



**The Institute of  
Chartered Accountants  
in Australia**

24 October 2005

The Chairman  
Australian Accounting Standards Board  
PO Box 204  
Collins Street West VIC 8007

Dear Sir

**ED 142: Financial Reporting of General Government Sectors by Government**

The Institute of Chartered Accountants in Australia (ICAA) welcomes the opportunity to make a submission on ED 142.

We agree that the ED is an important step towards convergence. However we are concerned that even though the financial statements produced under the ED will be General Purposes Financial Reports they will not have applied all the requirements of the Australian Accounting Standards. This results in financial statements that will not be directly comparable with other General Purpose Financial Reports even though they will purport to be prepared within the same framework.

We are concerned about the proposed removal of AAS 27 Financial Reporting by Local Governments, AAS 29 Financial Reporting by Government Departments and AAS 31 Financial Reporting by Governments before the finalisation of ED 142. We are also concerned about the potential implication for whole of government reporting which is not covered by the ED.

Our detailed comments can be found in the appendix to this letter.

Yours faithfully

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## Appendix

### Specific Matters for Comment to AASB

- a) The proposal in paragraph 5 that the GGS (as defined in GFSM 2001) of a government is a reporting entity:

We agree that the General Government Sector (GGS) is a reporting entity under the concept in SAC 1 due to the user need for information about the sector. As a result of this the financial statements that they produce will be General Purpose Financial Statements (GPFS).

On this basis we believe that the financial statements of the GGS should be prepared in accordance with all accounting standards applicable to other reporting entities as well as the Governmental financial statistics.

- b) the proposal, implicit in paragraph 5, that a GGS financial report prepared on a partial consolidation basis is a GPFR together with the proposal in paragraph 18 that the GGS should be prohibited from consolidating controlled entities in the PNFC and the PFC sector.

It is important that the users of the financial statements understand the basis of preparation and that it be as consistent as possible across entities. If GGS are deemed to be producing GPFS then their financial statements should be in accordance with the AASB accounting standards. As a result they should consolidate any entity under their control as determined by AASB 3 and AASB 127. The proposal as they currently stand will reduce the comparability to other GPFR and as a result undermines the value of the concept.

If there are differences between the requirements of the AASBs and the GFS the differences should be disclosed by way of note in the financial statements, including an explanation of why the variance has arisen. The proposal that where Australian Accounting Standards allow for optional treatments, only those treatments aligned with the Government Finance Statistics Manual 2001 (GFSM 2001) may be applied is a sound one and will assist with the above issue.

- c) the proposal in paragraphs 8 to 12 that, with limited significant exceptions, the GGS financial report should comply with other Australian Accounting Standards and, where it does not conflict with Australian Accounting Standards, GFSM 2001. The Board is particularly interested in comments on the proposal that where Australian Accounting Standards allow for optional treatments, only those treatments aligned with GFSM 2001 should be applied for the purposes of GGS financial reporting;

It is important that the users of the financial statements understand the basis of preparation and if GGS are deemed to be producing GPFS then their financial statements

should be in accordance with the AASB accounting standards. If there are differences between the requirements of the AASBs and the GFS the differences should be disclosed by way of note in the financial statements, including an explanation of why the variance has arisen. The proposal that where Australian Accounting Standards allow for optional treatments, only those treatments aligned with the Government Finance Statistics Manual 2001 (GFSM 2001) may be applied is a sound one and will assist with the above issue.

- d) the proposal in paragraphs 13 to 17 to require or allow disclosure of information in the GGS financial report that is determined in accordance with GFSM 2001 and, where it is determined in a different manner from corresponding information prepared in accordance with Australian Accounting Standards, provide a reconciliation to the GFS-related information;

It is important that the users of the financial statements understand the basis of preparation and if GGS are deemed to be producing GPFS then their financial statements should be in accordance with the AASB accounting standards. If there are differences between the requirements of the AASBs and the GFS the differences should be disclosed by way of note in the financial statements, including an explanation of why the variance has arisen. The proposal that where Australian Accounting Standards allow for optional treatments, only those treatments aligned with the Government Finance Statistics Manual 2001 (GFSM 2001) may be applied is a sound one and will assist with the above issue.

- (e) the proposals in paragraphs 19 to 23 that:
  - (i) the GGS's equity investment in non-consolidated controlled entities should be measured at fair value where fair value is reliably measurable and at the government's proportional interest in the net assets of the controlled entities where fair value is not reliably measurable;
  - (ii) where net assets is used as the basis of measurement, it is determined in a manner consistent with the net assets that are consolidated into the whole of government GPFR;
  - (iii) changes in the carrying amount of the GGS's equity investment in non-consolidated controlled entities during a reporting period are treated in a manner consistent with the treatment of a change in fair value under AASB 139 even if the carrying amount is not fair value; and
  - (iv) specify the treatment of jointly controlled entities and associates;

It is our view that the Australian Accounting standards should be applied to GGS as they apply to other entities and as such all entities that GGS control should be consolidated. However, if the AASB decides to depart from full consolidation as required by Australian Accounting Standards and adopt the partial consolidation approach, we believe that the methods of valuation of non-consolidated controlled entities would provide a reasonable alternative. However, disclosures in the financial statements should be sufficiently extensive to enable users to clearly identify which entities fall into which category and how they have been valued as well as the impact.

- (f) the proposals in paragraphs 26 to 31 relating to the format and content of the balance sheet and the treatment of convergence differences;

We agree with the current proposals concerning the content. However we consider that the proposed format for this content is quite confusing. We believe a better approach would be to require disclosures on the face of the balance sheet in accordance with the Australian Accounting Standards. Any other disclosures required should be done by way of note. We envisage the disclosure would be similar to those prepared by most entities when complying with AASB 1047 as at 30 June 2005.

It would also be of assistance if the ED explained why the liquidity format provides the most relevant and reliable format for these financial statements.

- (g) the proposals in paragraphs 32 to 40 relating to the format and content of the operating statement and the treatment of convergence differences, including the proposal:
  - (i) to mandate the classification of income and expenses by nature on the face of the operating statement, with the classification aligned with the GFSM 2001 classification scheme to the extent appropriate;
  - (ii) to mandate a comprehensive income approach whereby all non-owner movements in equity are recognised in a single operating statement; and
  - (iii) that the option in AASB 119 *Employee Benefits* (December 2004) of partially deferring actuarial gains and losses on defined benefit superannuation plans using a "corridor approach" should be prohibited, and that the remaining options of recognising them in operating result or in the other non-owner movements in equity section of the operating statement should be allowed. The Board is particularly interested in comments on whether the Standard should remove options entirely, and in so doing, prohibit recognition directly in other non-owner movements in equity;

We have no issues with the content proposed. However feel that the proposed format is quite confusing. We feel that a better format would be to disclose on the face of the income statement in accordance with the Australian Accounting Standards and any other disclosures would be done by way of note. We envisage the disclosure to be similar to that which was adopted by most entities in relation to the adoption of AASB 1047 as at 30 June 2005.

- (h) the proposals in paragraphs 41 to 43 relating to the format and content of the cash flow statement. The Board is particularly interested in comments on whether the Standard should also require a distinction between cash flows relating to investing in financial assets for "policy" and "liquidity management" purposes on the face of the cash flow statement and whether such a distinction would be useful and could be made with sufficient rigour for GPFR purposes;

We have no issues with the content proposed. However feel that the proposed format is quite confusing. We feel that a better format would be to disclose on the face of the cash flow statement in accordance with the Australian Accounting Standards and any other disclosures would be done by way of note. We envisage the disclosure to be similar to that which was adopted by most entities in relation to the adoption of AASB 1047 as at 30 June 2005.

- (i) the proposals in paragraphs 44 and 45 relating to additional information to be provided in the note containing the summary of significant accounting policies, illustrated in Appendix C. In particular, the Board is interested in comments on whether the proposed disclosures provide sufficient information to minimise the risk that users might perceive the GGS financial report as being a substitute for the whole of government GPFR;

We agree that the additional disclosures would be useful to users in reading the context in which the GGS financial statements are prepared.

- (j) the proposals in paragraphs 46 to 48 relating to additional disclosures. The Board is particularly interested in comments on whether the proposal in paragraph 46(d) to require disclosure of explanations of key technical terms used in the financial report is useful;

We agree that the additional disclosures would be useful to users in reading the context in which the GGS financial statements are prepared. In particular, the key technical terms may be useful to those users who are not familiar with all the technical terms under GAAP and/or GFS.

- (k) the proposals in paragraphs 49 to 52 relating to disclosures that provide disaggregated information about GAAP and GFS amounts on a functional basis, whereby functions are determined in accordance with GFSM 2001;

We don't feel that the standard gives sufficient guidance to enable GGS to determine a functional currency which will result in these paragraphs being inconsistently applied between entities and in particular for the same entity year to year.

While these proposals may work reasonably well for the whole of government we are concerned that they will be difficult to apply for departments and/or subsidiaries. The requirements here would also appear to duplicate some of the existing performance reporting.

- (l) the proposals in paragraphs 53 to 56 to specify principles for the presentation of performance indicators;

We agree that the additional disclosures should be useful to users of the financial statements. We are of the opinion that all information contained in the financial statements should satisfy the qualitative characteristics in the Framework for the Preparation and Presentation of Financial Statements.

- (m) the proposals in paragraphs 57 to 62 to require disclosure of:

- (i) the original budget, restated if necessary so that it is presented on a basis that aligns with the basis on which the financial statements and notes have been prepared (in accordance with the Standard); and
- (ii) an explanation of major variances between the original GGS budget and actual amounts;

We are of the opinion that this will provide useful information, as long as budgeted and actual information is prepared on the same basis and are comparable. This budget information disclosed should also be based on the published budget. This would facilitate the process of explaining major variances. The ED does not deal with what to do with changes to the “original budget”, we would suggest that any changes to the “original budget” be taken into consideration when compiling the disclosures required by paragraphs 57 to 62.

We also have concerns as to whether this will trigger Auditors-General to seek to audit the budget documents. We would not support changes to current practice in this area.

- (n) the proposals in paragraphs 63 to 67 relating to transitional requirements. In particular, the Board is interested in assessments of the costs and benefits of the approach proposed, compared with alternative approaches, including remaining silent in the Standard about transitional requirements, and thereby effectively requiring AASB 108 Accounting Policies, Changes in Accounting Estimates and Errors to operate in its own right;

We are concerned that the application date of 1 July 2006 is not achievable, particularly given the need for further debate on the GAAP/GFS issue and the amount of change that the ED is proposing.

This is a single year issue in the transition period. The proposed approach would result in increased audit expenses for governments due to changes in the comparative year.

- (o) the illustrated acceptable format for the financial statements and notes related to convergence differences in Appendix B. The Board is particularly interested in comments on:
  - (i) the columnar approach illustrated for the balance sheet and operating statement. In addition to any criticisms of the columnar approach, respondents are invited to provide an alternative that is consistent with the Exposure Draft’s proposals for the Board’s consideration; and
  - (ii) whether the illustration provides guidance that is helpful in implementing the proposals in the Exposure Draft, particularly those that adopt the requirements in AASB 101 as effectively amended by the proposals;

AS indicated previously we believe that the columnar approach is acceptable in the notes to the financial statements but not on the face of the statements. It is useful when it clearly illustrates the reconciliation between GAAP and GFS. However, we would recommend that all columns, including disaggregated information be totaled.

- (p) whether it is appropriate for the Standard to cross-reference to GFSM 2001, given that GFSM 2001 is not prepared by the AASB and that there is a need for the AASB to consider whether amendments to the Standard are necessary each time GFSM 2001 is amended. The Board is also interested in comments on whether

instead of GFSM 2001 the Standard should cross-reference to the GFS Manual published by the Australian Bureau of Statistics (ABS);

It is appropriate to reference to all of the GFSM 2001 and that any changes to GFSM 2001 should be reflected if appropriate in the Australian Accounting standard. We not do feel that reference to the GFS manual is required.

- (q) whether there are any aspects of GFSM 2001 that you consider should be prohibited from forming part of the basis upon which the GGS's financial report is prepared; and

No part of the GFSM 2001 has come to our attention that should not be included as part of the basis upon which the GGS's financial statements is prepared.

- (r) whether, overall, the proposals result in financial reports that are useful to users.

The key is to get comparable, consistent and uniform information to financial statement users. This ED is a step in the right direction, though it tends to be based on reconciliation rather than convergence. This fact leads to some very complex accounting disclosures and reconciliation that will need to appear in the financial statements. We believe that one set of converged financial statements is more likely to increase government transparency and accountability.

We do have concern that Australia is insisting on leading the way with GAAP/GFS harmonization. The IPSASB and the IMF review of the System of National Accounts is due in 2008. We are concerned that action without waiting for this report will not further the interests of international harmonization and will result in a repeat of potential significant change in a couple of years.

We are concerned about the proposed removal of AAS 27 Financial Reporting by Local Governments, AAS 29 Financial Reporting by Government Departments and AAS 31 Financial Reporting by Governments before the finalisation of ED 142 as it will leave the GGS with no specific guidance and the potential for their financial statements to be substantially different one year to the next as the requirements are changed.