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Mr David Boymal
Chairman
Australian Accounting Standards Board
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5 September 2007

Dear Mr Boymal

PROPOSALS ARISING FROM THE SHORT-TERM REVIEW OF THE REQUIREMENTS IN AAS 27, AAS 29 AND AAS 31

Thank you for the opportunity to comment on the Board's Exposure Draft ED156. The views expressed here represent those of all Australian members of the Australasian Council of Auditors-General (ACAG) with the exception of the Auditor-General for South Australia, who reserves his right to respond separately to auditing and accounting exposure drafts and related documents where he deems it appropriate.

From a public sector perspective, this exposure draft is important as the consequential changes of accounting standards will have a significant effect of general purpose financial reports prepared by governments and their agencies.

The attention that the Board has given to public sector accounting issues recently is welcomed and there a range of pressing issues where guidance for preparers and auditors. These are listed below in their order of priority:

- contributions (including accounting by grantors)
- heritage assets
- administered items
- control in the public sector
- public sector obligations
- disaggregated disclosures
- performance indicators

Several of these issues are dealt with in ED156, while others will need to be considered by Board in the longer term.

The opportunity to comment is appreciated and I trust you will find the attached comments useful.

Yours sincerely

Frank McGuiness
Chairman
ACAG Financial Reporting and Auditing Committee

Specific matters for comment

1. Proposed New Standards

(a) AASB 10XX *Administered Items*:

(i) the proposal to continue to limit the requirements relating to administered items to government departments, given the short-term nature of the current review of AASs 27, 29 and 31, rather than extending them to apply to other entities that receive parliamentary appropriations.

We agree with the proposal to limit the requirements relating to administered items to government departments in the short-term. However, as many other entities also have transactions that are akin to administered items, we believe it would be appropriate to review these requirements as a higher priority. An example, from one jurisdiction, would be the State Revenue Office, or equivalent, which administers certain resources on behalf of the State, such as land tax and stamp duty.

In addition, we strongly believe that a definition of administered items is warranted.

(ii) the proposal to require disclosure of items that a government department collects or distributes on behalf of another entity that are neither controlled nor administered items (see paragraph 13 of proposed AASB 10XX).

The proposal is supported. The disclosure of such items is relevant to parliamentary decision - making and enhances the discharge of accountability obligations. Such information may also be relevant for departmental performance assessments, particularly in relation to the effective and efficient administration of these items.

To provide clarity to the reader, disclosure of administered income and expenses dealt with in paragraph 13 should be dealt with separately from the disclosure of items that the government department collects or distributes on behalf of another entity and resources that the government department has legal custody over that are neither controlled nor administered.

Clarity is also sought in terms of what the Board considers to be ‘another entity’ in the context of AASB 10XX, paragraph 13.

(iii) in relation to government department transfers that are not controlled by the government department, the proposal to require disclosure of the broad categories of recipients and the amounts transferred to those recipients by government departments (see paragraph 20 of proposed AASB 10XX).

We agree with the proposal as the resulting information is considered relevant for obtaining a greater understanding of a government department’s financial activities. At the same time we point out the standard would require disclosure and on that basis we believe that the word “should” in paragraph 20 should be amended to “shall”.

(iv) the Board intends reviewing the requirements relating to administered items of not-for-profit entities in due course. Please indicate the priority you believe such a review should be given.

As mentioned in the response to (a)(i) above, we believe a high priority is warranted for the undertaking of this review.

(b) AASB 10XY Land Under Roads – Transitional Requirements: the proposed requirements for land under roads.

AASB 10XY states at paragraph 7 that the general principles of AASB 116 will apply once the transitional requirements for land under roads have elapsed. However, we recommend that additional guidance be provided in AASB 116 to cater for the difficulty in obtaining market-based evidence of fair values for land under roads.

ACAG is aware that some State jurisdictions have attempted to address these matters and have recognised land under roads. However, given there may be differing practices, and that this matter has remained on the Board's outstanding list for a considerable period, ACAG believes it is now an appropriate time for the Board to address both the issue of control of land under roads and development of objective valuation principles for this significant asset. If these issues cannot be resolved satisfactorily, ACAG believes that the recognition of land under roads should not be a requirement of Accounting Standards.

(c) AASB 10XZ Disaggregated Disclosures:

(i) the proposal to express the requirements in AASs 27 and 29 on disaggregated disclosures separately for local governments and government departments, rather than being merged into a single set of generic requirements.

We acknowledge this exposure draft addresses only short term requirements that affect the public sector, and therefore we support the proposal to establish separate requirements for local governments and government departments with regard to disaggregated disclosures.

However, we encourage the AASB to consider whether a single set of requirements for disaggregated disclosures could be developed, as this would create fewer accounting variations between different types of entities.

(ii) the proposal that assets deployed and liabilities incurred in relation to each major activity undertaken by a government department should be required, rather than merely encouraged, to be disclosed (see paragraph 15 of AASB 10XZ). The AASB is particularly interested in the costs/benefits of requiring such information.

As the requirements in AASB 114 *Segment Reporting* are akin to disaggregated disclosures, we see no reason as to why such disclosures are mandated in AASB 114, but merely encouraged for departments in existing AAS 29. However, ACAG members are not entirely convinced that the benefits that flow from the availability of the information will outweigh the costs of producing the information in all cases. This is an area where the requirement for disaggregated reporting might take a lead from the recently revised AASB 114 and eConsideration might be given to whether disaggregated departmental asset and liability information is currently used by management or governments in decision making or internal reporting.

(iii) the Board intends reviewing the requirements relating to disaggregated disclosures by not-for-profit entities in due course. Please indicate the priority you believe such a review should be given.

We recommend a medium priority be placed on the review of disaggregated disclosures for not-for-profit entities as these disclosures can be used to determine resource allocations and could potentially impact on policy decisions.

2. Proposed Amendments to Existing Standards

(a) AASB 3 *Business Combinations*: the proposal to amend the definition of reporting entity in AASB 3 to explicitly state that local governments, governments and most, if not all, government departments are reporting entities.

We agree with the proposal to amend the definition of a reporting entity to include local government, governments and most, if not all, government departments. However, we would prefer to see the definition of governments contained in existing AAS 31 to also be explicitly stated within AASB_3 as per the two imported definitions of local governments and government departments from AAS 27 and AAS 29, respectively. The Board may also wish to include a reference to the proposed revised AASB1004 on accounting for restructures of administered arrangements.

The proposal to include mentions of governments in AASB3 *Business Combinations* makes the document cumbersome as governments do not meet the definition contained in AASB3 of a business, which is as:

An integrated set of activities and assets conducted and managed for the purpose of providing:

- (a) a return to investors; or*
- (b) lower costs or other economic benefits directly and proportionately to policy holders or participants.*

The Board might consider amending the title of AASB3 to 'Business and Other Combinations' and adding text to describe the application of this standard to governments etc, including a reference to the proposed revised AASB1004 on accounting for restructures of administered arrangements.

(b) AASB 116 *Property, Plant and Equipment*:

(i) the proposal to include a statement in AASB 116 that 'Examples of property, plant and equipment held by not-for-profit public sector entities include but are not limited to infrastructure, cultural, community and heritage assets'.

As current Australian Accounting Standards do not state specifically that property, plant and equipment include -cultural, community and heritage assets, we agree with the Board's decision to include a new Aus paragraph making it clear that this is the case. We support the application of the Aus paragraph to all not-for-profit public sector entities, rather than limiting its application to only governments, government departments and local governments.

(ii) the proposal to provide Australian Guidance with AASB 116 relating to depreciation and fair valuation of heritage assets.

Constituents have expressed concerns on the lack of any formal accounting guidance surrounding heritage assets for many years. We note the short term measures outlined in the Australian Guidance to accompany AASB 116, however, we believe that the proposed guidance is currently not sufficient to address the unique nature and issues surrounding heritage assets. However, this should be addressed as part of the AASB's ~~short to~~ medium longer term review.

The Board's stated intention not to amend the principles in AASB116 in the short term requires greater clarity in the guidance given in paragraph G3 by giving a clear explanation of the meaning of the word "unlimited" by contrasting an asset having unlimited life with one having a very long or indefinitely long useful life. That guidance might also state that on-going measurement at fair value is irrelevant to considerations of whether depreciation is required.

It may be appropriate to include in the Basis for Conclusions a statement to the effect that the issue of not depreciating heritage assets with limited but indefinitely long useful lives, and the relevance of those assets being measured at their fair values would form part of the Board's proposal to undertake more comprehensive work in this area.

(c) AASB 127 *Consolidated and Separate Financial Statements*:

(i) the proposal to replace Aus paragraphs in AASB 127 with the AAS 31 paragraphs relating to control whilst retaining any aspects of the requirements currently in AASB 127 that remain relevant.

We support the proposal to replace Aus paragraphs in AASB 127 with the AAS 31 paragraphs relating to control.

In relation to the 'compliance with IAS 27' paragraph, we suggest the term 'government agencies' be defined or replaced with 'government departments'.

(ii) the AASB intends reviewing the requirements relating to control in the public sector in due course. Please indicate the priority you believe such a review should be given.

A high priority should be placed on the forthcoming review on requirements relating to control in the public sector.

(d) AASB 137 Provisions, Contingent Liabilities and Contingent Assets:

(i) the proposal to explicitly scope out of AASB 137, in respect of not-for-profit public sector entities, obligations arising from local government and government existing public policies, budget policies, election promises or statements of intent, and to effectively grandfather current practice in relation to those obligations until further research is undertaken. The Board is particularly interested in comments on whether the scope out is too broad or too narrow.

The existing AAS_31 requires all liabilities that satisfy recognition criteria to be recognised (with the exception of those arising under agreements equally and proportionately unperformed). At the same time, AAS31 provides some guidance about the treatment of welfare payments, multi-year public policy agreements and constructive obligations. The proposed replacement of this (and similar material in AAS27 and AAS29) with provisions that exclude these types of obligations from the scope of AASB137 represents a significant weakening of current requirements, notwithstanding the Board's proposed statement in AASB137 of not intending to change current practice. This gives rise to the risk that there will be no specific requirement in any standard for these types of public sector liabilities to be recognised when the definition and recognition criteria are met. The need to have recourse to the Framework through AASB108 is not considered to be an adequate substitute.

In ACAG's view, the appropriate course is for the Board to place the existing requirements in a separate standard, reducing the scope of AASB137 in the process. If inconsistent interpretations of existing provisions are apparent, the Board could clarify requirements in the separate standard or by way of an Interpretation. This approach would be no less effective than the proposal put forward by the Board in terms of grandfathering current practice.

A second, equally important, reason for maintaining the existing liability recognition requirements in the existing standards remains. The requirements provide an important part of the context for existing standards' treatment of contributions. In particular, AAS31, paragraph 14.1.7, which deals with multi-year agreements, submits that a "State does not control the contributed assets and therefore should not recognise revenues, until the Commonwealth Government has a present obligation which is binding...". That is followed by a reference to paragraph 12.1.2 which sets out the requirement to recognise all liabilities that meet the recognition criteria. If the existing requirements for the recognition of liabilities are not preserved within existing standards, the context within which contributions from the Commonwealth (or any government transferor) are accounted for is changed substantively.

BC38 suggests that an "Aus" paragraph will be inserted in AASB137 to advise that the exclusion of these types of liabilities from the scope of the standard is not intended to achieve a different result from the practice followed by not-for-profit entities. However we are concerned that the paragraph that is envisaged will not have the desired effect and despite the Board's intentions the basis of accounting for transfers between different levels of government will be altered.

(ii) the AASB intends reviewing the requirements relating to obligations arising from local government and government existing public policies, budget policies, election promises or statements of intent in due course. Please indicate the priority you believe such a review should be given.

We believe a medium priority should be given to the review associated with the abovementioned obligations, although grantor obligations, in conjunction with contributions, should be given a higher priority.

(e) AASB 1004 Contributions:

(i) the proposal to retain paragraphs 10.5, 10.5.1, 10.5.6, 10.5.7, 10.5.10 and 10.5.17 of AAS 29 on parliamentary appropriations to government departments and whether the material in this section is still needed given government departments' experience with accrual accounting principles and the nature of current arrangements between governments and government departments for parliamentary appropriations (see paragraphs 27 to 33 of the proposed revised AASB 1004).

Many Australian jurisdictions issue specific reporting directions to entities within their public sector that typically prescribe the reporting requirements that should apply in relation to parliamentary appropriations. We believe the retention of the applicable paragraphs from AAS 29 ~~is~~ are still necessary as they provide useful guidance and detailed information. Their retention would also avoid creating a vacuum as there are no comparable requirements in existing Australian Accounting Standards.

(ii) the proposal to retain paragraphs 8.2, 8.2.1 and 8.2.3-8.2.5 of AAS 29, relating to liabilities assumed by other entities, including the proposal to retain the symmetrical accounting approach adopted in AAS 29 instead of amending the requirements to be consistent with AASB 139 for derecognition of liabilities (see paragraphs 34 to 38 of the proposed revised AASB 1004).

We support the proposal to retain applicable AAS 29 paragraphs within the revised AASB 1004, including the symmetrical accounting approach. This approach is appropriate for derecognition of liabilities due to the relationship of entities assuming the departmental liabilities and the government departments themselves, within the context of the same controlling government.

(iii) the proposal to retain paragraphs 10.12, 10.12.6, 10.12.8 and 10.12.9 of AAS 29, relating to contributions of services and the appropriateness of applying the requirements beyond government departments to both local governments and governments (see paragraphs 39 to 42 of the proposed revised AASB 1004).

ACAG agree with the proposal to retain AAS 29 paragraphs relating to contributions of services and believe the proposal of applying the requirements to local governments and governments as well, would be in the best interests of users of their financial statements. Information on contributed services could be beneficial in determining the amounts and sources of likely future resource requirements.

(iv) the proposal to retain paragraphs 63 and 70 of AAS 27, paragraphs 11.1-11.2.4 of AAS 29 and 14.1.12 and 14.1.13 of AAS 31, relating to contributions by owners, and relocate them into a separate new section of AASB 1004 under ‘Contributions by Owners and Distributions to Owners of Local Governments, Government Departments and Governments’ (see paragraphs 43 to 49 of the proposed revised AASB 1004).

We agree with the proposal to merge the specific paragraphs from existing AASs 27, 29 and 31 and consider such a move as potentially avoiding any duplication of requirements in the proposed, revised AASB 1004.

Guidelines should be extended to include situations where there are transfers involving statutory bodies and public trading enterprises.

(v) in relation to a restructure of administrative arrangements (see paragraphs 50-55 of the proposed revised AASB 1004), the proposals to:

A: define restructures of administrative arrangements and to specify that they are in the nature of transactions with owners to be recognised on a net basis. The AASB notes that the definition affects a broader range of entities than government departments, and includes all government controlled not-for-profit entities. The AASB is particularly interested in comments on whether the proposals are suitable for all government controlled not-for-profit entities. The AASB is also interested in whether it is necessary to explicitly refer to for-profit government departments in the context of restructures of administrative arrangements (and therefore also refer to them in paragraph Aus14.2 of AASB 101).

ACAG agree with the new paragraphs 50-55 of the revised AASB 1004 and the requirements thereof. The proposals would generally be suitable for all government controlled not-for-profit entities.

The possibility that a for-profit government may exist should be allowed for.

B: require a transferee to disclose, where practicable, the expenses and income attributable to transferred activities for the reporting period, showing separately those expenses and income recognised by the transferor during the reporting period.

Where practicable, we support the proposed disclosures in relation to expenses and income attributable to transferred activities.

C: not specify a measurement basis for assets and liabilities transferred as a consequence of a restructure of administrative arrangements. The AASB is particularly interested in whether there are any anticipated adverse implications of the proposed non-specification of a measurement basis.

As Interpretation 1038 *Contributions by Owners Made to Wholly-Owned Public Sector Entities* does not specify the measurement basis to be adopted with respect to contributions by owners or distributions to ~~owners~~, ~~nor~~ neither owners, nor AASB 3

address measurement issues for entities under common control, we believe that the revised AASB 1004 should explicitly state the required measurement basis.

We also support the measurement basis being specified as a choice between fair value or net book value prior to transfer and that the Standard require that the measurement basis chosen be applied consistently for a financial period within each government. If no measurement basis were to be specified in AASB1004, fair value measurement might be inferred, for example to comply with AASB116, Aus15.1.

(vi) the proposal to incorporate the requirements from paragraphs 12.2(b)-(d) of AAS 29 relating to government department disclosure requirements, into AASB 1004 with:

A: the requirement from paragraph 12.2(d) of AAS 29 relating to disclosure of the fair value of goods and services received free of charge (or for nominal consideration) and recognised, being extended to both local governments and governments (see paragraph 58 of the proposed amendments to AASB 1004).

The proposal to fair value goods and services received free of charge, or for nominal consideration is supported, particularly the extension of the requirement to include local governments and governments as well.

B: the requirements from paragraphs 12.2(b) and (c) of AAS 29 limited to government departments (see paragraph 59 of the proposed amendments to AASB 1004).

We agree with the proposal within paragraph 59 to be limited to government departments only by requiring their financial report to disclose separately, appropriations by class and liabilities assumed during the reporting period.

(vii) the proposal to place the requirements to be retained from AASs 27, 29 and 31 at the end of AASB 1004 rather than integrating them with the current AASB 1004 requirements. The AASB notes that the integration approach would be more likely to raise the controversial revenue recognition issues for all not-for-profit entities that the AASB intends to deal with in the longer term. The AASB is particularly interested in whether, with the more general requirements already in AASB 1004, the inclusion of the AASs 27, 29 and 31 requirements would create implementation problems, including problems for entities that are not local governments, government departments or governments. For example, does the inclusion of specific requirements for contributions of services in the new section of AASB 1004, vis-a-vis the absence of such specific requirements in the old section of AASB 1004, create implementation issues for not-for-profit private sector entities?

The AASB should ensure that the requirements emanating from AASs 27, 29 and 31 are explicitly stated to apply only to governments, government departments and local governments, thereby, mitigating the risk of a non-government entity using those specific requirements.

We do not foresee the creation of implementation issues for not-for-profit private sector entities with regards to the inclusion of specific requirements for contributions of services.

However, it is a matter for the Board to consider in a conceptual sense, whether these treatments should apply in the public sector but not in the private sector.

(viii) the Board intends reviewing the requirements relating to contributions in due course. Please indicate the priority you believe such a review should be given.

Due to the major impact on public sector entities, we believe a high priority is warranted for the review of requirements in relation to contributions (including by grantors).

In the meantime it is important to retain material such as AAS31's paragraph 14.1.2 to ensure that preparers and auditors understand the nature of, and the accounting for, contributions. Paragraph 14.1.2 and similar material could be reinstated immediately before the proposed paragraph 21 that deals with liabilities that arise when a specific condition attaching to the transfer of an asset is not met.

3. Requirements/Guidance Adequately Addressed in other Standards

(a) Cash flows from government-controlled financial institutions: the proposal to not retain the requirement from paragraph 15.11 of AAS 31 relating to cash flows from government controlled financial institutions. The AASB is particularly interested in views on whether this proposal would lead to a loss of useful information.

ACAG does not support the proposal to dispense with the requirements of AAS 31 relating to cash flows from government controlled financial institutions. We are of the view that existing requirements do actually provide meaningful information as it enables users of government financial reports to assess separately the volume and nature of cash flows generated from activities, other than those undertaken by financial institutions.

(b) Restricted assets: the proposal to not retain material from paragraphs 90 and 91 of AAS 27 and paragraphs 12.3 and 12.3.1 of AAS 29 relating to disclosures about restricted assets, given that other Standards cover the matters addressed for different types of assets.

We agree with the proposal to not retain material relating to disclosures about restricted assets as other Australian Accounting Standards currently address this matter.

(c) Restructures of local governments: the proposal to effectively replace the current requirements for restructures of local governments with the general principles expressed in AASB 3 or AASB 1004, as applicable, for a transferee and AASB 5 or other relevant Standards for a transferor.

We agree with the above proposal as the general principles in the abovementioned Standards are adequate and appropriate in relation to local government restructures.

4. Requirements/Guidance that would no longer be Addressed in Standards

(a) Net cost of services format of the income statement: the proposal to not retain the explicit guidance on the validity of the net cost of services format of the operating statement currently provided in AAS 29.

We support the proposal to not retain the 'net cost of services' operating statement format provided in AAS 29.

AASB 101 is sufficiently flexible to allow entities to continue to adopt the net cost of services format, if they believe such a format provides better information to users of their financial reports.

(b) Performance indicators:

(i) the proposal to not retain guidance on performance indicators.

We agree with the AASB's decision to not retain guidance on performance indicators as non-mandatory guidance is deemed unnecessary unless specific requirements are explicitly mandated in the Standard to accompany the guidance. Therefore, until such

time that a review is undertaken by the AASB on performance indicators, we support the non retention of the guidance.

(ii) the Board intends reviewing the requirements relating to performance indicators in due course. Please indicate the priority you believe such a review should be given.

ACAG attach a low priority for the review to be undertaken on the requirements associated with performance indicators.

5. General Issues

(a) Encouragements in Standards: the proposal to remove each encouragement currently specified in AAS 29, unless there is justification for making it explicitly mandatory, on the basis that an encouragement in a Standard can be interpreted by constituents as an indicator of ‘best practice’ and that in practice encouragements might be treated by some as if they are requirements.

Given Australian Accounting Standards have the ‘force of law’, we believe that Accounting Standards should not be the mechanism to encourage ‘best practice’ in accounting and financial disclosure. Where there is justification for elevating matters contained within existing AAS 29 that are intended to provide encouragement they should become mandatory requirements, but all other remaining encouragement paragraphs should be removed.

(b) Definition of government departments: the proposal that, where applicable, the scope of the Exposure Draft should include government departments, as currently defined in AAS 29. The AASB is particularly interested in whether that definition is considered appropriate and whether the definition has implications for financial reporting by agencies that are not formally designated as government departments.

We support the scope of the Exposure Draft to include government departments and don’t foresee any implications for financial reporting by agencies that are not formally designated as government departments.

(c) Regulatory or other issues: are there any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals?

All Australian State and Territory governments have specific Acts that prescribe particular financial reporting obligations for the many entities that represent them. Once the Exposure Draft proposals are issued in the form of an Australian Accounting Standard, those Acts, such as the *Financial Management Act 1994* in Victoria may require amendment to ensure consistency.

(d) Best interests of the Australian economy: are the proposals in the best interests of the Australian economy?

We generally agree that the proposals are in the best interests of the Australian economy, particularly in relation to areas where previous guidance was not available, for example, heritage assets, even though such guidance is a short term measure which will be reviewed as part of the AASB’s long-term review.