



Government of Western Australia
Department of Education

Your ref :
Our ref :
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Mr Kevin Stevenson
Chairman
Australian Accounting Standards Board
PO Box 204
COLLINS ST WEST VIC 8007

Dear Mr Stevenson

I welcome the opportunity to provide comments to the Australian Accounting Standards Board (AASB) on ED 212 *Not-for-Profit Entities within the General Government Sector*. I apologise for the lateness of this submission, but having examined closely the submissions, stages and AASB deliberations from the April 2012 meeting, I recognise the need for a submission and hope you will consider it.

I have extensive experience in the GAAP/GFS harmonisation project dating back to 2004. Whilst working at WA Treasury, I was involved in Phase 1 of the project and I commend the AASB on its work for whole-of-government (WoG) and the General Government Sector (GGS) reporting. I have also been involved in Phase 2 of the project since its beginnings in 2008 in the following capacities:

1. WA Treasury in the GAAP/GFS Harmonisation working group for the formation of Phase 2, HoTARAC, and analysis and commenting on ED 174;
2. WA Office of Auditor General - contributing to ACAG comments on ED 212; and
3. Department of Education - large entity in the GGS - directly affected by proposals.

As such, I have experience in the policy development, audit issues and perspectives, and at a directly affected agency. I can offer multiple perspectives and hence the value in this late submission.

Overall, the Department of Education does not support the proposals in ED 212 and Phase 2 of the project. We appreciate the work of the AASB in developing these proposals to allow deeper consideration of the issues. Again, we commend the AASB on its work with Phase 1 of the project for the WoG and GGS. The current status quo provides a good accounting standards framework in which users needs are met at the sectoral level and individual entities level. The work should stop there and Phase 2 be abandoned, though the AASB could still pursue some projects if benefits exceed costs. The costs to jurisdictions in applying the proposals in ED 212 are likely to be significant and exceed any perceived benefits.

Given this, the Department does not support the proposals in ED 212 and supports the well-articulated Alternative View (para AV1 – AV5). Responses attached.

If you have any queries regarding the submission, please contact John Stanley on 08 9264 4162.

Yours sincerely

JOHN STANLEY
MANAGER FINANCIAL POLICY

Att.

General Comments

This doesn't seem much of a dilemma for the AASB; overall there seem to be only 3-4 'real' (public sector) submissions that are supporting the proposals: Department of Finance and Deregulations - Australian Government, SA Department of Treasury and Finance, HoTARAC (though mixed, and within that NSW, Queensland and WA strongly opposed) and the ABS. The other submissions appear to be opposed or opposed/mixed. The ACAG submission is quite compelling as it represents all jurisdictions and they have independently and objectively assessed the proposals. Importantly, the entities affected that responded have been strongly opposed which should be compelling too.

Responses below include some points of disagreement with some of the comments made by supporters of the proposals. Overall observation, sometimes staff in central agencies i.e. Treasury/Finance, think they are making a correct policy choice – such as attempting to meet users needs for GGS entity level financial reporting, but haven't consulted with those entities and haven't really thought through the impact at that level. This is often because those individuals working in central agencies have considered ED 212 from a theoretical or limited perspective. It is likely that their only experience in GFS implementation is at the sectoral level. As a consequence, they lack insight into the practicalities and idiosyncrasies of implementing GFS in financial reporting at the GGS entity and being involved in this level of financial reporting. This is where notions such as the following can be pursued but in fact would only provide illusory benefits:

- a 'bridge' between the financial statements of the GGS entity and the WoG/GGS;
- provide consistency when comparing results with other GGS entities;
- clearly show the entity's contribution to the WoG or 'clear line of sight';
- enhance transparency and accountability; and
- provide for comparability as well as consistency and clarity for users.

Without substantive evidence, some of these are no more than slogans.

As a compromise, if the jurisdictions other than NSW, Queensland and WA still want ED 212, they should be encouraged to consider these comments and other submissions, consider the costs highlighted below and properly consider the impact. Then if the Commonwealth and other jurisdictions still prefer to proceed with the proposals, a new standard is not necessary, because any jurisdiction can apply GAAP/GFS at the entity level under the existing accounting standards to the extent it is relevant (refer AV 4). **As a minimum, the proposals in ED 212 must not be forced upon the jurisdictions that are clearly opposed to it because those jurisdictions have determined that the costs would exceed the benefits.**

The Commonwealth for example may have different users needs to those in WA for example and can be responsible for their accounting policy choices which may be inappropriate for other jurisdictions. In all my experience, I cannot think of a single user, preparer, auditor, finance staff or anyone in WA who would benefit from or welcome these proposals. In South Australia for example, the ACAG submission at (a)(i) highlights some good examples of entities for which there will be reduced comparability and be clearly detrimental to financial reporting. In contrast, the SA Department of Treasury and Finance submission is supporting the proposals, so has the necessary consultation and due process been conducted by that jurisdiction?

Another key consideration for the AASB is that if ED 212 proposals are implemented it takes Standards out of AASB's hands for current and future developments of the GFS Manual as amended by the IMF/ABS. This would create greater divergence with the other sectors in Government (PNFC and PFC) as well as private sector entities. Transaction neutrality for all reporting entities in Australia is clearly preferable. As we understand it,

there is an IMF GFS Review in April/May 2012¹ proposing for GFS rules that comes up with:

- Statement of Government Operations;
- Other Economic Flows;
- Statement of Sources and Uses of Cash; and
- Balance Sheet.

The first two reports will be foreign to users, compounding divergence with other government entities and of no benefit. More generally, in contrast to the self-contained Australian Accounting Standards, the GFS Manual is hard to read and interpret. Moreover, the remedial cost of resourcing the current dearth of interpretative material or personnel appears to be considerable whilst the current budget austerity measures do not bode well for preparers/auditors seeking clarifications.

A cursory glance of this review document¹ highlights a few issues that may be difficult for GAAP practitioners to understand such as:

- Stock Positions are discussed in paragraph 3.32, where the SNA talks about asset ownership for recognition (and 3.36 discusses economic owners/legal owners) whereas IFRS is based on control.
 - If there is a difference, how do we account for the difference?
 - How does this impact PPP's?
- Does paragraph 3.38 suggest proportionate recognition of asset based on quality of risk transferred to economic owner?
- Is there an anomaly caused by the artificial distinction for consolidation when stipulating GGS as a reporting entity? Consider:
 - The GGS reports an investment in a fully owned company (most likely in PNC/PFC sector) under equity accounting rules (think NBN Co) in accordance with GFS requirements.
 - Under AAS, the agency holding that investment on behalf part of government would fully consolidate the fully-owned company.
 - This understates the liability aggregate for GGS in budgets and statements utilising the GFS Framework compared with the concepts contained in AASB 127. This does not appear to be necessarily consistent with objectives in paragraph 3.65 of that same GFS framework document (managing liquidity) and diverges from requirements in AASB 7.39.

These may or may not be valid issues, but the key point is that the requirement to comply with accounting standards and the GFS Manual will result in increased misunderstandings in preparing and auditing as well as increased complexity in financial statements. The time to prepare and audit general purpose financial reports (GPFR) will increase which will go against all jurisdiction's aim of timelier reporting as well as the loftier aim of a 'Reduced Disclosure Regime'.

GFS focuses on providing information for the assessment of the macroeconomic impact of a government and each of the government's sectors, the Department considers that this is already addressed through AASB 1049 *Whole of Government and General Government Sector Financial Reporting*. The Department agrees with AV 4 that is not possible to achieve GAAP/GFS harmonisation at the microeconomic entity level. Furthermore, in WA the effort of one agency and one audit team is required to produce and audit the WA *Annual Report on State Finances* (ARSF). Currently knowledge of the GFS Manual is restricted to a few WA Treasury staff, a few auditors responsible for the AASB 1049 audit, and John Stanley. As an estimate, this is less than 10 people in WA and infers a

¹ Chapter 3 Economic Flows, Stock Positions and Accounting Rules of the GFS System of the International Monetary Fund (IMF) *Government Finance Statistics Manual 2012* (GFSM 2012) has been released to the IMF website for comment.

significant learning curve for mature reporting at agency level under the GFS framework. Therefore, the costs to implement, train, educate all the preparers, auditors and users are prohibitive and without benefit.

Responses to the Requests for Specific Matters for Comments are below.

- (a) The Department does not believe that the proposals will lead to an overall improvement in general purpose financial reporting by the not-for-profit (NFP) entities within the GGS. There is insufficient evidence that the proposals would increase the usefulness of financial statements to end users that would justify the costs of restatement of financial information or inclusion of additional disclosure notes.

Rather, the proposals will reduce the quality of the financial statements of GGS entities, as the information is not likely to be relevant to the needs of a broad range of users of GPFR. The inclusion of this information is therefore likely to reduce the usefulness, transparency and accessibility of GGS entity financial statements. Further, this would be a costly exercise to 'educate' external users such as Parliament and the also the public/taxpayers for no benefits. Furthermore, it would be a costly exercise to educate/train the 'internal' users/preparers/auditors. There would be training required for budget analysts, accountants and auditors (including private sector auditors) for no benefits. This would be costly and compounded by ongoing education costs to maintain currency with the nuances of GFS compared to GAAP reporting.

There would also be no increase in comparability in GPFR as the proposals will increase inconsistencies between GGS entities compared with the PNFC/PFC sector entities, between not-for-profit entities and for-profit entities, both in the public and private sectors. This is detrimental and is far greater than the illusory benefits such as a 'clear line of sight' or 'bridge'.

IFRS as adopted by the AASB providing transaction neutrality/sector neutral reporting is well accepted by users and should be continued for GGS entities.

- (i) The Department believes the project should not proceed. However if the AASB proceeds, in principle it should apply to all entities in the GGS. Currently there are no NFP entities within the GGS in WA.
- (ii) The Department believes the project should not proceed. However if the AASB proceeds, the stipulation of the version of the ABS GFS Manual applied is supported.
- (iii) The Department does not support the proposal to limit GAAP recognition and measurement options to those that align with GFS. Firstly, it is not the role of an accounting standard setter to restrict GAAP options to maintain consistency between subsidiaries and consolidated financial statements. Consistent with AASB 127, it is the role of the parent entity rather than an accounting standard setter to ensure consistent accounting policies are adopted on consolidation.

More importantly, there would be unacceptably large costs. It is incorrect in practice to make the generalist comment that

"most jurisdictions already limit GAAP options for entities within the GGS to align with GFS to facilitate consolidation at whole of government level, therefore the proposal would not impose an unreasonable burden. The cost of fair valuing assets is already incurred to satisfy the requirement of AASB 1049 and incremental cost is insignificant."

This is incorrect for WA and would impose an enormous and unnecessary burden that may be applicable for other jurisdictions also that perhaps hasn't been duly considered by all jurisdictions' Treasury/Finance agencies. Moreover, it does not take into account the large asset bases held by governments are not exposed to highly active markets.

In WA, only land and buildings are mandated by Treasurer's Instructions to be at fair value within the broader category of property, plant and equipment (PPE). These are material assets for the GGS whereas items like plant, equipment, infrastructure (other than road networks) and other assets are only approximately 7% of PPE at GGS level (source: *2010-11 Annual Report on State Finances (ARSF)* for GGS). So the GGS can easily comply with fair value as there is higher materiality levels and hence a lower level of precision. It is a vastly different situation at entity level.

The cost and efforts involved in determining fair values for all items of PPE and intangible assets at the individual entity level (to the extent permitted under AASB 138 *Intangible Assets*) far outweigh the benefits of this information for the primary users of the financial reports for all GGS entities, even more acutely so for smaller agencies. Here are just some examples in WA, highlighting the burdensome impact if this proposal proceeded:

1. The Department of Transport has material Infrastructure at cost. This includes breakwaters that may last 100 years, navigation aids (e.g. pylons in Swan River), wharves, channel development (dredging), jetties (timber and concrete) and associated infrastructure (e.g. drainage, car parks, electrical). All these infrastructure assets are held for the public benefit or common good and there is obviously no active, secondary or any market applicable. Everything has separate useful lives and the current treatment at cost under AASB 116 is clearly the only appropriate accounting treatment. Fair value would be almost impossible to develop, nonsense to attempt to come up with, could only be desktop, of no conceivable benefit and cost prohibitive.

This example alone highlights that market value as required by GFS is irrelevant in some circumstances and hence this proposal in ED 212 is ill-considered and impossible.

2. The Department of Health has \$668M of 'Other Plant & Equipment' at cost. These include many items of predominantly medical equipment but also furniture and fittings and plant and equipment that would be prohibitively expensive to value and of no benefit to users.

In liaison with Health Corporate Network Financial Services, Department of Health, their opinion is that it is not feasible to introduce this requirement. They note the adverse implications and impracticalities of the proposed requirement to value Plant & Equipment at fair value:

- Resources – there are currently 13,910 items of medical equipment on the WA Health fixed asset register. To obtain individual fair values for this large amount of equipment will be time consuming and costly. The cost and resources involved will outweigh the potential benefit of ascertaining fair value.
- Asset life – in general, most items of Health plant and equipment will have an average useful life of about 10 years or less. In this short span of time, the fair value is not likely to fluctuate substantially.
- Obsolescence – with the current rate of change and improvement in the technology environment, the equipment might become obsolete and spare parts no longer in production well before the end of its original expected useful life. In this case, it would be difficult to estimate or obtain a fair value.

- Market – it is likely that there is no resale market for many of the items of medical equipment in question since the use of this equipment is quite specialised and in general limited to the medical field.
3. The Department of Education has many assets at cost: motor vehicles, buses, computers, communications equipment, office equipment, library collection and miscellaneous assets. There is no market for most assets and to impose fair value would be cost prohibitive and clearly of no benefit. Hence, these are appropriately reported at cost and with appropriate depreciation policies for these different classes of assets, this is the best accounting policy. Fortunately, some of these classes of PPE could 'escape' the proposed requirement by being immaterial to total PPE. Others would need to 'escape' the proposed requirement if it became a Standard through the arguable case that the cost basis with appropriate depreciation policies is the best available proxy for fair value.
 4. What about agencies that hold fleets of motor vehicles? In contrast to the Health plant and equipment these can be more volatile. This could be a product of economic reality and volatility might increase for other assets owing to resource/labour shortages followed by lulls
 5. What about computer software (Intangible Assets – no active market)?

Even perhaps the biggest supporter, the Commonwealth submission, is asking for 'exemption' for specialised military equipment/very highly specialised assets – asking for the retention of the cost option. Why introduce a requirement if the only pragmatic solution is to 'escape' the requirement (or better still seek exemption like the Commonwealth)? This wastes time of accountants and auditors at each and every agency for this type of negotiation to 'escape' fair value. Costs to obtain and keep complying with fair value would be exorbitant and fair value is nonsense for some assets held for purely 'public benefit'. This is all a futile waste of public sector resources, the only benefit being to any private sector valuers if doing valuations on behalf of agencies/state Valuer General.

This is a time of fiscal restraint in Australia and this proposal would be costly and to the detriment of front line public services and must be rejected. The only solution is to not introduce the requirement. These examples provide the AASB opportunity to finally consider just some of the adverse implications. If different jurisdictions have different circumstances such that fair value for PPE for items held for the public benefit, with no active market, and make the accounting policy decision to mandate fair value, then that is their prerogative. This all ties into the first point made, that jurisdictions (parent entity) are best placed to make accounting policy decisions for its GGS entities (subsidiaries) and not the accounting standard setter.

- (iv) For the sake of brevity, the Department concurs with the concerns raised by ACAG in full. Most importantly, the Department does not believe GAAP/GFS harmonised information is relevant at the entity level and on this basis we do not support any requirements to disclose such information on the face or in the notes to the financial statements.

If the AASB proceeds with the proposals, the information should be disclosed only in the notes and at line item level, so that GFS-type note disclosures reconcile to the GAAP primary financial statements.

- (v) Agreed, until such time as AASB 1050 is more fundamentally reviewed.

- (vi) The Department does not support introducing requirements regarding budgeted financial statements at the entity level until the AASB conducts its separate project on budget reporting. The Department also supports the concerns raised by ACAG.
- (vii)A. If the AASB proceeds with the proposals, the Department supports requiring entities to disclose information about elections made to comply with the version of the GFS Manual adopted.
 - B. The Department supports the proposal, pending a more fundamental review of AASB 1052.
- (viii) This appears appropriate.
- (ix) No comment, Tier 1 reporting requirements are required in WA and there remains doubt as to the extent to which relief from Tier 1 reporting requirements is suitable for government agencies.
- (x) For the sake of brevity, the Department concurs with the concerns raised by ACAG. The proposals should be rejected and the current 'Net Cost of Services' should continue to be included in the Statement of Comprehensive Income as this continues to meet users needs.
- (xi) If the Exposure Draft becomes a Standard, the Department considers an extended transitional period of 5 years or more would be more appropriate.
- (b) No, as discussed in the 'general comments' and (a), the Department does not believe that GAAP/GFS is relevant at entity level, given that GFS is designed for macroeconomic analysis and fully support AV 4 and all Alternative Views. We also do not believe that increasing comparability, by itself, results in an improvement in quality of financial statements. The Department also supports the comments made by ACAG about differing needs of users of financial reports of WoG/GGS and users of individual agencies financial reports.
- (c) No. Sector neutrality is arguably in the economy's best interests, and the proposals represent a significant departure. Training and system upgrade costs would be prohibitive for no demonstrable benefits.

Extension of application of GFS Fair Value benefits valuation professionals. In contrast, it generates significant expense and workload for public service entities at a time of fiscal restraint in Australia. Consequently, the diversion of scarce resources is detrimental to front line public services, provides no observable benefit to Australian taxpayers and must be rejected.

- (d) Refer to numerous comments in General Comments and (a)(iii). Also and for the sake of brevity, the Department concurs with the concerns and comments raised by ACAG.