



# Department of Treasury and Finance

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Mr David Boymal  
Chairman  
Australian Accounting Standards Board  
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Our Ref:  
07 DEC 2005

Dear Mr Boymal

## **EXPOSURE DRAFT 142 - FINANCIAL REPORTING OF GENERAL GOVERNMENT SECTORS BY GOVERNMENTS**

The Victorian Department of Treasury and Finance welcomes the opportunity to respond to the Exposure Draft. Victoria strongly supports the position outlined in the recent Heads of Treasury submission to the AASB that the reporting standard for the General Government sector reporting entity should:

- Provide for an auditable general purpose financial report, but exclude the need for explanation of variance between budget and actual to be audited;
- Consolidate investments in entities in other sectors as a single line based on either fair value or net assets of those entities;
- Require adoption of one approach to convergence based on the conceptually best treatment for those items where there is a significant difference in recognition or measurement between the GAAP and GFS frameworks;
- Clearly express support for the "down-the-page" presentation in the financial statements;
- Present on the face of the financial statements certain significant GFS-based measures that are derived from the numbers presented within those statements; and
- Otherwise comply with accounting standards.

A more detailed discussion of these concerns is included in Attachment A.

As you will be aware, Victoria has a particular interest in the outcome of the AASB's deliberations on the GFS/GAAP standard. This is because Victoria is one of only two Australian jurisdictions which applies the accounting standards as the primary basis of reporting for both its budget and outcome reports, reflecting the Victorian Government's commitment to transparency and accountability in financial reporting.

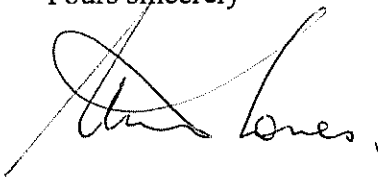
This makes the contents and the timing of the new standard of key importance for Victoria. A particular concern is that the new standard improve the information available to users of the Victorian Government's reports. Consistent with the Heads of Treasury position, Victoria believes that the illustrative multi-column format approach presented in the Exposure Draft would reduce, rather than improve, the understandability and comparability of government general purpose financial reports.

Victoria has only two convergence differences to report under a GFS/GAAP converged operating statement – *Bad debts written off* and *Provision for doubtful debt* – and prefers a single column operating statement format as illustrated in Attachment B. A multi-column format is not required, and would not meet the primary test of improving information for users. Attachment B also includes Victoria's preferred presentation format for the other main financial statements.

Victoria's preferred GFS/GAAP converged operating statement is an adaptation of the operating statement format developed in compliance with AASB 101 and used for the first time in the *2005-06 Victorian Budget*. In devising the A-IFRS format, Victoria sought to provide for a smooth transition to the GGS reporting standard and avoid two major changes to reporting in close succession. We would be concerned if the new standard required a significant change to the reporting format, in the absence of a compelling rationale under which the benefits of the change in terms of improved information outweighed the risks of confusion for users.

As noted in the Heads of Treasury submission, it is recognised that the re-drafting and re-issue of the Exposure Draft requested by Heads of Treasury will require that mandatory application be deferred until 2007-08. The date of application is a key concern for Victoria which requires sufficient time to communicate and prepare for any changes in accounting standards because these will impact on both budget and outcome reporting in Victoria. Mandatory application of the GFS/GAAP converged reporting standard for financial reporting periods commencing 1 July 2007 will enable Victoria to plan for publication of its first report under the new standard which will be the *2007-08 Victorian Budget* scheduled for release in May 2007.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Murray Jones', with a stylized flourish at the end.

Murray Jones  
**Director, Budget and Financial Management**

## ***Specific Comments on ED 142***

### **Meaningful GAAP/GFS Convergence**

The Standard should result in financial statements that present users with clear results, rather than statements that simply display a reconciliation between two frameworks.

Except for

- the disclosure matters discussed below,
- the specific requirement that the report is a general purpose financial report for the general government sector,
- applying a specific rule for the consolidation of investments in other sectors of government, and
- instances where GFS treatment is more conceptually appropriate,

the Standard should generally follow GAAP requirements and definitions for measurement and recognition

The requirement to disclose GFS measures on the face of the financial statements should be restricted to the following aggregates derived from numbers measured and reported within the financial statements:

- GFS net operating balance (with the option to use an alternative title such as “net result from transactions”);
- GFS net lending/borrowing (with the derivation disclosed by way of note);
- the GFS cash flow surplus/deficit as an additional disclosure on the cash flow statement; and
- GFS net worth, GFS net financial worth.

We support mandating the requirement to present assets on the balance sheet in the order of liquidity as set out in Appendix B of ED 142, but this choice could well be left to preparers given that it complies with the requirements of AASB 101.

The requirements to present, by way of note, disaggregated information based on broad classification of government purpose should be restricted to those expenses arising from transactions and net acquisitions of non-financial assets. The disaggregated disclosure of other items such as revenue, liabilities and financial assets is strongly opposed. Transactions and re-measurements arising from other than expenses, and movements and balances in non-financial assets and liabilities are generally not identified to specific purposes and could not be allocated except on an arbitrary basis. This additional information requested has no meaningful management purpose, and so requesting it is contrary to recent accounting standards on disaggregated disclosures which require segment disclosure based on the way that information is presented to the entity’s governing body.

We also consider the requirement in paragraph 49 to disaggregate information based on the broad functions of government identified in chapter 6 of GFSM 2001 to be inappropriate and strongly oppose its inclusion. The government purpose classifications administered by the ABS more meaningfully reflect government activities in Australia, are often the basis of grants, including allocations to the States through the Commonwealth Grants Commission funding formulae, and are consequently of significance to management and other users. They have been

used for disaggregated reporting for a number of years, and reporting on this basis will need to continue. Consequently the requirement to use GFSM 2001 government functions will result in additional, unnecessary and unwarranted disaggregated reporting.

Finally, for the purposes of this proposed standard, GAAP accounting should be followed for the re-measurement of debts for those considered to be doubtful. We understand that the current GFS treatment of doubtful debts is under consideration by the IMF for possible change. Therefore, any differences should be disclosed by way of a note indicating that this is a temporary difference until the IMF treatment is clarified.

Other than the matters discussed above, there should not be any mandating of GFS requirements, measures or definitions. We consider that AASB 101 is sufficiently principles-based that jurisdictions will be able to disclose other GFS items they consider relevant.

### **IMF (GFSM 2001)**

We have discussed above the particular circumstances why disaggregated reporting must be based on ABS classifications of purpose rather than functional classifications used in GFSM 2001. However we also have a general concern about the use of GFSM 2001 definitions and interpretations. The ABS fulfils a similar role to that which the AAASB plays for GAAP. While accounting standards are set by the IASB, the AASB reviews them, considers whether they are of benefit to Australia, adds Australian paragraphs when appropriate, and places the Australian version into law. In the same way that the users of accounting standards in Australia can refer to the AASB version, the users of GFS in Australia should be able to refer to the ABS version of the GFS manual and seek guidance from ABS staff as appropriate.

### **Budgetary Information**

The ED proposes presenting the original budget on a basis consistent with this standard. It should be made clear that the budget information to be presented (whether on the face or by way of note) is only that information originally presented on the face of the financial statements, and does not extend to budget information previously disclosed in the notes. This is important given that published government budgets typically provide many pages of details which are not necessarily within the notes to outcome financial reports.

We are particularly concerned by and oppose the requirement to explain major variances between the original GGS budget and actual amounts. In the absence of any reason to the contrary the requirement is assumed to have to be met by explaining the variances as part of the notes to the financial statements. As such this discussion and explanation would be subject to audit. The reasons for the variation may be verifiable, but not auditable, or may not fall within the expertise of the auditor. While disclosure of such variances is to be encouraged, the appropriate place is in a management discussion and analysis or similar reporting of performance by management outside of the financial report. Consequently we consider that the standard should be silent on this issue and paragraph 57(b) should be deleted.

## **Performance Indicators**

Many of the comments made in the last paragraph also apply to performance indicators. While paragraphs 53 to 56 are couched in voluntary terms their inclusion is likely to encourage audit pressure for their inclusion in the financial report and consequent audit. We consider that where performance indicators are disclosed, the appropriate place is in a management discussion and analysis or similar reporting of performance by management outside of the financial report. Consequently we consider that the standard should be silent on this issue and paragraph 53 to 56 should be deleted.

## **Presentation Format**

“An essential quality of the information provided in financial reports is that it is readily understandable by users.” [quotation from Framework] An accounting standard that results in the kind of multi – column display with numerous sub-totals illustrated in Appendix B does not meet this characteristic. Moreover this presentation requires a level of knowledge about the GFS framework that will be rare amongst users compared to knowledge about GAAP and therefore does not meet the expectation in the Framework.

Furthermore, this multi-column presentation involves practical difficulties in fitting typical disclosures on a page in a reasonable size font, especially for entities where there is a legal requirement to use B5 size pages. Typically a government would report together outcomes for both whole of government and general government sector with a comparative year for both. Under the example presented in the ED this could result in 16 columns in an operating statement – a number impossible to fit and likely to confuse any reader. If, as is likely, there is in future greater international convergence with US practices then two comparative years might be required resulting in a further eight columns. Consequently Victoria rejects the proposed solution as not being acceptable. Attachment B provides preferred illustrative formats of the three financial statements.

## **Valuation methodologies**

We have a particular concern that GAAP requirements under revaluation models are often more onerous than GFS methodology to measure at market valuation, and these requirements place a substantial burden on government agencies. This has most impact for property, plant & equipment, but is also a concern for investment property. For plant & equipment we believe that AASB 116 should have additional paragraphs to give primacy to valuations based on depreciated replacement cost; the requirements to revalue every asset in the same class at the same time and that there is not a material difference between carrying and fair value should be judged on a class rather than individual asset basis, should be waived to allow cyclical valuations, and guidance should encourage substantial use of indices as a revaluation tool, especially for crown land in remote locations that is rarely sold.

For investment property, Australian guidance should indicate that the purpose of the property should be evaluated from the viewpoint of the consolidated economic entity rather than individual reporting entities. The property standard allows companies to reflect potential gains if they sold their land assets. This does not apply to government entities as they are rarely able to sell their land assets. If sold by government direction, any revenue is generally paid into the consolidated fund. Given that this standard would disallow the cost option which would be

applied in similar circumstances in the private sector, we suggest that a revaluation similar to that in AASB 116 be added to AASB 140 for use by the public sector.

### **Timing of adoption**

The standard is currently proposed to be mandatory for annual reporting periods beginning on or after 1 July 2006, with earlier adoption possible. Although this standard is not specifically applicable to budgets it may well affect them and thus has implications for the government budget to be issued in April/May 2006. Given this fact and that there are a number of issues identified which may take some time to resolve, we recommend that mandatory adoption be deferred until for annual reporting periods beginning on or after 1 July 2007, with earlier adoption possible.

### **Application to other entities**

The preface advises that the FRC's broad strategic direction has been considered in the context of three phases and that the board has deferred decisions on the extent to which its proposals in the ED should be further applied. If an appropriate accounting standard for reporting the General Government Sector is achieved then preparers should be entitled to adopt consistent reporting for any general purpose financial reports of the entities (departments and other agencies) making up the general government sector.

### **Investments in PFC's and PNFC's**

We support the proposals in paragraphs 19 to 23 for the accounting for the GGS's equity investments in non-consolidated entities deemed to be controlled by the sector.

## Summary:

In summary our main concerns are:

- the requirement to explain variances from budget
- excessive adoption of GFS principles and requirements
- disaggregation disclosures based on IMF classifications of government functions rather than the Australian Government Purpose Classifications
- implications of mandating the IMF version of GFS, whereas the ABS is the Australian reference for all other GFS reporting;
- potential reporting of performance indicators; and
- presentation formats which are regarded as impractical to implement;

Victorian Department of Treasury and Finance supports a standard for the General Government reporting sector reporting entity that:

- Provides for an auditable general purpose financial report, but excludes the need for explanations of variance between budget and actual to be audited;
- Consolidates investments in entities in other sectors as a single line based on the net assets of these entities;
- Requires convergence through the adoption of a single approach where there is a significant difference in recognition or measurement between the GAAP and GFS frameworks, based on the conceptually best treatment for those items;
- Clearly expresses support for a down-the-page presentation in the financial statements with separate identification in the comprehensive operating statement of those items that, under the GFS framework, would be “transactions” and those that would be “other economic flows” (re-measurements) – as illustrated in Attachment B. Where convergence introduces items that are not in the GFS framework this will require a decision as to the conceptually appropriate classification;
- Presents on the face of the financial statements certain significant GFS measures that are derived from the numbers presented within those statements;
- Provides for optional reconciliation between GFS and GAAP measures and any additional less significant GFS measures in the notes; and,
- application of any final accounting standard be mandatory for financial reporting periods commencing 1 July 2007.
- Otherwise complies with accounting standards.
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Consequently, the Department is not supportive of the ED as it currently stands and would seek a satisfactory resolution of these issues via a thorough rework of the ED.

**Operating statement for the General Government Sector for the financial year ending 30 June**  
(\$ million)

	<i>Notes</i>	<i>2004</i>	<i>2005</i>	<i>Published budget 2004-05</i>
<b>Income from transactions</b>				
Taxation		10,131.9	10,414.9	10,271.8
Interest income		374.5	339.7	435.5
Fair value of assets received free of charge or for nominal consideration		374.0	16.7	...
Grants income		12,628.4	13,462.3	13,080.5
Sale of goods and services		2,569.2	2,695.8	2,533.8
Dividends and other income		2,420.0	2,895.7	2,643.1
<b>Total income from transactions</b>		<b>28,497.9</b>	<b>29,825.1</b>	<b>28,964.7</b>
<b>Expenses from transactions</b>				
Employee benefits		(9,988.4)	(10,746.5)	(10,480.5)
Superannuation		(1,936.7)	(1,908.9)	(1,880.0)
Interest expense (other than superannuation)		(451.3)	(444.9)	(476.2)
Depreciation and amortisation		(1,067.9)	(1,138.8)	(1,200.1)
Grants and transfer payments		(4,651.7)	(5,160.0)	(5,087.7)
Supplies and services and other expenses		(9,428.6)	(9,631.1)	(9,311.4)
<b>Total expenses from transactions</b>		<b>(27,524.7)</b>	<b>(29,030.2)</b>	<b>(28,435.9)</b>
<b>Net result from transactions (net operating balance)</b>	<b>2</b>	<b>973.2</b>	<b>794.9</b>	<b>528.8</b>
<b>Other economic flows - Gains/(losses)</b>				
Net actuarial gains on superannuation defined benefit plans		1,636.5	1,328.8	90.7
Net gain on equity investments in unconsolidated subsidiaries measured at proportional share of net assets/(liabilities) <sup>(a)</sup>		--	--	--
Net gain / (loss) from disposal of physical assets		(44.8)	(26.6)	11.9
Impairment write down of property plant and equipment		(178.3)	(125.5)	8.4
Net gain/(loss) on other financial assets or liabilities at fair value through operating result		(1,369.5)	173.0	(85.2)
Other expenses from other economic flows	3	(15.6)	(0.8)	(9.6)
<b>Total</b>		<b>28.4</b>	<b>1,349.0</b>	<b>16.2</b>
<b>Net operating result</b>		<b>1,001.5</b>	<b>2,143.9</b>	<b>545.0</b>
<b>Other economic flows - Other non-owner movements in equity</b>				
Gain/(loss) on revaluation of properties		2,182.2	8,954.2	802.0
<b>Comprehensive result</b>		<b>3,183.7</b>	<b>11,098.1</b>	<b>1,347.0</b>
<b>GFS key fiscal aggregates</b>				
GFS net operating balance		973.2	794.9	528.8
Net transactions in non financial assets	4	(1,089.1)	(457.8)	(1,186.5)
Net lending/borrowing		(115.9)	337.1	(657.7)

*The accompanying notes form part of these financial statements.*



## Balance sheet for the General Government Sector as at 30 June

(\$ million)

	Notes	2004	2005	Published budget 2004-05
<b>Financial assets</b>				
Cash assets		1,300.9	1,803.3	1,377.1
Receivables and prepayments		1,393.9	1,913.8	1,557.7
Deposits, debt securities and loans		3,526.9	2,860.3	3,353.1
Shares and other equity		34,039.4	36,878.4	34,521.0
<b>Total financial assets</b>		<b>40,261.0</b>	<b>43,455.8</b>	<b>40,808.8</b>
<b>Non financial assets</b>				
Inventories		95.5	101.6	92.1
Buildings		11,990.0	13,650.2	12,888.2
Plant and equipment and infrastructure systems (other than roads)		1,957.3	1,931.6	2,163.7
Road networks		16,842.9	16,322.1	17,786.7
Land		10,042.0	17,698.2	10,392.6
Intangible and other non financial assets		3,807.9	4,292.4	3,897.1
<b>Total non financial assets</b>		<b>44,735.7</b>	<b>53,996.1</b>	<b>47,220.4</b>
<b>Total assets</b>		<b>84,996.7</b>	<b>97,451.9</b>	<b>88,029.2</b>
<b>Liabilities</b>				
Deposits and payables		3,234.5	3,155.5	3,317.3
Superannuation		11,710.6	10,493.5	12,378.0
Other provisions		3,737.3	3,952.6	3,917.7
Securities and loans		5,507.4	5,530.3	5,672.0
Other liabilities		614.4	642.4	614.4
<b>Total liabilities</b>		<b>24,804.3</b>	<b>23,774.3</b>	<b>25,899.4</b>
<b>Net assets</b>		<b>60,192.4</b>	<b>73,677.5</b>	<b>62,129.8</b>
<b>Equity</b>				
Accumulated surplus/(deficit)		47,421.8	51,945.9	48,565.2
Other reserves		12,770.6	21,731.6	14,054.2
<b>Total equity</b>		<b>60,192.4</b>	<b>73,677.5</b>	<b>62,619.4</b>
<b>Key fiscal aggregates</b>				
<b>Net Worth</b>	5	60,596.9	74,071.0	62,619.4
<b>Net Financial Worth</b>	6	15,861.2	20,074.8	15,399.0

The accompanying notes form part of these financial statements.

## Cash flow statement for the General Government Sector for the financial year ending 30 June 2007

(\$ million)

## Cash flow statement for the General Government Sector for the financial year ending 30 June

(\$ million)

	2004	2005	Published budget
Notes			2004-05
<b>Cash flows from operating activities</b>			
<b>Cash received</b>			
Taxes received	9,873.6	10,318.3	10,361.7
Receipts from sale of goods and services	4,154.5	3,695.8	2,230.2
Grants and subsidies received	12,610.8	13,451.6	13,080.0
Interest received	411.0	343.4	434.8
Other receipts	1,193.6	2,537.7	2,683.1
<b>Total cash received</b>	<b>28,243.5</b>	<b>30,346.7</b>	<b>28,789.9</b>
<b>Cash paid</b>			
Benefits to employees	(9,809.1)	(10,522.3)	(10,283.1)
Superannuation payments	(2,026.8)	(1,797.2)	(1,121.8)
Interest paid	(457.4)	(384.8)	(483.5)
Grants and subsidies paid	(4,548.7)	(5,290.4)	(5,030.6)
Payments for goods and services	(8,931.0)	(9,826.4)	(9,330.3)
Other payments	..	(19.4)	..
<b>Total cash paid</b>	<b>(25,773.0)</b>	<b>(27,840.5)</b>	<b>(26,249.3)</b>
<b>Net cash flows from operating activities</b>	<b>2,470.6</b>	<b>2,506.2</b>	<b>2,540.6</b>
<b>Cash flows from investing activities <sup>(a)</sup></b>			
Proceeds from sale of non financial assets	126.5	128.0	80.9
Purchases of non financial assets	(2,345.3)	(1,965.8)	(2,470.9)
<i>Net cash from non financial investing activities</i>	<i>(2,218.8)</i>	<i>(1,837.7)</i>	<i>(2,390.0)</i>
Net cash flows from investments in financial assets for policy purposes	(158.3)	(512.8)	(481.6)
Net cash flows from other investing activities	937.9	416.3	193.6
<i>Net cash from financial investing activities</i>	<i>779.6</i>	<i>(96.4)</i>	<i>(287.9)</i>
<b>Net cash flows from investing activities</b>	<b>(1,439.1)</b>	<b>(1,934.2)</b>	<b>(2,677.9)</b>
<b>Cash flows from financing activities (a)</b>			
Net advances received	(0.1)	(0.8)	..
Net borrowings and other financing	(844.0)	(44.7)	213.6
<b>Net cash flows from financing activities</b>	<b>(844.0)</b>	<b>(45.4)</b>	<b>213.6</b>
<b>Net increase/(decrease) in cash and cash equivalents</b>	<b>187.4</b>	<b>526.6</b>	<b>76.2</b>
Cash and cash equivalents at beginning of period	1,107.8	1,295.2	1,295.2
<b>Cash and cash equivalents at end of period</b>	<b>1,295.2</b>	<b>1,821.7</b>	<b>1,371.4</b>
<b>Cash surplus/(deficit)</b>	<b>251.8</b>	<b>668.4</b>	<b>150.6</b>

The cash surplus/(deficit) is equal to the net cash flows from operating activities less net cash from non-financial investing activities.

The accompanying notes form part of these financial statements.

**Note 2 Expenses classified by Function**

\$ million

	2004	2005	Published budget 2004-05
General public services	965	761	1 649
Public order and safety	2 494	2 889	2 590
Education	7 395	8 111	7 532
Health	7 066	7 710	7 379
Social security and welfare	2 145	2 216	2 109
Housing and community amenities	1 016	1 519	1 200
Recreation and culture	769	706	963
Fuel and energy	113	48	40
Agriculture, forestry, fishing, and hunting	443	297	469
Mining, manufacturing, and construction	20	22	18
Transport and communications	3 426	3 122	3 086
Other economic affairs	327	382	391
Other purposes	1 347	1 246	1 007
<b>Total expenses by function</b>	<b>27 525</b>	<b>29 030</b>	<b>28 436</b>

**Note 3 Other income and expenses from other economic flows**

\$ million

Assets not previously recognised	11.5	18.7	(0.0)
Amortisation - intangible non-produced assets	(25.7)	0	(9.6)
Write down of inventory	(1.4)	(19.4)	(0.0)
	<b>(15.6)</b>	<b>(0.8)</b>	<b>(9.6)</b>

**Note 4 Net acquisition of non-financial assets**

\$ million

Purchases of non-financial assets	2,345.3	1,965.8	2,470.9
Less: sales of non-financial assets	(126.5)	(128.0)	(80.9)
Less: depreciation	(1,067.9)	(1,138.8)	(1,200.1)
Plus: change in inventories	5.7	6.1	(3.4)
Plus: other movements in non-financial assets	(67.5)	(247.1)	..
<b>Total net acquisition of non-financial assets</b>	<b>1,089.1</b>	<b>457.8</b>	<b>1,186.5</b>

**Note 5 Net Worth**

\$ million

Net assets	60,192.4	73,677.5	62,129.8
Add back provision for doubtful debts	404.5	393.4	489.6
<b>GFS net worth</b>	<b>60,596.9</b>	<b>74,071.0</b>	<b>62,619.4</b>

**Note 6 Net Financial Worth**

\$ million

<b>Total financial assets</b>	<b>40,261.0</b>	<b>43,455.8</b>	<b>40,808.8</b>
Add back provision for doubtful debts	404.5	393.4	489.6
less liabilities	(24,804.3)	(23,774.3)	(25,899.4)
<b>Net Financial Worth</b>	<b>15,861.2</b>	<b>20,074.8</b>	<b>15,399.0</b>