Australian Government
Australian Accounting Standards Board

Level 7, 600 Bourke Street
MELBOURNE VIC 3000
Postal Address
PO Box 204
Collins Street West VIC 8007
Telephone: (03) 9617 7600
Facsimile: (03) 9617 7608

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Ms Stephenie Fox
Technical Director
International Public Sector Accounting Standards Board
International Federation of Accountants
277 Wellington Street West
Toronto
Ontario M5V 3H2
CANADA

Dear Stephenie,

IPSASB Consultation Paper
IPSASs and Government Finance Statistics Reporting Guidelines

The Australian Accounting Standards Board is pleased to submit its comments on the Consultation Paper (CP) *IPSASs and Government Finance Statistics Reporting Guidelines* to the International Public Sector Accounting Standards Board.

The AASB supports the work of the IPSASB in addressing the current state of differences between IPSASs and GFS reporting guidelines. The AASB's most significant comments on the more substantive specific matters for comment raised in the CP are noted in this letter for your consideration, and expanded on further in the attached, together with responses to the other Specific Matters for Comment and the Preliminary View.

With respect to the identification of differences between IPSASs and GFS reporting guidelines and their resolution, the AASB agrees with the way many of the issues are categorised as resolved in Table 2 of the CP. However, the AASB would prefer that assessments of resolution are based on the alignment of principles, rather than practical application alone.

In regard to reducing differences between IPSASs and GFS reporting guidelines, the AASB suggests the IPSASB consider taking a more systematic approach within the broad Conceptual Framework context of ensuring general purpose financial statements provide useful information to users. Consistent with this view and the IPSASB's approach to updating its Standards (see, for example, the IPSASB document *Process for Reviewing and Modifying IASB Documents*), the AASB suggests that undue emphasis is not placed on GFS convergence at the expense of IFRS convergence.

In regard to potentially using fair value disclosures in the financial statements as a way of addressing certain IPSAS/GFS measurement basis differences, the AASB is concerned that such an approach would not be appropriate, since financial statement disclosures may require more costly measurements to meet qualitative characteristics than estimates incorporated into GFS measures.

In addressing the future of IPSAS 22 *Disclosure of Financial Information about the General Government Sector*, before contemplating making improvements to that Standard, the AASB suggests the IPSASB should first obtain evidence of the effectiveness of its principles. Given the low uptake of IPSAS 22, this evidence could be collected only after making IPSAS 22 mandatory. Accordingly, the AASB suggests the IPSASB considers making IPSAS 22 a mandatory Standard, rather than an effectively optional one. The IPSASB could establish a project to consider amendments to IPSAS 22 that could be made in due course, such as requiring governments to adopt accounting policy options in IPSASs that are more closely aligned with GFS requirements.

If you have queries regarding any matters in this submission, please contact me or Lisa Panetta (lpanetta@aasb.gov.au).

Yours sincerely,

K.M. Stevenson

Kevin M. Stevenson
Chairman and CEO

Specific AASB comments on IPSASB Consultation Paper
IPSASs and Government Finance Statistics Reporting Guidelines

Specific Matters for Comment

The AASB provides the following comments on the IPSASB's Specific Matters for Comment set out in the CP.

Specific Matter for Comment 1 *(See Section 3 and Appendix B)* With respect to the summary in Table 2 of progress on reducing differences and the supporting detail in Appendix B: (a) Do you agree that the issues categorized as resolved (Category A in Table 2) are indeed resolved? (b) Are there further differences between IPSASs and GFS reporting guidelines that should be added to this list? If so, please describe these.

(a) Issues Categorised as Resolved

The AASB does not agree that all of the issues categorised as resolved in the CP are indeed resolved, as explained below.

The AASB observes that the issues categorised as resolved (in terms of no significant differences between IPSASs and GFS requirements) in fact appear to reflect varying degrees of resolution. However, the AASB would prefer that assessments of resolution are based on the alignment of principles, rather than practical application alone. The importance of this distinction between principle and practical application is evident by comparing the CP's assessments of issues A6 and A2, while alignment of both principle and practical application appear to be absent from the commentary on issue A8.

Issue A6 (defense weapons – capitalization and classification) states that SNA changes have satisfied recommendations on capitalization and classification but notes that more guidance is needed to remove differences that arise through different interpretations of IPSASs. Therefore, the issue seems to have been resolved in principle. However, in regard to the practical application of the principles, the AASB thinks that the rules being applied, in IPSASs as well as in GFS reporting guidelines, need to be addressed by both the IMF and the IPSASB. Consistent with this, the AASB acknowledges the issue of more guidance on defence weapons is included in Table 2 as issue B5.

In comparison with issue A6, issue A2 (investments in unquoted shares – measurement) notes that IPSAS 29 *Financial Instruments: Recognition and Measurement* requires fair value where it can be determined reliably, but cost otherwise. Appendix B (page 52 of the CP) states that fair value is used in the majority of cases, but when cost is used, that measurement basis is not consistent with the current market price basis in 2008 SNA. Therefore, although the practical application of the rules generally results in no difference between IPSASs and GFS reporting, there is still a misalignment of the principles mandated by the IMF and the IPSASB, thereby increasing the risk that significant differences could arise in practice in the future.

Furthermore, also in regard to issue A2, this inconsistency in measurement basis is not identified for further consideration in other parts of Table 2 and so is hidden from view. In addition, it is not clear on what basis the CP concludes that fair value is used in the majority of cases, which may understate the significance of the continuing difference.

Issue A8 (costs associated with R&D and other intangible assets) states that IPSAS 31 *Intangible Assets* and 2008 SNA are aligned, but issue C6 states that there could be differences in practice under GFS. The details for issue A8 in Appendix B of the CP indicate that SNA treats research and development as a single category, so that research potentially might be capitalised, whereas under IPSAS 31 research is always expensed. The issue, therefore, does not appear to have been resolved either at a principles level or in practice. This is separate from the issue of the definition of "research", which is identified as a continuing difference under issue D12.

On a further note, the basis on which issues have been listed in Table 2 as resolved appears to vary, with commentary on some of the issues indicating that further work is either desired or possible. If further work is desired, then the issue does not appear to have been resolved satisfactorily. For some issues, this is a question of the appropriate extent of guidance.

Based on the points made above, the AASB considers that the IPSASB could usefully clarify what it means by 'resolved'. In addition, the IPSASB could more clearly indicate the types of GFS financial reports that the differences relate to, such as whole of government, general government sector, and/or other sector financial reports.

(b) Further Differences

To some extent, the AASB's response in (a) above provides a partial response to this question. Further differences that should be addressed in Table 2 where they arise under IPSASs are set out in the following paragraphs.

Although issues B6 and C1 address differences in measurement bases for assets, liabilities and net assets/equity, and the discussion in Sections 5 and 6 and Appendix B of the CP also refers to improving the consistency of valuation guidance, the CP does not refer to the equity method of accounting. This is a special measurement basis applied to investments in associates and interests in jointly controlled entities under IPSAS 7 *Investments in Associates* and IPSAS 8 *Interests in Joint Ventures*. With its long history in accounting standards, the equity method deserves particular reference as a difference between IPSASs and GFS as it would need to be addressed separately from other measurement issues.

The CP does not refer to a range of other differences between IPSASs and GFS requirements, in particular those that do not affect the measurement of key fiscal aggregates such as net operating balance, net lending/(borrowing) and net worth. For example, there are differences in consolidation eliminations for the whole of government financial statements. In particular, under GFS, certain transactions between the GGS and entities within the Public Non-Financial Corporations (PNFC) sector and Public Financial Corporations (PFC) sector are not eliminated on whole of government consolidation, whereas under IPSAS 6 *Consolidated and Separate Financial Statements* intragroup transactions that are not transactions with external parties are eliminated in full. The GFS treatment has the effect of ‘grossing up’ both GFS revenue and GFS expenses by equal amounts. For example, a GGS may compensate a PNFC sector entity for a community service obligation, imposed by the GGS, that requires the PNFC sector entity to provide free services to a cohort of private individuals. The compensation provided by the GGS to the PNFC sector entity is not eliminated for whole of government reporting under the GFS Manual (instead it is ‘rerouted’ through the household sector of the economy and therefore treated as an expense of the GGS to the household sector, and an expense of the household sector to the PNFC sector entity, and therefore revenue of the PNFC sector entity).

There are further differences between IPSAS and GFS for both the whole of government and the GGS. IPSAS 28 *Financial Instruments: Presentation* classifies prepaid expenses as non-financial assets, whereas GFS classifies them as financial assets. In addition, IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets* may classify an amount within provisions, whereas GFS would classify the amount as accounts payable.

There are also differences between IPSAS and GFS requirements for the PNFC and PFC sectors that are not identified in the CP. For example, deferred tax assets and liabilities that might be recognised by entities in the PNFC or PFC sectors are not recognised under GFS. The AASB thinks that Table 2 should also address deferred tax requirements even though they arise in a for-profit context under IAS 12 *Income Taxes* or other national standards.

<u>Specific Matter for Comment 2 *(See paragraphs 4.11 to 4.17)*</u>

Do you agree that the IPSASB, in conjunction with the statistical community, should develop guidance on the development of integrated Charts of Accounts, which would include (i) an overview of the basic components of an integrated Chart of Accounts, and (ii) wider coverage such as that listed in paragraph 4.16 of this CP?

The AASB thinks that general guidance on integrated Charts of Accounts would be useful by broadly identifying the benefits of integration (paragraph 4.16(a)), but any detail on this should be left to business case considerations. The AASB is concerned that examples of integrated Charts of Accounts (paragraph 4.16(c)) are likely to be voluminous and jurisdiction-specific, and require updating whenever significant changes occur to IPSASs or to GFS reporting guidelines, which would not be an efficient use of the IPSASB’s resources.

The AASB suggests the IPSASB consider the development of an XBRL taxonomy in relation to IPSASs in conjunction with general guidance on the development of integrated Charts of Accounts, but should leave the “wider coverage” matters identified in the CP to jurisdictions and their advisers.

Specific Matter for Comment 3 *(See paragraphs 5.2 to 5.4)*

(a) Do you think that the IPSASB should take a more systematic approach to reducing differences between IPSASs and GFS reporting guidelines?

(b) If so, are there changes other than those listed in paragraph 5.4 which the IPSASB should consider adopting?

(a) Approach to Reducing Differences

The AASB suggests the IPSASB consider taking a more systematic and, consistent with paragraph 5.3 of the CP, conceptual approach to reducing differences between IPSASs and GFS. The AASB considers the IPSASB should adopt the changes proposed in paragraphs 5.4(a) to (d) of the CP, within the broad Conceptual Framework context of ensuring that general purpose financial statements provide useful information to users. As an alternative to including GFS comparisons in all IPSASs (paragraph 5.4(e)), it would be more efficient to include GFS comparisons or differences in one Standard, such as IPSAS 22 or a replacement IPSAS.

Furthermore, the AASB suggests the IPSASB does not place undue emphasis on GFS convergence at the expense of IFRS convergence. Transaction neutrality remains an important consideration given the existence of both for-profit and not-for-profit entities within the public sector (and within GFS reports).

(b) Other Changes the IPSASB Should Adopt

The policy approaches identified in paragraphs 5.4 (a), (b) and (d) should be developed in conjunction with reconsideration of the IPSASB's current document *Process for Reviewing and Modifying IASB Documents* (described in paragraph A20 of the CP).

Specific Matter for Comment 4 *(See paragraphs 5.5 to 5.19)*

Are there other areas where IPSAS changes could address GFS differences? Please describe these.

Other areas where the AASB thinks IPSAS changes could address GFS differences in respect of the issues classified under part C (opportunities to reduce differences: GFS reporting guidelines), part D (differences that will need to be managed) or even part A (resolved issues) are as follows:

(a) As noted under Specific Matter for Comment 1, issue A2 (investments in unquoted shares – measurement) inadequately addresses the use of cost measurement as an alternative to fair value, which represents a difference with GFS. To reduce this difference, the AASB suggests the IPSASB considers updating IPSAS 29 for the change in IFRS 9 *Financial Instruments* that requires such investments to be measured at fair value, with cost possibly adopted as a reasonable measure of fair value in some circumstances.

(b) The AASB notes that some of the GFS differences in Table 2 are determined by reference to IASB Standards under the hierarchy in IPSAS 3 *Accounting Policies, Changes in Accounting Estimates and Errors* for determining accounting policies, since there is no corresponding IPSAS. Issue A3 (employee stock options) is described as resolved by reference to IFRS 2 *Share-based Payment*, and issue C2 (extractive industries) refers to IFRS 6 *Exploration for and Evaluation of Mineral Resources*. However, the AASB is concerned that, in jurisdictions where national Standards on these topics are in place, the comparison with GFS might not be the same. The IPSASB could address this concern by issuing IPSASs corresponding to these IFRSs so that the GFS comparison on these topics would be the same for all entities reporting under IPSASs, which would improve the comparability of financial reports.

(c) Issues D2 (recognition criteria) and D3 (measurement) both refer to the possibility of the IPSASB requiring additional disclosures, such as disclosure of valuations relevant to statistical reporting. The AASB is concerned that specifying additional fair value disclosures in financial statements for the purpose of addressing a difference in measurement bases might not be an appropriate approach since financial statement disclosures may require more costly measurements to meet qualitative characteristics than estimates incorporated into GFS measures. The AASB notes the IPSASB may have addressed this concern by stating in paragraph 4.6 of the CP that current value estimates may be good enough for GFS reports without requiring potentially more costly fair value measurement in financial statements. The IPSASB’s statement suggests that, in some cases, reconciling IPSAS and GFS information in IPSAS-compliant financial statements might be more appropriate than extending fair value requirements under IPSASs. Furthermore, issue D4 (financial statement presentation) refers to reconciling IPSAS and SNA amounts, and the AASB suggests this could be considered in conjunction with proposals for additional or changed measurement requirements.

(d) Issue D8 (biological assets) refers to a difference in the timing of consumable biological assets being classified as inventory under IPSAS 27 *Agriculture* and GFS. The AASB noted there may be scope for the IPSASB to reconsider that classification in conjunction with the IASB, since the IASB is currently progressing a limited project in relation to bearer biological assets.

(e) The AASB notes that issue D11 (transactions between the central bank and government entities) could be considered by the IPSASB in conjunction with issue B2 (currency on issue/seigniorage).

In respect of defence weapons (paragraph 5.13 of the CP), the AASB suggests the IPSASB considers the level of detail that should be specified in IPSASs in terms of principles versus rules in responding to requests for more guidance on classification of defence weapons as property, plant and equipment, inventory, or expenses. Some of the issues would be affected by the comments in (c) above concerning reconciliation of amounts rather than remeasurement using fair values under IPSASs, for example in respect of inventory measurement (paragraph 5.12) and measurement generally (paragraph 5.15).

Specific Matter for Comment 5 *(See paragraphs 5.20 to 5.28 and page 39)*

This CP describes three options concerning IPSAS 22: Option A, revisions to improve IPSAS 22; Option B, withdrawal of IPSAS 22 without replacement; and, Option C, replacement of IPSAS 22 with a new IPSAS.

(a) Are there any further IPSAS 22 options that should be considered? If so, what are these?

(b) Which one of the options do you consider that the IPSASB should consider adopting?

(a) Further IPSAS 22 Options

Before contemplating making improvements to IPSAS 22 *Disclosure of Financial Information about the General Government Sector*, the AASB suggests the IPSASB should first obtain evidence of the effectiveness of the principles in IPSAS 22. Given the low uptake of IPSAS 22, this evidence could be collected only after making IPSAS 22 mandatory. Accordingly, the AASB suggests the IPSASB considers making IPSAS 22 a mandatory Standard, rather than an effectively optional one. The IPSASB could establish a project to consider amendments to IPSAS 22 that could be made in due course, such as requiring governments to adopt accounting policy options in IPSASs that are more closely aligned with GFS requirements.

(b) Which Option Should the IPSASB Consider Adopting?

As noted in response to (a), the AASB suggests the IPSASB considers making IPSAS 22 a mandatory Standard and in due course amending it based on evidence derived from its adoption. Depending on the evidence, this could lead to Option C – replacing IPSAS 22 with a new IPSAS that adopts an integrated approach. This would allow the GFS-related requirements to be collected in one IPSAS rather than scattered through the many IPSASs. Other IPSASs, such as IPSAS 1 *Presentation of Financial Statements*, would not be complicated by the need to specify GFS-related reporting requirements. Under this approach, just one IPSAS would need to be updated for GFS developments, instead of potentially having to update a number of IPSASs. That would be required even if other IPSASs merely included GFS comparisons as a matter of note.

Whereas paragraph 5.26 of the CP refers to the identification of IPSAS options that are aligned with GFS, greater benefits would ensue from the replacement IPSAS if it were to require governments to adopt GFS-aligned options that are consistent with IPSASs. This could significantly reduce differences between IPSASs and GFS requirements.

<u>Preliminary View 1 *(See paragraphs 5.29 to 5.34)*</u>

The IPSASB should amend Study 14, *Transition to the Accrual Basis of Accounting: Guidance for Governments and Government Entities,* to include a chapter on IPSAS options that reduce differences with GFS reporting guidelines.

Given the time it might take for a standard-based solution to IPSAS/GFS harmonisation matters, the AASB thinks that a useful interim measure would be to include in Study 14 a discussion on the selection of options in IPSASs. It would be helpful to include such discussion to assist governments in considering the adoption of the accrual-based IPSASs.