Australian Government

Department of Finance and Deregulation

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Mr Kevin Stevenson
Chairman
Australian Accounting Standards Board
PO Box 204
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Dear Mr Stevenson

ED 212- ***Not-for-Profit Entities within the General Government Sector***

The Department of Finance and Deregulation (Finance) welcomes the opportunity to provide comments to the Australian Accounting Standards Board on Exposure Draft – ED 212 *Not-for-Profit Entities within the General Government Sector*.

Finance holds the view that these proposals will result in improved financial reporting and that the benefits will outweigh the costs. Much of the work required to implement this standard has already been carried out, as most jurisdictions already choose GAAP options that align with GFS, and value assets at market value for consolidation purposes.

While the exposure draft makes some attempt at harmonisation of GAAP and GFS, Finance believes that requiring on-the-face presentation will provide a better result and one that is more consistent with the objective of achieving a single set of reports.

Finance is in favour of making this standard mandatory for the Commonwealth and all state and territory jurisdictions.

Responses to the Specific Matters for Comment from the exposure draft are attached, as well as additional comments.

If you have any queries regarding this submission please contact Peter Gibson on 02 6215 3551.

Yours sincerely

Peter Gibson
Assistant Secretary
Accounting Policy
31 October 2011

Department of Finance and Deregulation Response to ED 212 Not-for-Profit Entities within the General Government Sector

General Comments

The Department of Finance and Deregulation (Finance) believes that these proposals on the whole will lead to an improvement in financial reporting. The proposals would lead to a better result if GAAP/GFS harmonised presentation is required in the primary financial statements. This is explored further in Additional Comments, below.

Responses to the Requests for Comments are below.

(a) whether the proposals would lead to an overall improvement in general purpose financial reporting by not-for-profit entities within the GGS.

These proposals overall will lead to an improvement in general purpose financial reporting, subject to specific comments below. They will provide additional disclosures, enhancing transparency and accountability, and it will ensure comparability between entities within the same jurisdiction and will provide a clearer link between an entity and its whole of government. The clearer link is something specifically asked for by parliamentary users, and the previous Minister for Finance and Deregulation, wrote to the Board several years ago in this regard. In this respect we note that the proposals include more than simply GAAP/GFS harmonisation.

The GFS classification of items into 'transactions' and 'other economic flows' in GAAP/GFS presentation, more clearly presents the operations of the entity split between those items that management has direct control over, the transactions, and those items that it has less control over, other economic flows. This provides a more comprehensive picture of the organisation and provides more useful information to users on the performance of management.

While GFS had the original intent of being applied to the macroeconomic sector, applying GFS principles at entity level will lead to significant benefits. These include:

- Additional information will be provided to users by adopting a GFS presentation format, enhancing transparency and accountability;
- Harmonisation will more readily show the contribution of each GGS entity to the whole of government; and
- No significant information or disclosure will be lost

Finance notes that the AASB has previously mandated the use of particular accounting treatments, for example in AASB 1049. Requiring a GAAP option that aligns with GFS to be chosen is appropriate as it will ensure consistent accounting treatments are adopted by entities within the same jurisdiction.

Irrespective of your response to this general question, the AASB would value specific comments on:

(a)(i) the proposal to limit the entities affected by the proposals in this Exposure Draft to not-for-profit entities within the GGS. In particular, the Board seeks comment on whether the proposals should also apply to for-profit entities within the GGS (see paragraphs 2 and BC10-BC13);

These proposals are appropriate to apply to for-profit entities within the GGS. Applying these proposals to for-profit GGS entities will not lead to significant differences as the proposals are consistent with the current requirements of AASB 101 *Presentation of Financial Statements* (AASB 101) and AASB 107 *Cash Flow Statements* (AASB 107).

However, Finance does not hold a strong view about this and could accept application to only not-for-profit entities.

(a)(ii) the proposal that the version of the ABS GFS Manual to be applied is a version that was effective at the beginning of the previous annual reporting period or any version effective at a later date, rather than necessarily the latest version (see paragraphs 9 and BC14-BC15);

This is appropriate, in line with the recent amendments to AASB 1049.

(a)(iii) the proposal to limit GAAP recognition and measurement options to those that align with GFS and thereby require the same accounting policies as those adopted under AASB 1049 for whole of governments and the GGSs (see paragraphs 10-12 and BC16-BC25);

This proposal will ensure consistency between the jurisdictions, between GGS entities and their whole of government, and will fortify the benefits and relevance of harmonisation at both an entity and whole of government level.

The proposal to limit GAAP recognition and measurement options would have minimal implementation impact as most HoTARAC jurisdictions already require individual agencies to adopt options that align with GFS.

Additionally, most entities within the GGS will already have completed the significant task of determining market value for their assets in order for consolidated statements to be prepared under AASB 1049, so this will not be an issue for most entities.

Finance notes that the AASB has previously mandated the use of particular accounting treatments, for example in AASB 1049. Requiring a GAAP option that aligns with GFS to be chosen is appropriate as it will ensure consistent accounting treatments are adopted across entities within the same jurisdiction.

However, Finance has concerns about application of fair value to specialised military equipment. Such equipment doesn't always have a market value (exit price) and even depreciated replacement cost can be problematic as it is not always possible to determine a replacement cost for the same service potential. Accordingly, Finance favours the retention of the cost option for very highly specialised assets.

(a)(iv) the proposal to require disclosure, under both Tier 1 and Tier 2 requirements, either in the financial statements or in the notes, of information based on GAAP/GFS harmonised classification and presentation principles for controlled items and, separately, administered items (including classification of income and expenses as transactions and other economic flows, and classification and presentation of cash flows from investing activities for policy purposes and liquidity management purposes) (see paragraphs 13-18, 22 and BC26-BC35).

The proposal provides useful information to users of financial statements on the contribution that the GGS entity has made to the whole of government and provides consistency when comparing GGS entities, subject to the specific comments outlined below.

In relation to this proposal, the Board is particularly interested in comments on:

(a)(iv)A. whether the on-the-face or in-the-notes presentation option should be allowed and, if not, whether on-the-face presentation of GAAP/GFS harmonised information should be prohibited given the potential for complexity; and

Presentation of GAAP/GFS harmonised information on the face will result in more meaningful and less confusing information being conveyed to users and would be consistent with the objective of obtaining a single set of government reports as stated on page six of the exposure draft. Relegating the harmonised information to the notes does not provide uniformity of presentation and a clear read between an entity and its whole of government.

GAAP/GFS presentation in its own right is not inherently complex and has already been largely adopted by one jurisdiction. Any potential for complexity arises as a result of the proposal to require multiple columns to be presented side by side in the one statement. The simultaneous presentation of administered items, controlled items, and their comparatives results in a minimum of four columns in each financial statement (assuming that the budgets are shown elsewhere in the notes). If a third statement of financial position is required under AASB 101 *Presentation of Financial Statements* then this increases to five columns in the statement of financial position. This is what will give rise to complexity, and this particular presentation is not supported by Finance

The disclosure of GAAP/GFS harmonised information should not be inhibited because it is tied to the side by side disclosure of administered and controlled items. It is not necessary for controlled and administered items to be included sided by side in the same statement. If there are concerns about complexity, we propose that this requirement be removed.

Due to the potential complexity, Finance supports continued separate disclosure of controlled and administered items, at least until AASB 1050 *Administered Items* is reviewed.

(a)(iv)B. the proposal to require disclosure of GAAP/GFS harmonised classification information at line item level, where it is presented in the notes; and whether information at the line item level would be more beneficial than at the GFS category level;

Finance agrees with the proposal to require disclosure of GAAP/GFS harmonised classification information at line item level, where it is presented in the notes. This will result in information that is more meaningful and useful to users.

(a)(v) the proposal to require AASB 1050 to continue to apply to government departments, to the extent its requirements are not satisfied by the proposals in this Exposure Draft (see paragraphs 19 and BC29-BC31);

Agree.

(a)(vi) the proposal to require disclosure, under both Tier 1 and Tier 2 requirements, of any original budgeted financial statements reflecting controlled or administered items presented to parliament, recast to align with the presentation and classification adopted in the primary financial statements and accompanying information about administered items or the GAAP/GFS harmonisation note (whichever is judged to be the more useful) and an explanation of variances (see paragraphs 23-29 and BC40-BC42);

Finance has concerns about the inclusion of budgeted figures as they are unaudited and would potentially 'clutter' the financial statements. This could diminish users ability to understand the information being communicated. It is premature to require disclosure of budgeted information in this format, pending the AASB's separate project on budget reporting.

If budgeted financial information is required, disclosure should be consistent with the requirements in AASB 1049 – *Whole of Government and General Government Sector Financial Reporting*.

Finance does not support the inclusion of a mandatory requirement for explanation of variances between actual and budget outcomes, as this is considered to be management information that does not generally form part of the general purpose financial reports. However, Finance concedes that such information could be useful in some circumstances.

(a)(vii) the proposals relating to other disclosures, from both a Tier 1 and Tier 2 perspective (see paragraphs 30-32), in particular relating to:

A requiring information to be disclosed in the accounting policy note (paragraph BC36), including disclosures about the version of the ABS GFS Manual adopted and, where relevant, a later version (paragraph BC15); and

Agree.

(a)(vii)B not requiring disclosure of disaggregated information, except to the extent it continues to be required by AASB 1052 for government departments (paragraphs BC37-BC39);

Agree.

(a)(viii) the proposal to provide no specific transitional requirements, except to require an entity to change the elections it previously made under AASB 1 to the extent necessary to comply with the ABS GFS Manual (see paragraphs 33-35 and BC44-BC47);

Agree.

(a)(ix) unless already provided in response to other specific matters for comment relating to disclosures, the proposal to exempt entities adopting Tier 2 requirements from certain disclosures (shown as shaded text in this Exposure Draft);

Agree. These exemptions are consistent with the principles of the reduced disclosure requirements.

(a)(x) the illustrative examples, and whether they provide guidance that is appropriate/helpful in implementing the proposals (see Illustrative Examples A and B and paragraphs BC49-BC50); and

The illustrative examples are appropriate and helpful as guidance in implementing the proposals.

The net cost of services format in Illustrative Example B might be improved by showing the operating result line <u>before</u> splitting it between continuing and discontinued operations to maintain the flow in arriving at the operating result.

(a)(xi) the proposed operative date (see paragraphs 3-4 and BC48);

Agree.

(b) unless already provided in response to specific matter for comment (a) above, whether overall, from both a Tier 1 and Tier 2 perspective, the proposals would result in financial statements that would be useful to users;

These proposals will result in financial statements that will be useful to users. They will provide consistency when comparing results with other GGS entities and will clearly show the entity's contribution to the whole of government.

(c)	**whether the proposals, from both a Tier 1 and Tier 2 perspective, are in the best interests of the Australian economy; and**

No comment.

(d)	**unless already provided in response to the specific matters for comment above, the costs and benefits of the proposals relating to both Tier 1 and Tier 2 requirements relative to the current requirements, whether quantitative (financial or non-financial) or qualitative.**

Finance feels that, while experiences may vary between jurisdiction, on the whole the costs are relatively minor when compared to other standards that have been implemented (particularly the adoption of AEIFRS), and are justified by the benefits, which include providing useful information to users of financial statements on the contribution that the GGS entity has made to the whole of government and provides consistency when comparing GGS entities.

For preparers at entity level, the major change is a presentational one, not a significant change to recognition and measurement. For most Commonwealth users this will be as simple as switching from one financial statement template to another. For at least one jurisdiction, the new format is already substantially mandated for use by entities.

We note in particular that entities within the GGS will already have completed the significant task of determining market value for their assets in order for consolidated statements to be prepared under AASB 1049, so this will not be an issue in relation to GAAP/GFS harmonisation at entity level.

Finance has already undertaken some detailed planning for implementing entity level harmonisation, and has found that there is relatively little to be completed because of the few practical recognition and measurement differences – certainly by comparison with say the introduction of accrual accounting or the implementation of IFRS, or some recent accounting standard changes such as the fair value standard.

We have confidence that agencies will be able to adapt in the same way as central agencies have done in preparing budgets and note they will have the added benefit of assistance from those central agencies.

Additional comments:

While the proposed approach would result in an overall improvement in general purpose financial reporting, giving entities the option of presenting on a GAAP basis in the primary statements and on a GAAP/GFS harmonised basis in the notes potentially creates two sets of financial statements in the one document, reporting on the same operations in different ways. This could lead to confusion for users of the financial statements.

A better result would be achieved if GAAP/GFS harmonised presentation is required in the primary financial statements. This would result in more meaningful and less confusing information being conveyed to users and would be consistent with the objective of obtaining a single set of government reports as stated on page six of the exposure draft.

Finance is aware that international standard setters may at some point in the future implement changes to accounting standards that take a different approach to the proposals in this exposure draft. We consider these proposals important, relevant and useful, and hence hold the view that they should be adopted, notwithstanding the possibility of changes to international accounting standards at some time in the future.

Recognition and measurement

Finance suggests the Board redraft paragraph 10 of the ED. This states that 'only those options aligned with the ABS GFS Manual shall be applied', where Australian Accounting Standards allow for optional recognition and measurement. This raises a problem, as situations where no GAAP option aligns with GFS, are not considered in the ED. For example, in paragraph 25 of AASB 102 Inventories, where a choice is allowed between the first-in, first-out and weighted average cost formula. Finance suggests aligning this provision with that of paragraph 13 in AASB 1049.

Comments on the alternative view of an AASB member

AV 2: Meeting needs of users of general purpose financial statements While Mr Robert Williams agrees with the rationale for not proceeding with ED 174, in that there was insufficient evidence that the proposals in ED 174 were substantive enough to satisfy the needs of a broad range of users of general purpose financial statements of entities within the GGS, he believes the Board's rationale in paragraph BC3 for not proceeding with ED 174 is equally applicable to the proposals in ED 212. Furthermore, he considers the proposals in ED 212 are even less substantive than the proposals in ED 174. Accordingly, he argues the stated aim in ED 212 of improving financial reporting for not-for-profit entities within the GGS will not be achieved, nor will the proposals in ED 212 meet the needs of a broad range of users of general purpose financial statements of not-for-profit entities within the GGS.

Finance did not agree with the rationale for not proceeding with ED 174, in that ED 174's proposals would satisfy the needs of a broad range of users of general purpose financial statements within the GGS. Similarly, Finance believes that the proposals in ED 212 will satisfy the needs of users and will result in improvements to financial reporting by not-for-profit entities within the GGS. Producing financial statements on the same basis within the GGS and the whole of government will provide additional information to users, give a clear indication of the entity's contribution to the whole of government and will provide for comparability as well as consistency and clarity for users.

AV 3: Costs/benefits justifications Mr Williams does not think that ED 212 adequately articulates why the benefits exceed the costs. He is concerned that the costs of implementing the proposals in ED 212 would be equally costly to that of ED 174, whether the presentation and classification of items are disclosed on the face of the financial statements or in the notes, as the same costs, such as training costs and the potential costs of changing accounting systems, would still be required. In addition, he believes the costs of implementing the proposals in ED 212 would be substantial, as most people at the entity level have little or no knowledge of GFS. Mr Williams also thinks that, based on paragraph BC3, there are little perceived benefits in implementing the proposals in ED 212, and therefore the costs of the proposals would exceed any perceived benefits at the entity level.

See Finance's response to part d. Finance has done some preliminary costings of implementation, using an approach that supports agencies through use of check lists etc, relying on the fact that there are few <u>practical</u> differences between GAAP and GFS that will apply at entity level. These costings suggest that the implementation will not be costly relative to other changes to accounting standards.

Finance concedes that other jurisdictions may have other factors which drive implementation costs. However Finance would expect those jurisdictions to provide support for their views.

AV 4: No need for a new standard

Mr Williams thinks that no new Standard is necessary, because any entity can apply the proposals in ED 212 under existing Standards if, or to the extent, that is considered relevant, for the following reasons:

(a) AASB 101 Presentation of Financial Statements permits an entity to use relevant additional sub-headings and line items;

(b) if GFS/GAAP information were relevant, then entities within the GGS would be currently required to make such a presentation under paragraphs 55 and 85 of AASB 101, which state that "an entity shall present additional line items, headings and sub-headings ... when such presentation is relevant to an understanding of an entity's financial position and ... financial performance.";

(c) a parent entity (i.e. central government agency) can require that its subsidiaries adopt uniform accounting policies, including GAAP options that align with GFS, and most jurisdictions already mandate this. So the proposals will not improve financial reporting; and

(d) disclosure of administered items has already been required for government departments under AASB 1050 Administered Items.

Finance agrees with Mr Williams' assertions for (a), (c) (other than the last sentence) and (d). In relation to (b), different entities sometimes have different ideas on what is relevant and how items are best presented or disclosed. While there should be flexibility in certain circumstances, in order to ensure the consistency and usefulness of financial statements it is necessary for certain requirements to be mandated.

Finance believes that there are a range of views about whether the proposals can be implemented within the existing standards. Finance continues to have concerns about whether the existing standards allow the appropriate disclosures of discontinued operations. Finance also understands at least one State Auditor-General is of the view that the GAAP/GFS proposals cannot be implemented under existing standards.

AV 4 (2) Possibility of GAAP/GFS harmonisation at microeconomic level

Mr Williams thinks that it is not possible to achieve GAAP/GFS harmonisation at the entity level, since GFS focuses on providing information for the assessment of the macroeconomic impact of a government and each of the government's sectors, whereas ED 212 focuses on entities at the microeconomic level (i.e. entity level within the GGS). He believes the fact that it is necessary to 'deem' individual entities within the GGS as 'institutional units' for the proposals to work, further demonstrates the impossibility of GAAP/GFS harmonisation at the microeconomic (entity) level, because they do not satisfy the GFS definition of 'institutional units'.

Finance fails to see how deeming reporting entities to be institutional units demonstrates the impossibility of GAAP/GFS harmonisation at entity level. The individual reporting entity is perfectly able to apply GFS/GAAP harmonised reporting.

While GFS had the original intent of being applied to the macroeconomic sector, Finance is of the opinion that applying GFS principles at entity level will lead to significant benefits. These include:

- Additional information will be provided to users by adopting a GFS presentation format, enhancing transparency and accountability;
- Harmonisation will more readily show the contribution of each GGS entity to the whole of government; and
- No significant information or disclosure will be lost.

AV 5: Improvement of the quality of financial reporting
Mr Williams does not agree that the proposals in ED 212 will result in an overall improvement to the quality of financial reporting for not-for-profit entities within the GGS, as he thinks the information proposed is not likely to be relevant to a broad range of users. Mr Williams thinks, given that AASB 127 *Consolidated and Separate Financial Statement* requires consolidated financial statements to be prepared using uniform accounting standards, but does not require the subsidiaries to use those policies in their separate financial statements, comparability between subsidiaries is not necessary to improve financial reporting. Therefore, Mr Williams thinks that improving the quality of financial reporting (largely by improving comparability between the not-for-profit entities within the GGS) would not be a sufficient reason to justify the issuance of a new Standard. Otherwise this reason will be equally relevant to issuance of a new Standard for both for-profit and not-for-profit entities in both the public and private sectors.

The difference between the public and private sector is that public sector consolidation is required to be done on a GAAP/GFS harmonised basis. This is clearly not the case in the private sector.

Finance believes that the proposals in ED 212 will result in an overall in the quality of financial reporting and will be relevant to a broad range of users.

The main improvements in the quality of financial reporting arise other than through comparability between agencies. These are:

- A clearer 'read through' from agency to consolidated position;
- A clearer distinction will within controlled items between those primarily within management control (transactions) and those that are not (other economic flows); and
- Subject to Finance's reservations about budgets, the clearer reporting of budgets and budget variances.