

Submission on ED212: Not-for-Profit Entities within the General Government Sector

Submitted by: Associate Professor Sue Newberry, University of Sydney,
susan.newberry@sydney.edu.au

Although I do appreciate that the AASB is attempting to comply with the FRC's directive, I do not think the proposals in ED212 will lead to the anticipated improvement in financial reporting, or that financial reports prepared in accordance with the standard will provide users with the reports with the characteristics identified in para 1(a), (b), and (c). Because users have long been identified as the focus of financial reporting, my submission will deal with these characteristics and my concerns about the effect of the proposed standard before considering other questions for which specific responses are sought.

Overall, the intent seems to be to bring together GAAP and GFS by limiting options within GAAP to those allowed within GFS and, where GFS differs from GAAP as, for example, with inventory, to, in effect, require GFS. The proposed standard will not encompass the GFS requirements and therefore those complying with it will need to refer to both GAAP and GFS.

Para 1 proposes that "financial reports prepared in accordance with this Standard provide users with": (a) "information about the stewardship by the entity and accountability for the resources entrusted to it"; and (c) "information about the financial position, performance and cash flows of the entity."

How are the users supposed to understand the reports that result from application of this standard? To have any chance of understanding a financial report, the users need to be able to understand how the financial reports are put together and understand the accounting policies. The proposed standard will not require different presentation from GAAP. Users of these financial reports would not necessarily even realise that both GAAP and GFS are required and being applied. Even if users did realise that both GAAP and GFS are required, to have any hope of understanding the financial reports they would need to have a reasonable understanding of both and of the inconsistencies between them. I question the reasonableness of such an imposition on users. In other words, the financial reports are unlikely to provide users with useful information to assess stewardship, performance financial position or cash flows.

Para 1 proposes that "financial reports prepared in accordance with this Standard provide users with": (b) "a bridge between the financial statements of the entity and the financial statements of the GGS/whole of government, and information about the contribution of the entity to the GGS/whole of government."

There is no explanation of how such reports will achieve these aims. I am not convinced any these aims stated in (b) are achievable. For example, to appreciate the contribution of a single sub-entity to the financial results and position of a group of entities, it is necessary to know what has gone on between the sub-entity and other sub-entities, and between the sub-entity and the parent entity. The sub-entity's financial reports are before eliminations for consolidation; and consolidated financial reports do not provide information about what has been eliminated. Users of financial

reports have no way of identifying the part played by any particular sub-entity in achieving the group. The objectives identified in (b) are not credible.

Specific matters for comment

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

The proposed standard adds a level of complication to financial reporting that will greatly add to users' difficulties comprehending financial statements. This would not be an improvement.

- a)(i). The proposal to limit the entities affected by the proposals to not-for-profit entities:

If the whole of government financial statements must apply GAAP/GFS and this effort to drive the requirements down to sub-entity level is to apply to only some sub-entities, how will that help to improve reporting? Some sub-entities will apply GAAP/GFS and others won't. What are users supposed to make of this? If the GAAP/GFS requirement is to be driven down to lower levels, then it should be driven down consistently. (As already stated above, I disagree with the proposal to drive the GAAP/GFS requirement down)

- a) (iii) the proposal to limit GAAP recognition and measurement options to those that align with GFS...The explanation in para 12 and subsequently makes it apparent that this will be enormously complicated. It will be costly for those preparing the financial statements and I question the expectation that the benefit will be greater than the cost. In addition, it will demand of users a level of knowledge of both GAAP and GFS that is unreasonable.

- a) (iv) the proposal to require disclosure ... either in the financial statements or in the notes... and in particular "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"...

The suggestion that on-the-face presentation should be prohibited for the reason given highlights my point about the expectations being imposed on the users. What worries me is that were such presentation to be prohibited it would not remove the complexity. Rather, it would remove the most obvious way of drawing the user's attention to the fact that the financial statements are not what they seem. The user would not be alerted and could therefore be misled even more easily into thinking the financial reports look like those of a business and should be interpreted in the same way. If the financial reports are intended to assist users, that aim would not be achieved by pretending the GAAP/GFS statements are not complex.

- a) (vi) the proposal to require disclosure of original budgeted financial statements... The further explanation of this proposed requirement clarifies the point that only the original budget would be shown, and not subsequent adjusted budgets. I have two concerns about this, the first being that such a requirement could open scope for

gaming in the budgeting process because only the original and not later budget adjustment figures would be shown. My second concern relates to the GAAP/GFS stated intent for this proposed standard. If the budget is not part of the GFS, why is it being proposed?