



Department of Treasury and Finance

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

ITC 25 Request for Comments on Request for Views *Agenda Consultation 2011*

The Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC) welcomes the opportunity to respond to the Australian Accounting Standards Board on ITC 25 Request for Comments on Request for Views *Agenda Consultation 2011*.

In its submission to the IASB, HoTARAC has stated its view that future development of standards should encompass the perspectives of the not-for-profit (NFP) sector to achieve a single set of global financial reporting standards for the for-profit and the NFP sectors (including the public sector). HoTARAC believes that this is achievable through the continuation of the IASB's practice of issuing principle-based accounting standards, the completion of its conceptual framework and the use of generic/sector neutral terminology.

In addition, HoTARAC believes that completion of the conceptual framework project (including Phase G which relates to the NFP sector), is of utmost importance because the conceptual framework assists the IASB in setting standards that are principle-based, internally consistent and internationally convergent (as noted in the *Agenda Consultation 2011*). Attempting to determine conceptual issues at the standards' level prior to the completion of the conceptual framework project may result in inconsistencies between standards, lack of understandability and, consequently, extensive disclosures.

HoTARAC recommends that the following projects be given priority:

- Liabilities, Post-employment Benefits and Discount Rates
- Emissions Trading Schemes;
- Government Grants;

- Presentation and Disclosure standard;
- Other Comprehensive Income; and
- Financial Instruments.

If you have any queries regarding HoTARAC's comments, please contact Steve Mitsas from the Department of Treasury and Finance, Victoria on +613 9651 2645.

Yours sincerely



Grant Hehir

CHAIR

**HEADS OF TREASURIES ACCOUNTING AND REPORTING ADVISORY
COMMITTEE**

7 November 2011

HoTARAC Response to Request for Views *Agenda Consultation 2011*

Question 1

What do you think should be the IASB's strategic priorities, and how should it balance them over the next three years?

1. HoTARAC believes that one of the main IASB strategic priorities should be a single set of global financial reporting standards for the for-profit and the Not-For-Profit (NFP) sectors (including the public sector). To this end, the IASB should liaise closely with the International Public Sector Accounting Standards Board (IPSASB).
2. Deferral of NFP considerations, and in particular the practice of developing standards that are solely applicable to the for-profit sector, is leading to national standard setters that cater for both sectors, such as Australia, developing NFP/public sector paragraphs to IFRSs for local application. This creates a risk that implementation and adoption practices will diverge. Alternatively, standard setters may decide to move away from applying the IASB's accounting framework and adopt other more suitable frameworks for the NFP sector (for example, New Zealand has recently announced using IPSAS as a basis for its public sector financial reporting).
3. This has led to a number of undesirable outcomes. Fragmentation of NFP and for-profit accounting is leading to increasing divergence in accounting practices for the sectors, with a resultant lack of comparability, comprehensiveness and understandability. Delegating responsibility for the NFP sector to the national standard setters also results in the duplication of accounting standard setting effort and reduces resourcing that may be otherwise available to the IASB.
4. The recent global financial crisis and lack of transparency in national government accounts, reinforces the need for a robust framework of public sector accounting. A single global set of standards for both NFP and for-profit sectors, widely adopted and accepted, would enhance public sector accountability:
 - (a) by setting a global benchmark for both sectors; and

- (b) by facilitating a common pool of accounting professionals for financial statement preparation and audit.

Question 1(a)

Do you agree with the two categories we identified and the five strategic areas within them? If you disagree, how do you think the IASB should develop its agenda, and why?

5. HoTARAC agrees that the work of the IASB broadly falls into two main categories:
- (a) developing financial reporting; and
 - (b) maintaining existing IFRSs.

However, HoTARAC has recommendations regarding the strategic areas within the categories as noted below.

Question 1(b)

How would you balance the two categories and five strategic areas? If you have identified other areas for the IASB's agenda, please include these in your answer.

Developing financial reporting category

A single set of global financial reporting standards for For-Profit and Not-For-Profit sectors

6. Although it is noted in paragraph 9 of the *Preface to IFRSs* that IFRSs are designed to apply to the general purpose financial statements and other financial reporting of profit-oriented entities, HoTARAC strongly encourages the IASB to consider issues pertinent to NFP activities in the private sector, public sector or government. One example of where this has occurred recently is the revision of IAS 24 *Related Party Disclosures* whereby a partial exemption is provided from the disclosure requirements for government-related entities – entities that are related by virtue of being controlled by the same government can provide reduced related party disclosures. As a result, IAS 24 is now more appropriate for the NFP public sector.
7. While HoTARAC acknowledges that the IPSASB prepares accounting standards for the public sector [excluding Government Business Enterprises (GBEs)], HoTARAC is of the view that it is an opportune time now to promote or at least consider not-for-profit (including public sector) perspectives in IFRSs for the following reasons.

- (a) While some specific NFP issues and characteristics may need additional consideration, development of transaction neutral standards, arguably, should not be unduly onerous.
- (b) A relatively modest investment in the consideration of NFP sector issues in the development of accounting standards and projects at this stage, may prevent a major exercise in future convergence of standards between the two sectors.
- (c) Due to the recent global financial crisis, a number of large entities now have government ownership. HoTARAC is of the view that the IASB should devote more time and effort in considering how to account for transactions that might result from increased government involvement in the private sector. Therefore, with regards to the 'developing financial reporting' category, HoTARAC is of the view that consideration of the not-for-profit sector (including public sector perspectives) should be a strategic area for the IASB. The inclusion of this strategic area would be consistent with the key aspect of considering reporting issues that cater to a more diverse IFRS community.
- (d) Currently, there is a divergence in accounting concepts/treatments between the Standards issued by the IASB and the IPSASB for certain transactions. For example, IPSAS 20 *Related Party Disclosures* does not explicitly consider key management personnel (KMP) of a parent entity to be a related party of a subsidiary entity. IAS 24, on the other hand, considers KMP of a parent entity to be a related party for the subsidiary entity. Although the IPSASB specifically develops accounting standards for the public sector (excluding GBEs), considering not-for-profit perspectives for IFRSs may provide a viable option for jurisdictions to achieve consistency and comparability across all types of entities via a single framework of Standards. HoTARAC believes this suggestion directly relates to objective (c) of the IFRS Foundation (as set out in Appendix A to the Agenda Consultation document).
- (e) A number of projects listed in Appendix C of the *Agenda Consultation 2011*, e.g. emissions trading schemes and grants issued by governments, consist of the government as one party to an economic event. The IASB should not neglect the

accounting for the government side of these transactions in order to achieve a more robust conceptual outcome, increase comparability and understanding and the possibility of greater support among constituents.

8. While this may not necessarily mean that the IASB should develop Standards specifically for the NFP sector and/or public sector, future development of Standards should be sector and transaction neutral. The continuation of IASB's practice of issuing principle-based accounting standards would make this objective more achievable. HoTARAC notes, from the April 2011 *Report of the IFRS Foundation Trustees' Strategy Review*, that the Trustees have considered the development of standards for non-private sector entities at a later stage.

Conceptual Framework

9. While the strategic areas are not prioritised, HoTARAC believes that the completion of the conceptual framework project (including Phase G which relates to the NFP sector) is of utmost importance for the following reasons.
 - (a) As noted in the *Agenda Consultation 2011*, the conceptual framework assists the IASB in setting standards that are principle-based, internally consistent and internationally convergent. Ideally, new standards should be formulated and existing standards should be revised, based on the principles in the conceptual framework. Therefore, the conceptual framework project should be completed first before other projects to enable consistency across standards. HoTARAC believes attempting to determine conceptual issues at the standards' level may result in inconsistencies between standards, lack of understandability and, consequently, extensive disclosures. This is the current situation where individual projects at the standards level are finalised in tandem or ahead of the conceptual framework projects, which has led to inconsistencies in proposed accounting treatments across projects. For example, the IASB has made a tentative decision for the leases project, that the asset and liability recognised under a lease contract for a lessee should exclude variable lease payments, except for those that are considered disguised minimum lease payments. This contrasts with the approach taken in recent redeliberations on the *Revenue from Contracts with Customers* project, where the IASB decided to include uncertain consideration when determining the transaction price.

(b) Although HoTARAC is of the view that accounting standards should take into account the NFP perspective as mentioned above, in the shorter term, the conceptual framework can provide guidance for transactions or issues relating to the NFP sector which are not specifically contemplated in the IFRS.

10. Based on the above reasoning, the conceptual framework should be transaction and sector neutral (i.e. as generic as possible). Sector neutrality in the wording of the proposed conceptual framework would assist in this. For example, focusing on the use of the word 'resources' instead of 'cash flows' so that it can be applied in both for-profit and NFP contexts and can be applied across the private and public sectors.

Maintaining existing IFRSs category

11. HoTARAC believes that the IASB needs to carefully balance the number of projects regarding the maintenance of existing IFRS with more fundamental projects regarding the development of IFRS. In this regard, HoTARAC believes the emphasis should be on developing, rather than maintaining IFRS. In particular, HoTARAC believes that the Board needs to avoid having too many narrow scope issues, which although may produce timely responses, may, delay, exacerbate or fail to address more fundamental issues. For example, the removal of the concept of the expected return on plan assets in IAS 19 *Employee Benefits* exacerbated existing and more fundamental problems associated with the discount rate, that time would arguably be better spent addressing the more fundamental discount rate issue.

12. Although HoTARAC agrees with using post-implementation reviews as a form of maintenance of existing IFRSs and is useful for identifying minor issues, HoTARAC believes that standards should be immediately reviewed and amended as necessary when major conceptual or practicality issues were identified. Adopting a strict review only after two years of implementation of a standard may not be optimal, as entities would by the end of two years have an established internal system to cope with the relevant standard. Further, HoTARAC is of the view that the existence of a post-implementation review process should not justify short-cuts being taken in the due process of developing (and researching/understanding the implications of) new or amended pronouncements. Consistent with HoTARAC's views in paragraph 11 above, HoTARAC believes it is

critical that deliberations prior to finalisation of a new or amended pronouncement properly consider all issues identified at that time.

Question 2:

What do you see as the most pressing financial reporting needs for standard-setting action from the IASB?

Question 2(a)

Considering the various constraints, to which projects should the IASB give priority, and why? Where possible, please explain whether you think that a comprehensive project is needed or whether a narrow, targeted improvement would suffice?

13. In many ways, determining which projects to:

- (a) undertake;
- (b) remove; and
- (c) prioritise;

should be driven by strategic priorities as discussed above. Although the IASB agenda criteria may assist, HoTARAC is of the view that the IASB needs to better convey its rationale when setting its priorities. For example, there were questions raised on the appropriateness of undertaking the project on the fundamental review of leases during the global financial crisis when the most urgent projects were deemed to be those on financial instruments. In this example, other projects may have ranked as a higher priority based on the criteria of 'relevance to users of the information involved and the reliability of information that could be provided' and 'resource constraints'.

14. Notwithstanding the above paragraph, HoTARAC recommends the following projects be given priority.

Liabilities, Post employment Benefits and Discount Rates

15. HoTARAC believes that the related projects on Liabilities, Post employment benefits and Discount rates should be given priority, as they raise a number of significant issues, which have been highlighted by the global financial crisis. Concerns have emerged about

the current method of valuing long term liabilities and the requirement to use particular discount rates in determining these values.

16. As noted on page 21 of *Agenda Consultation 2011*, IFRSs use a variety of discount rates. HoTARAC sees potential in developing a standard providing guidance on the use of appropriate discount rates (similar to guidance on fair value in IFRS 13 *Fair Value Measurements*). There is currently no guidance on the use of discount rates, and different standards have different discount rate requirements without the appropriate justification to explain the difference. For example, IAS 19 and IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* both aim to give a present value figure of the liability by using a discount rate. However, the discount rates required by each standard are different, and the justification for this difference is not apparent. Therefore, HoTARAC considers the development of consistent guidance to be a priority for the IASB.
17. The IASB should also consider whether volatility engendered by the use of a single bond rate to discount long term liabilities, including defined benefit plan obligations, diminishes the ability of users of financial statements to make informed judgements of financial performance. For example, current IAS 19 uses high quality corporate bond rates, or in the absence of deep bond markets, a government bond rate. In the wake of the global financial crisis, these are not necessarily interchangeable; as investors have sought safe havens, and as a consequence, some government bond rates have fallen with a corresponding rise in the corporate borrowing rates. The value of a liability is inversely related to the discount rate, so changes in the discount rate, which may be unrelated to the future cash flows in respect of the liability, drive changes in expense and profit.

Emissions trading schemes (ETS)

18. HoTARAC believes the ETS project should be one of the top priorities of the IASB. Governments are currently developing and implementing carbon pricing schemes. In the absence of guidance, divergent accounting practices are developing in accounting for common sets of facts, compromising comparability between financial statements. The Kyoto protocol underpinning most of these schemes, is an international agreement with facilities for international trading of carbon permits. A continuing lack of guidance in this area results in divergent accounting practices, which is a particularly undesirable outcome.

19. While standard setters and their constituents have been unable to reach consensus on these issues in the past, national governments, responsible for implementing these schemes, are each developing mechanisms to record and account for carbon pricing. Consideration of transactions from the government side, where they are initiated, may pave the way for agreed guidance on accounting for these transactions by all affected entities.

Government Grants

20. As noted on page 23 of *Agenda Consultation 2011*, there are inconsistencies between the conceptual framework and IAS 20, as well as comparability issues resulting from the choices available in IAS 20. HoTARAC offers the following additional reasons for urgently updating IAS 20:

- (a) To ensure it is conceptually consistent with the performance obligation focus of the IASB's Exposure Draft *Revenue from Contracts with Customers*.
- (b) Currently, IAS 20 only considers government grants from the perspective of the grantee. Given the symmetrical characteristics of a grant transaction, HoTARAC strongly recommends the IASB also consider the grantor side of the transaction. The current situation in IAS 20 is tantamount to a hypothetical IAS 17 *Leases* which only addresses lessee accounting and not both lessee and lessor accounting.

Presentation and Disclosure Standard

21. HoTARAC shares the concerns expressed globally about the voluminous disclosures that have resulted from disclosure requirements being considered on a topic-by-topic basis. As mentioned in relation to the suggested "Presentation and Disclosure standard" project (in Appendix C to the Agenda Consultation document), consideration of all disclosures in a holistic way via a single IFRS may facilitate rationalisation of the existing requirements spread across a large number of standards. Therefore, to ensure general purpose financial statements continue to be genuinely useful to the broad range of users, HoTARAC urges the IASB to give this project a high priority.

22. Further, HoTARAC is aware of the review (requested by the IASB in October 2010) conducted by the Institute of Chartered Accountants of Scotland and the New Zealand Institute of Chartered Accountants regarding the levels of disclosure in existing IFRS - *Losing the excess baggage – reducing disclosures in financial statements to what's important*. Given the detailed nature of the recommendations arising from that review, HoTARAC also urges the IASB to act on those recommendations in the context of a “Presentation and Disclosures” project.

Other Comprehensive Income (OCI)

23. In HoTARAC’s view the OCI project should be a priority for the IASB. HoTARAC considers that this issue is more conceptual in nature, and recommends that it is determined at the conceptual framework level, with any additional specific requirements in the relevant standards. The current development of OCI at a standard level has been on an ad hoc basis, and a set of overarching principles may address concerns about which items should be included in OCI.

Financial Instruments

24. HoTARAC strongly recommends the IASB commit to completing the financial instruments project. This is very important to provide certainty to preparers of financial statements in preparation for implementation of the new requirements.

Question 2(b)

Adding new projects to the IASB’s agenda will require the balancing of agenda priorities with the resources available. Which of the projects previously added to the IASB’s agenda but deferred (see table page 14) would you remove from the agenda in order to make room for new projects, and why? Which of the projects previously added to the IASB’s agenda but deferred do you think should be reactivated, and why? Please link your answer to your answer to question 2(a)

25. In answering question 2(a) above, HoTARAC has indicated those projects they believe should be given priority by the IASB. Consequently, these can be accommodated by assigning relative priorities to existing projects, with no requirement to remove projects from the IASB’s agenda.

26. HoTARAC has identified ‘complexity in financial reporting’ as an item IASB may wish to consider adding to its list of projects. Some national standard-setters are already performing research on this matter, as it is perceived important for meeting financial reporting user needs.