

21 October 2005

Professor David Boymal FPNA  
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Australian Accounting Standards Board  
Level 4  
530 Collins Street  
Melbourne VIC 3000

Dear David

**Re: General Government Sector reporting**

The National Institute of Accountants (NIA) is pleased to be able to respond to the exposure draft issued by the Australian Accounting Standards Board (AASB) on reporting for the general government sector (GGS). It has been an issue subject to vigorous debate. We hope our contribution to the discussion assist in the AASB delivering a workable compromise between the two sides of the argument that have clearly emerged during the time this debate has been running.

We should at the outset set down the key principles of our approach because we understand it is different to the approaches taken by some of the other parties engaged in this debate. In particular, our approach to this discussion commences with one principle at its very heart. The government that is doing the reporting is the reporting entity. The sector known as the general government sector is one portion of government activity that should both be reflected on in the context of the budget sector and also whole of government.

The NIA acknowledges the importance of having a framework that limits the flexibility of political leaders to use accounting standards for the purpose of improving their cosmetic appearance to the electorate. Eliminating choices in accounting for transactions in the public sector appears to be the most convenient and necessary means by which to achieve the reporting discipline that is desired by commentators – including members of our organization – that we have consulted in formulating this submission.

The NIA submits that the two sides of the debate have made valuable contributions to the discussion, but that it is time for participants to consider how the wishes of all sides can be catered for and an improved framework for government report achieved in this country.

**Democracy and the consequent accountability**

This debate on government reporting is far more significant than some commentators acknowledge. Governments have a captive audience as

stakeholders. Every citizen in a democracy is a stakeholder of government. Parents send their children to government schools, people receive treatment at hospitals, elected councils make decisions affecting local services and the taxes paid by workers are administered and used by governments – State, Federal and Territorial – for the provision of services.

In the case of governments the case for transparency in reporting and comprehensive disclosure is more compelling because of the sheer weight of numbers of individuals that are eligible to participate in voting at a general election to choose the composition of the Federal Parliament. The Australian Electoral Commission's (AEC) web site makes note of the fact that as at 30 September 2005 there were 13,127,401 individuals enrolled with the AEC. That figure compares more favorably when considered beside the 8 million people the Australian Stock Exchange (ASX) states in its most recent shareholder ownership survey results that have either a direct or indirect involvement in the stock market. That share ownership survey covered the 2004 calendar year-end.

The analysis above, however, has limitations because the figures related to those enrolled with the AEC only cover those people that are capable of exercising a direct power to vote at the ballot box. There is a broader range of stakeholders affected by government activity, which is the same debate presently being entertained by a committee of the Federal Parliament on corporate responsibility. People that are below voting age or vulnerable in some way such as old age or illness must also be considered when determining the appropriate regime of accountability when reporting to the community. One only needs to think about the scale of the Federal Government's tax system and the health services provided by State governments to fully understand the way in which the notion of stakeholder should be interpreted. A 10-year old child walking into a milk bar on the local shopping strip in the suburbs of any Australian state is paying goods and services tax when he or she buys sweets. That child is under voting age but is participating in the economy by using pocket money to buy something on which a consumption tax has been levied. Another useful example is that of pensioners receiving health services from governments. They are also people that are as a result of their age and state of health that are vulnerable. At either extreme – whether the people we are talking about are children or ailing pensioners – what we have are people that are vulnerable in their own way. Only the highest form of accountability represented by comprehensive and reliable reports will do to ensure that those people can have confidence in the way governments' fulfill the responsibility in managing scarce resources.

There is a further issue that must always be considered in contemplating financial reporting regulation for the government sector. Elected officials are often perceived to be in a position to set the rules for individuals and entities in the broader community. It is important that the public sector is actually and is perceived to be the ultimate pillar of virtue where accountability is concerned. This requires the public sector doing its best to ensure that its accounting and disclosure practices are at least comparable with those in the for-profit and not-for-profit sectors to the extent where government may need to and does apply more stringent reporting requirements to its own affairs.

## **Complete set of data for government reporting**

Central to the debate over GAAP-GFS is the notion of what information is needed by users that want to have an understanding of government activity. We note that there are concerns on both sides of the debate about the needs of users of financial statements issued by government that relate to the understandability and comprehensiveness of material by various parties. These tensions are both necessary and healthy because without robust debate there is no real prospect of effecting any changes to a framework that can stand up to scrutiny.

All sides of this debate have contributed fragments to the picture of a 'whole' that is yet to be properly defined by the AASB. We all understand what is meant, for example, by whole of government financial statements under the current reporting regime. The exposure draft that is the subject of consideration by the AASB talks about a set of financial statements formulated in accordance with concepts that originate from both what we might term the conventional accounting framework and the framework for government financial statistics. What has not yet occurred is the formulation of a framework for government financial reporting that provides a comprehensive set of data for the analysis of government activity that meets the needs of all potential users of the financial statements of a government.

The NIA does not object to the AASB issuing the standard on reporting for the GGS, otherwise known as the budget sector with a proviso that the standard is seen as part of a broader reporting framework for the reporting entity known as government. Our views on how such a framework might work and some of the concerns we have about the exposure draft are outlined below.

### **A proposed framework standard**

The NIA agrees that the present form of reporting for government may not present information in a form that suits the broadest possible audience that would like to analyse government activity. Whole of government reports prepared in accordance with accounting standards serve one particular purpose whereas reports prepared using GFS principles provide a different data set for the purposes of analysis of a different kind. We are concerned that the present proposal has been released without a comprehensive vision of what the final framework for a GPFR issued by the Federal, State or Territory governments should be like.

The result of the current work being done by the AASB on public sector accounting should be an accounting standard that states that a suite of financial statements forms a general purpose financial report (GPFR) for the reporting entity known as government. An accounting standard should be issued specifying that a GPFR for the reporting entity known as government consists of reports covering:

- Whole of Government financial statements in accordance with GAAP;

- Financial statements covering all of the sectors set down by the GFS framework – the GGS, public finance corporations (PFC) and public non-finance corporations - as issued by the International Monetary Fund (IMF); and,
- Any other information a government believes is required for users of its financial reports to understand the activities of government.

We note the tentative decision by the AASB to remove the local government, government department and whole of government standards from the suite of accounting pronouncements affecting the public sector. We would expect that governments would report the whole of government in accordance with the general suite of accounting standards. This may necessitate the AASB issuing standards that cover specific issues - such as grantor accounting in the context of a service concession arrangement – where the for-profit standard setting regime of the International Accounting Standards Board (IASB) has been silent on the appropriate accounting for the government end of a service concession.

The contents of the individual reports that result from the application of parts of government financial statistics (GFS) and generally accepted accounting principles (GAAP) should be prepared in accordance with a subsequent standard developed for each sector by the AASB. The financial statements resulting from the application of these standards should be regarded as a part of a suite of reports making up the GPFR for government rather than the traditional approach of segment reporting that places the individual statements in the financial statement notes. For example, the current proposed standard covering the GGS under this framework would be used to prepare the GGS financial statements that are one of four mandated components of the government's GPFR.

The third aspect to this proposed framework standard asks governments to consider whether there is anything else that they believe stakeholders must know in order to understand more clearly the financial position, financial performance and financial management of a government. Such a global clause in a standard is critical because it sets down a moral obligation on the part of governments to think about disclosing more information if it is believed such information is critical to a users understanding of government activity. A government is free to build goodwill with the community at large by providing information that explains the government's activities in more detail. A 'catch all' clause in such a standard would also force governments to not think solely in a minimalist way when planning for the preparation of financial statements. This type of clause also reflects our belief that financial reporting standards of any description set down principles rather than quantitative rules. We therefore believe any standard based on the above proposals should aim to encourage governments to go beyond any minimum standard requirements.

### **Presentation of financial statements**

In our thinking on the development of this concept of an overarching standard that sets down the requirements for a government GPFR we have concluded there is a need to specify the way in which this suite of reports should be

presented. We are mindful that there are various legislative and resource pressures that exist in some jurisdictions and as such this submission briefly discusses a proposal for a 'benchmark presentation' as well as an 'accepted alternative presentation'.

This proposal is based on the notion that each of the sets of financial statements are prepared as individual reports in their own right and the entire suite – released at once or over a short period of time – constitutes the government's GPFR. In other words, we are advocating that the board should entertain the concept that the government GPFR could – like a serialised encyclopedia or a Royal Commission report – have multiple volumes that deal with the sectors and the entirety of government as described above.

Our preferred approach would be that the whole suite of reports be tabled and released at the one time so that the full picture is available to the community at once. We consider this to be the 'benchmark presentation'. Users are entitled to have access to such information at once where possible so that they can make judgments about whether the government is fulfilling its responsibilities and various accountabilities in the appropriate manner. This approach would be consistent with the convention of providing everything at once between two covers.

We are conscious, however, that there are various legislative requirements that drive government reporting and on occasions governments may have to devote resources to the publication of one set of data, typically the budget outcomes statement, before the statements describing the whole of government activity. One of the concerns we have in this context is that there may be a danger the reliability of the information presented may be compromised if the reporting deadlines are too tight or – as is the case in some contexts – legislation requires one set of financial statements such as the budget outcomes to be lodged by a specific date with the parliament. We have proposed what we regard as an 'accepted alternative presentation' of the GPFR for government.

An 'accepted alternative presentation' is for the government concerned to publish separately the reports in a sequence approved by the relevant auditor general of a particular jurisdiction. That sequence should be publicized so that the community knows when to expect the balance of the suite of financial statements of the government GPFR to be released. Each of the four financial statements form part of the GPFR. Nothing has come to our attention that would suggest these financial statements prepared under the framework proposed above could be called special purpose financial reporting (SPFR).

### **Government is the reporting entity**

The reporting entity for the purposes of the standard ought to be the government. Specific guidance is provided in the conceptual framework, particularly in the Statement of Accounting Concepts (SAC) dealing with the definition of the reporting entity, that the government is the controlling entity and as such is to be regarded as the reporting entity in the arrangements as they are outlined below. We submit that any other approach to the reporting

entity concept is inadequate and compromises a core reporting principle in this environment. It is also inconsistent with our view that the government is the economic entity and as such it should be regarded as the reporting entity.

We agree that the GGS is an important part of government activity and requires acknowledgment. It is not in itself the reporting entity when one considers the notions of control that permeate the accounting literature and the standard cannot proceed with that fundamentally flawed premise. Our proposed framework is more consistent with the conceptual framework and we ask that the AASB give serious consideration to our notion of a suite of reports rather than the single financial report making up the GPFR for the reporting entity that is government.

### **Absence of explanation of 'reporting entity' decision**

We continue to be disappointed with the absence of an adequate explanation for the board's decision to call the GGS financial statements a GPFR and for the GGS to be called a 'reporting entity'. One would expect that a fundamental decision such as this would warrant further detail than is provided so the community can better understand the nature of the proposals that have been placed before it.

The exposure draft may out the concerns that exist for some board members, but without an explanation of the actual decision it is unclear to readers unfamiliar with the way in which these matters have unfolded why board members are concerned.

An exposure draft without such an explanation should never leave the AASB because it is incomplete without these details. A reader cannot hope to comment on the proposals on a fully informed basis in such circumstances.

### **General Purpose Financial Report**

Under our conceptual framework a reporting entity is obliged to prepare a GPFR in order to fulfill its obligations to be accountable to the stakeholders interested in its performance. We consider that the conceptual framework does not prohibit the approach we have outlined provided the governments applying the framework we have suggested do so in good faith.

### **Concern about selective disclosure and management reporting**

During the course of the debate on the exposure draft concerns have been expressed by some commentators that the governments will ignore the results presented in the WoG reports and only reflect those results that are contained in the GGS financial statements. We are also aware that members of the AASB have expressed concerns about the ability of governments to selectively point to the certain line items and reflect on those line items in commentary. While these concerns are all valid and have a place they are not matters the AASB can readily deal with. The matter of the quality of disclosure and how reporting is done ought to be addressed by the auditors responsible for the review of the financial statements of governments. Members of the AASB

cannot themselves effectively regulate behavior merely by drafting their standards a particular way. The system depends on the audit offices in each jurisdiction in Australia doing their job in a way that ensures governments comply with the accounting standards as issued by the AASB.

**General comment on the exposure draft**

We agree with the general proposition that the GGS report should refer to the WoG report as a 'health warning' to users so they know to refer to another document for further information about government activity. That is appropriate.

We are generally pleased with the clarity of the proposed statements, but we believe the proposed standard should not itself lead to a GPFR but set down requirements for a financial statement that forms a part of a suite of documents that collectively form the GPFR for the reporting entity that is government.

We would be pleased to comment further on these proposals should you wish to explore them with us. Feel free to contact me at any time on 0407 408 000 or [tom.ravlic@nia.org.au](mailto:tom.ravlic@nia.org.au) .

Kindest Regards

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National Institute of Accountants

9 January 2006

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Dear David

**Re: Public sector reporting project**

The National Institute of Accountants (NIA) has in recent months been made aware of continuing concerns related to the way in which governments may communicate the results reported using the standard that arises from the GAAP-GFS project currently being undertaken by the Australian Accounting Standards Board (AASB).

Concerns centre on the possibility of governments asserting that the result presented for the budget sector is the government's ultimate reporting result.

We cannot agree on principle that the only result that is relevant is the result reported for the budget sector and we would therefore oppose any attempt by governments to characterise that figure as being the only relevant measure of government performance.

It would in our view be detrimental to argue that information presenting a result that has been prepared under a GAAP-GFS is the only relevant set of data to analyse government activity. As argued in our submission on the exposure draft on the financial statements for the budget sector, the most appropriate solution is to investigate the way in which the concept of a general purpose financial report can be expanded to include all of the relevant data rather than just a portion.

Our concern becomes deeper when we consider the unsophisticated analysis that can sometimes appear in the daily press. It would be quite simple for a government to claim the budget outcomes result as being the most relevant result in a situation where a significant group of individuals are ill-equipped to question the accuracy or the appropriateness of government briefings given to them. The AASB needs to ensure that the message it sends outwith the finalisation of any standard is that the standard provides for the production of a result that deals with the budget sector only and not other parts of government activity.

The GAAP-GFS project is one to 'harmonise' the two frameworks underlying accounting practice in the public. To 'harmonise' does not mean grant or guarantee supremacy to any single ideal. We would encourage the



AASB to further consider our proposed framework for public sector reporting as it reflects on the exposure draft in its board meetings over the next year.

We would appreciate it if the AASB would consider this as a supplementary submission on the exposure draft.

Should you wish to talk further about the matters raised above please contact me on either 03 8665 3143 or 0407 408 000.

Kindest Regards

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