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23 May 2005

Mr David G Boymal
 Chairman
 Australian Accounting Standards Board
 P O Box 204
 COLLINS STREET WEST VIC 8007

Dear Mr ~~Boymal~~ *David*

Draft Exposure Draft ED 14X Financial Reporting of General Government Sectors by Governments

I have recently read the above draft exposure draft posted on the AASB's website. I fully recognise that this document is still a working document under consideration by the Board. However, I am so disturbed by certain decisions made by the Board I have decided to submit some limited comments for consideration by the Board prior to its finalisation.

- (a) Constant reference is made through out the document to the IMF's *Government Finance Statistics Manual 2001*. Indeed an understanding of this document is fundamental to an understanding of the objective and thrust of the exposure draft given that the ED is being prepared by the Board in response to the FRC's strategic direction that "...the Board should pursue as an urgent priority the harmonisation of Government Finance Statistics (GFS) and Generally Accepted Accounting Principles (GAAP) reporting.....". I believe the ED should be understandable to not only those intimately involved in Government financial reporting (and likely therefore to be familiar with the GFS Manual) but also to a wider range of AASB's constituents. This latter group includes the general community who are impacted by the Government's Budget decisions and to whom the Government and Parliament are very much accountable. Indeed the proposed GGS GPFR should be purposely designed to meet the needs of such users as well as the needs of the more sophisticated users. Such constituents are highly unlikely to be familiar with the GFS Manual. They do however have a right to have access to a budget outcome statement that is understandable and relevant to their needs and therefore has due regard to the stewardship and accountability responsibilities of the Government and Parliament.

I therefore believe that the GFS Manual should be reproduced as an appendix to the proposed ED or as a separate document accompanying the proposed ED. At the very least – but not my preference – the manual should be placed directly on the AASB's website or the ED and the AASB's website should be cross-referenced to the IMF website address at which the manual is freely available. However, I believe inclusion on the AASB website and as an appendix to or separate publication accompanying the proposed ED (and in due course the resultant standard) is fundamental and preferred given that (as stated in (r) on page 14 of the draft ED) "reference to GFSM 2001 is a stationary reference".

- (b) I find it particularly disappointing that the AASB's website does not include an up-to-date detailed project summary relating to this project. I believe the AASB's constituents are entitled to a succinct summary of the main issues that have been considered by the Board during its deliberations on the proposed ED and a summary of the conclusions (including their basis) reached in regard to those issues. A project summary is one way of recording such matters. Given the significance of the project and the lack of a project summary of decisions reached on the AASB's website, I believe it would be helpful if the ED included a section outlining the basis of conclusions reached by the Board on the key issues impacting the ED. For example, I believe constituents should be told the basis of the Board's decision that the GGS financial report can be considered to be a stand-alone GPFR – a decision I find quite remarkable!

- (c) I believe the ED lacks clarity as to what constitutes the Government's "Budget". A financial report under IFRS comprises a balance sheet, an income statement, a statement of changes in equity, a cash flow statement and notes to those statements. In Government circles, there is much talk about the Budget's so-called surplus or deficit usually without any reference as to whether what is being talked about is an income statement operating surplus or deficit or an operating cash surplus or deficit as reported in the cash flow statement. The FRC's strategic direction states that "the objective should be to achieve an Australian accounting standard for a single set of Government reports... in which the outcome statements are directly comparable with the relevant budget statements". From my observations it seems that the Board is willing to leave the format of the Budget statements up to the Government, but at the same time wishes to establish a standard covering an outcomes GPFR that is "comparable with the relevant budget statements".

In my view this can only be meaningfully achieved if the Budget statements adopt the same format as the outcomes GPFRs prepared in accordance with the accounting standards. It should NOT be the reverse, that is the format of the GPFR should not be driven by the format of the Budget statements, such format being very much at the whim of Government, as was amply evidenced by the reporting of the proposed "Future Fund" impacts in the recent Budget statements. In my view the Board should mandate that the Budget statements must include a Budget balance sheet, income statement, cash flow statement and statement of changes in equity in the same format and content as required to be reported in the outcome statements, under the proposed ED. Without any such mandating, in my view the Budget statements will be without an appropriate foundation for their preparation and are likely to make comparison with the outcome statements difficult and confusing.

- (d) I have noted that the ED proposes that a GGS GPFR be prepared as a stand alone financial report. In my opinion, such a report will have many of the same characteristics as a parent entity (of an economic entity) financial report – in particular it will reflect investments in controlled entities and dividends or other distributions from such entities. While it is well recognised that the financial report of a parent entity that is a publicly listed entity is a GPFR, AASB 127 requires that each entity that is a parent of a group that is a reporting entity shall present consolidated accounts. Under the Corporations Act such consolidated accounts are presented along with the parent entity GPFR. Consequently, if IFRSs are principle-based standards (as is continually claimed), it would seem to me that under any reasonable interpretation of AASB 127, a GGS GPFR is very much akin to a parent entity financial report and therefore should only be presented in conjunction with a "whole-of-Government" consolidated set of accounts. It would seem to me that if the AASB intends that this is not to be the case (which is obviously its intention), there is a need to exclude GGS GPFRs from the scope of AASB 127. However, I remain unconvinced that there is any valid reason for such exclusion for after all any such exclusion is akin to promoting "Enron" type accounting with all the difficulties of unconsolidated controlled entities. At the very least I believe the ED should explain the basis of the Board's decisions in regard to this matter beyond merely wishing to comply with the FRC's strategic directions.
- (e) I have noted that it is intended that investments in unconsolidated controlled entities be accounted for at fair values or if not reliable, the proportion of the net assets of the controlled entity recognised in the whole-of-Government accounts. It would seem that where fair values are used such values might cause the carrying value of an investment recognised in the GGS financial report to exceed the recognised net assets relating to the controlled entity in the whole-of-Government accounts. For example, the fair value of an investment might include the fair value of internally generated intangibles, including goodwill, while such intangibles will not be recognised in the whole-of-Government accounts. This seems to be not only anomalous but also irrelevant to the objective of preparing a GGS financial report in that its main purpose apparently is to report the results of Government activities dependent on taxation and other Government revenues, rather than to report the results of the controlled entities in the PNFC and PFC sectors. It would be far simpler to require such investments to be carried at cost in the GGS GPFR and also more cost effective as there would seem to be little benefit in deriving the fair values of such entities merely to record such values in the GGS financial report and not in the whole-of-Government financial reports..

- (f) I also wish to query that if it is appropriate to prepare a set of GPFRs for the GGS sector, should there also be prepared a set of GPFRs for the PNFC sector and a set for the PFC sector. These three reports could then be read in conjunction with the whole-of-Government report that, in my opinion, should report the income statement, balance sheet and cash flow statements broken down into these three sectors. I believe this would be innovative and almost certainly considerably increase the transparency of the stewardship and accountability of Governments over controlled entities established outside the GGS.
- (g) In my opinion, a GGS report should include a note detailing the names of all non-consolidated controlled entities and dividends and distributions from those entities recognised in the GGS financial report together with the reported surplus/deficit of each such entity. This reporting is essential to help control deliberate manipulation of the reported operating results of the GGS sector by varying the dividends and other distributions from the unconsolidated controlled entities between years.

The above only covers the more significant issues I have noted from my reading of the draft ED.

Finally, let me state that I believe the AASB has a heavy responsibility to fully consider each of the above issues without regard to the FRC's strategic direction for it is the Board (and not the FRC) that has the statutory responsibility to ensure financial reporting under the standards established by the Board result in relevant and reliable financial reporting.

I will be pleased to discuss the above issues with you. In view of the significance of the above issues I believe this letter should be made publicly available and therefore I would not object to it being posted on the AASB's website.

Yours sincerely



Keith Alfredson

-----Original Message-----

From: David Boymal
Sent: Friday, 21 October 2005 10:46 AM
To: 'Keith Alfredson'
Cc: Robert Keys
Subject: RE: GGS Exposure Draft

Thanks Keith,

we are walking on a tight -rope on this topic.

All best regards to you

David

-----Original Message-----

From: Keith Alfredson [mailto:keithalfredson@hotmail.com]
Sent: Friday, 21 October 2005 9:54 AM
To: dboymal@asb.com.au
Subject: GGS Exposure Draft

Dear David

It is not my intention to make a further detailed submission on the GGS exposure draft. All that I wish to say is included in my earlier letter dated 23 May 2005 and I ask that that letter be considered as my final submission on the exposure draft, along with this email.

I particularly believe that the AASB should adopt the approach of the IASB and prepare a summary of conclusions reached and at least place it on the AASB's website. As I stated in my letter of 23 May I believe constituents should be told the basis of the Board's decision that the GGS financial report can be considered to be a stand-alone GPFR and also why AASB 127 is not applicable so that the GGS financial reports must be presented with the "whole-of-government" accounts, and not just cross-referenced to those accounts. I might add that I am pleased that the ED appears to assume that the "whole-of-government" accounts are available at the same time as the GGS financial report -a fact that I believe should be explicitly stated. Of course, this is in stark contrast to statements made by one high profile promoter of the ED who has consistently stated that the "whole-of-government" accounts have little value as they ""can only be produced with a long time lag after the period to which they relate".

Yours sincerely

Keith Alfredson