of borrowings would not be classified as 'financing activities' when they are a type of borrowing. ACAG suggests the AASB provide guidance on how these borrowings should be classified in the statement of cash flows.

## **Terminology**

ACAG does not support the change in terminology in the proposals from "owners in their capacity as owners" to "holders of claims classified as equity" as this does not cover all types of entities. For example, public sector entities have equity members, but the entity has not issued equity interests. ACAG suggests the AASB clarify whether the terminology "holders of claims classified as equity" can be modified by public sector entities to reflect their circumstances.

**2. Whether there any significant inconsistencies or other issues between the proposals and the requirements of ASIC RG 230 Disclosing non-IFRS financial information that should be addressed by any resulting standard**

ACAG would like to see in a resulting standard something similar to RG 230.25 which includes the overarching restriction that non-financial information should be included only where the "inclusion of that information is necessary to give a true and fair view, or present fairly, the financial position and performance of an entity". This "true and fair view, or present fairly, " override directs that management have a reference when explaining facts or circumstances relating to a transaction or balance (similar to AASB 108 and voluntary changes in accounting policy). This is especially important when non-IFRS financial information has now been included as a requirement within the IFRS framework.

**3. Whether, overall, the proposals would result in financial statements that would be useful to users**

ACAG believes it is unlikely that the proposals will result in public sector financial statements being more useful for users in the public sector as the proposals:

- are heavily focused on the disclosure needs of private sector investors which have different needs to public sector users. For example, the distinction between operating, investing and financing, are important to capital markets and in particular investors when determining returns on investment. Public sector users have different needs which focus primarily on stewardship and the delivery of government programs which are not addressed by this ED
- promote more consistency in financial statements which is not as problematic in the public sector, as each jurisdictional Treasury provides a specified format for the financial statements which reduces the inconsistency between public sector entities.

**4. Whether the proposals are in the best interests of the Australian economy**

ACAG is not able to comment on whether these proposals are in the best interests of the Australian economy.

**5. Whether the proposals are auditable, or whether they would give rise to any auditing or assurance challenges**

ACAG believes that certain proposals in the ED will give rise to auditing challenges which are detailed below.

**Integral and not integral associates and joint ventures (JVs)**

ACAG has identified the following challenges that may arise when auditing integral and non-integral JVs and associates:

1. As stated in question 1, the definition and examples of significant interdependency focus on the private sector, rather than specific aspects of the NFP and public sectors. This poses challenges when applying the proposals in a public sector context. ACAG recommends the AASB include guidance and examples on applying the principles in the public sector.
2. The decision on whether an associate or JV is integral to the entity is heavily based on management's judgement. Any areas that are based primarily on management's judgement are inherently more difficult to audit and for the auditor to obtain sufficient appropriate audit evidence. This may also result in unnecessary disagreements with management.

## Unusual income and expenses

ACAG does not support the inclusion of “unusual income and expenses” in their current form as the proposals and the current definition in paragraph 100 of the ED are vague and therefore open to interpretation. ACAG has identified the following challenges that may arise when auditing unusual income and expenses:

1. Determining the completeness of disclosures on usual income and expenses.
2. The proposals are heavily reliant on management’s judgement on whether it is reasonable to expect items of income or expense that are similar in type and amount will not arise for several future reporting periods. This will require auditors to understand management’s judgement, explanation of, and rationale for which income and expenses are unusual. Any areas that are based primarily on management’s judgement are inherently more difficult to audit and obtain audit evidence. This may also result in unnecessary disagreements with management.
3. Unusual income and expenses are based on expectations about the future rather than the past, creating challenges for auditors.
4. The definition uses the term “reasonable to expect” which is open to interpretation and potentially vary between management, the auditors and users.
5. There is no specific definition of “several future reporting periods”. This makes the proposals difficult to consistently apply and open to interpretation.
6. Ensuring that information presented is unbiased and that disclosures are complete. There is a greater incentive for entities to report unusual expenses rather than unusual income.

ACAG believes the proposals to disclose unusual income and expenses will impose a burden on unlisted for-profits and not-for-profit entities and may result in higher audit fees.

## Management performance measures (MPMs)

ACAG questions whether it is necessary to require the disclosure of MPMs in financial statements as entities can provide value-added additional information as appropriate without it being mandated.

ACAG has identified the following challenges that may arise when auditing MPMs:

1. Determining the completeness of MPMs disclosed in the financial statements. It is not clear in the proposals whether the International Board intends for MPMs mentioned in social media such as tweets, Facebook etc to be captured as a public communication. If MPMs encompass all public communications including social media, it makes it difficult for auditors to provide reasonable assurance that the MPMs are complete given the numerous communications that would need to be scanned.
2. Adjustments may be difficult to audit if the entity calculates its performance measures using accounting policies that do not comply with IFRS standards.
3. MPMs are based on management judgement. This will require auditors to understand management’s judgement, explanation of, and rationale for the MPM calculations. Any areas that are based primarily on management’s judgement are inherently more difficult to audit and for auditors to obtain sufficient appropriate audit evidence. This may also result in unnecessary disagreements with management.

**6. Unless already provided in response to specific matters for comment 1 – 5 above, the costs and benefits of the proposals relative to the current requirements, whether quantitative (financial or non-financial) or qualitative. In relation to quantitative financial costs, the AASB is particularly seeking to know the nature(s) and estimated amount(s) of any expected incremental costs, or cost savings, of the proposals relative to the existing requirements**

ACAG is not able to comment on the costs and benefits of the proposals relative to the current requirements.