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Mr David Boymal
Chairman
Australian Accounting Standards Board
PO Box 204
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24 October 2005
Our Ref: DR

Dear David

ED 142 'Financial Reporting of General Government Sectors by Governments'

Deloitte Australia welcomes the opportunity to comment on the proposals contained in Exposure Draft ED 142 'Financial Reporting of General Government Sectors by Governments' ("ED 142" or the "exposure draft").

In accordance with the Financial Reporting Council's (FRC's) strategic direction, we understand that the primary objective of the Board was to achieve an Australian accounting standard for a single set of Government reports which are auditable, comparable between jurisdictions, and in which the outcome statements are directly comparable with the relevant budget statements.

In our opinion, the proposals of the exposure draft regarding the preparation and presentation of General Government Sector ("GGS") financial reports have partially achieved this objective. That is, GGS financial reports will be auditable, comparable between jurisdictions, and outcome statements will be comparable with the relevant budget statements. However, in our opinion, the proposals of the exposure draft do not achieve convergence between GFS and GAAP and, consequently, do not enable governments to prepare a single GGS financial report that will satisfy both GFS and GAAP requirements.

We appreciate that the Board has no authority with respect to the formulation of GFS, as it applies in Australia, and was only prepared to depart from the methodology prescribed by existing Australian Accounting Standards in limited circumstances. This being the case, in our opinion, the 'reconciliation' approach proposed by the exposure draft is arguably the only solution to presenting both GFS and GAAP information in the same financial report.

However, we remain to be convinced whether a GGS financial report prepared in accordance with the proposals of the exposure draft will provide users with relevant and useful information. Accordingly, we believe it is important that the Board gives due consideration to the views expressed by the preparers and users of government financial reports in this regard.

If you have any questions concerning our comments, please contact Darryn Rundell on (03) 9208 7916.

Yours sincerely

Darryn Rundell
Partner

MATTERS FOR SPECIFIC COMMENT

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

In our opinion, the GGS does meet the key criteria for being regarded as a 'reporting entity'. In particular, it would be reasonable to expect the existence of users who are unable to command the preparation of financial reports (of the GGS) tailored so as to satisfy, specifically, all of their information needs.

Accordingly, we agree that the GGS should be regarded as a 'reporting entity' for the purpose of applying the standard.

Comment (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 sector and the PFC sector.

We have no concern with the GGS financial report being regarded as a general purpose financial report (GPFR) even although, as proposed by the exposure draft, such financial report would be prepared on a partial consolidation basis (i.e., excluding controlled entities in the PNFC sector and PFC sector).

To ensure consistency in the basis of preparation of GGS financial reports, we agree that the GGS should be prohibited from consolidating controlled entities in the PNFC sector and PFC sector.

Comment (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.

Where options exist within Australian Accounting Standards, we agree that it is appropriate for the GGS to adopt those options that align with the principles of GFSM 2001.

However, we have the following comments in relation to the examples of particular options in Australian Accounting Standards that have been outlined in paragraphs 11(a) to (d) of the exposure draft:

(a) Paragraph 11(b) of the exposure draft indicates that assets are required to be measured at fair value under GFSM 2001 and, accordingly, that assets within the scope of AASB 116 *Property, Plant and Equipment*, AASB *138 Intangible Assets* and AASB 140 *Investment Property* would be measured at fair value (in order for the GGS financial report to comply with paragraph 10 of the exposure draft). In our opinion, it is unclear whether the requirements of paragraph 10 of the exposure draft, and the related guidance in paragraph 11(b), override the "active market" precondition to the revaluation of intangible assets (as prescribed by AASB 138). We presume that paragraph 10 is not intended to override the requirements of AASB 138, however, we recommend that this be clarified.

(b) Paragraph 11(c) of the exposure draft indicates that financial instruments that are required to be measured at fair value under GFSM 2001 must be measured at fair value under AASB 139 *Financial Instruments: Recognition and Measurement*. In our opinion, it is unclear whether the requirements of paragraph 10 of the exposure draft, and the related guidance in paragraph 11(c), require all such financial assets to be classified in the GGS financial report as *'financial assets at fair value through profit or loss'* or *'available-for-sale financial assets'* or a combination of the two classifications based on the requirements of AASB 139. In our opinion, it is arguable that the classification of financial assets as *'available-for-sale financial assets'* in the GGS financial report is more consistent with the principals and rules of GFSM 2001, however, it is unclear as to whether this is the intended outcome of applying the proposals of the exposure draft. By contrast, it may well be the intent of the Board that financial assets should be classified as *'financial assets at fair value through profit or loss'* in the GGS financial report. We recommend that this matter be clarified.

    In the event that the exposure draft is intended to prescribe that financial assets that are required to be measured at fair value under GFSM 2001 must be designated as *'financial assets at fair value through profit or loss'* in the GGS financial report, has the Board considered the impact of the recent amendments to AASB 139 which limit the availability of the designation of financial assets as *'financial assets at fair value through profit or loss'*?.

Comment (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.

We have no concerns or comments regarding these proposals.

Comment (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.

We have a number of concerns regarding the proposals contained in paragraphs 19 to 23:

(a) Although a conceptually superior approach (consistent with AASB 139), in our opinion, it will be impractical and potentially onerous in many instances to require investments in controlled entities in the PNFC sector and PFC sector to be measured at fair value in the GGS financial report. In our opinion, the pragmatic approach would be to require, or at least permit, such investments to be measured with reference to the government's proportionate share of the net assets of the controlled entity (in a manner consistent with the measurement of the net assets in the whole-of-government consolidated financial statements).

(b) Assuming that the proposals in paragraphs 19(a) and (b) of the exposure draft (to require investments in controlled entities in the PNFC sector and PFC sector to be measured at fair value in the GGS financial report) are retained in the standard, we are concerned by the proposals that:

- *'any change in the fair value of the investment shall be treated in accordance with AASB 139'*
- *'any change in the consequential carrying amount of the investment shall be treated as if the change in carrying amount is a change in fair value and therefore accounted for in a manner consistent with the requirements in AASB 139'.*

In accordance with the requirements of AASB 139, changes in the fair value of financial assets are treated differently depending on whether the financial asset is classified as *'financial assets at fair value through profit or loss'* or as *'available-for-sale financial assets'*. That is, in accordance with AASB 139, the change in fair value may be recognised in profit or loss or directly in equity (in accordance with the AASB 139 classification).

In our opinion, it is unclear whether the requirements of paragraph 10 of the exposure draft, and the related guidance in paragraph 11(c), require investments in controlled entities in the PNFC sector and PFC sector to be classified in the GGS financial report as *'financial assets at fair value through profit or loss'* or *'available-for-sale financial assets'* or a combination of the two classifications based on the requirements of AASB 139. This would impact the treatment of any changes in the fair value of investments in controlled entities in the PNFC sector and PFC sector. In our opinion, it is arguable that the classification of equity investments as *'available-for-sale financial assets'* in the GGS financial report is more consistent with GFSM 2001, however, it is unclear as to whether this is the intended outcome of applying the proposals of the exposure draft. By contrast, it may well be the intent of the Board that such investments (or even all financial assets) should be classified as *'financial assets at fair value through profit or loss'* in the GGS financial report. We recommend that this matter be clarified.

In the event that the exposure draft is intended to prescribe that investments in controlled entities in the PNFC sector and PFC sector must be designated as *'financial assets at fair value through profit or loss'* in the GGS financial report, has the Board considered the impact of the recent amendments to AASB 139 which limit the availability of the designation of financial assets as *'financial assets at fair value through profit or loss'*?.

Comment (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 have no concerns or comments regarding these proposals, other than as outlined below with respect to the paragraph references in paragraph 28 of the exposure draft.

Paragraph 28 of the exposure draft makes reference to *'corresponding amounts disclosed in accordance with paragraph 14 of this Standard'*. We believe that this reference should be to paragraph 13 of the exposure draft (which would then be consistent with the wording adopted in paragraph 35 of the exposure draft).

Comment (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 concerns or comments regarding these proposals, other than as outlined below with respect to the treatment of actuarial gains and losses.

In relation to the treatment of actuarial gains and losses, we believe that the standard should mandate the treatment that the Board believes is aligned with the principals or rules of GFSM 2001. This would be consistent with the proposals contained in paragraph 10 of the exposure draft.

Comment (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 concerns or comments regarding these proposals.

Comment (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 have no concerns regarding these proposals and we believe that the disclosures will 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.

Comment (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 have no concerns regarding these proposals and we believe that disclosure of explanations of key terms used in the GGS financial report will be useful.

Comment (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 have no concerns or comments regarding these proposals.

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

We have no concerns or comments regarding these proposals.

Comment (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 have no concerns or comments regarding these proposals.

Comment (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 proposed transitional requirements of the exposure draft may result in differences in the measurement of assets and liabilities recorded in the GGS financial report and the assets and liabilities of the GGS recorded in the whole-of-government ("WofG") consolidated financial report. This may occur as a result of:

- the WofG adopting 1 July 2004 as the date of transition to A-IFRS in the preparation of the first WofG A-IFRS compliant financial report (i.e., the 30 June 2006 annual financial report); and

- the GGS effectively adopting 1 July 2005 as the date of transition to A-IFRS in the preparation of the first GGS A-IFRS compliant financial report (i.e., the 30 June 2007 annual financial report).

Differences would arise, for example, where an election is made under AASB 1 to measure items of property, plant and equipment at the date of transition to A-IFRS at their fair value and use such fair values as deemed cost at that date.

It is arguable that the application of paragraph 24 and 25 of AASB 1 would enable the dates of transition to A-IFRS for the GGS and the WofG to be synchronised. Although that would require the determination of which entity (the GGS or the WofG) is the parent entity and which entity is the subsidiary.

We believe that the wording and application of the transition requirements of the exposure draft should be reconsidered by the Board in order to ensure that no undue measurement difference arise between the GGS and the WofG financial reports.

Comment (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.

In our opinion, it is sufficient for the appendix to provide only one approach to the presentation of GGS financial statements based on the application of the proposals in the exposure draft.

However, we believe that it would be beneficial to the preparers of GGS financial reports for the appendix to include a narrative explanation of some of other presentation methods that would also be acceptable.

Comment (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).

Although not ideal, we accept that the Standard should be cross referenced to GFSM 2001.

We make no comment as to whether it would be more appropriate for the Standard to cross reference to the GFS Manual published by the ABS, rather than GFSM 2001.

Comment (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.

We have not identified any other aspects of GFSM 2001 that we believe should be prohibited from forming part of the basis upon which the GGS financial report is prepared.

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

Refer to the comments made in our covering letter.