

GAAP/GFS Harmonisation: Entities within the GGS
Alternative approaches for issuing a Standard

Background and introduction

- 1 The FRC's direction to the AASB states:
"The Board should pursue as an urgent priority the harmonisation of Government Finance Statistics (GFS) and Generally Accepted Accounting Principles (GAAP) reporting. The objective should be to achieve an Australian accounting standard for a single set of Government reports which are auditable, comparable between jurisdictions, and in which the outcome statements are directly comparable with the relevant budget statements" (FRC Bulletin 2002/5 18 December 2002, as modified by FRC Bulletin 2003/1 11 April 2003).
- 2 In response to the direction, the AASB made a tentative decision at its October 2009 meeting that staff should develop non-mandatory guidance on GAAP/GFS harmonisation for entities within the GGS. At its December 2009 meeting, the AASB was informed of the FRC's view that the issue of non-mandatory guidance would not satisfy the FRC's direction. Accordingly, this paper considers issues pertinent to the next step for the Board's work on GAAP/GFS harmonisation for entities within the GGS. In particular, consistent with draft minute item 20, third (b), of the AASB's December 2009 meeting, this paper considers alternative approaches that could be employed in issuing a Standard.
- 3 At its December 2009 meeting, the AASB also noted that the work it has done on GAAP/GFS harmonisation for entities within the GGS has highlighted some possible shortcomings in the current standard setting arrangements. Accordingly, the AASB has directed staff to draft a separate paper, for consideration at a future meeting, on how governance and operational relationships might be improved from the perspective of the AASB's role. This paper is written within the context of the existing standard setting arrangements.
- 4 In developing ED 174 *Amendments to Australian Accounting Standards to facilitate GAAP/GFS Harmonisation for Entities within the GGS [AASBs 101, 107 and 1052]* (issued January 2009) the Board considered whether to adopt an approach similar to AASB 1049 *Whole of Government and General Government Sector Financial Reporting*, which addressed recognition, measurement, classification, presentation and disclosure matters pertinent to GAAP/GFS harmonisation. The approach in AASB 1049 effectively defined GAAP/GFS harmonisation for the whole of government (WoG) as 'adoption of an option in GAAP that aligns with GFS' in relation to recognition, measurement, classification and presentation. On reviewing constituent comments on ED 174, a significant majority of Board members expressed the view that user needs would not be satisfied if GFS classification and presentation principles were imposed on the format of the financial statements of entities within the GGS. However, the Board was more amenable to GFS recognition and measurement principles that are consistent with GAAP being imposed on entities within the GGS. These Board views on recognition and measurement versus classification and presentation form the basis for much of the discussion in this paper.

Alternative approaches for issuing a Standard on GAAP/GFS harmonisation for entities within the GGS

- 5 In writing this paper, staff have reflected back on the extensive discussions that have taken place on this topic within the context of the FRC direction and feel that there are broadly two alternative approaches that could be taken in issuing a Standard:
- (a) Approach A: develop an opt-in Standard that adopts ED 174 (amended to reflect the Board's decisions on technical issues in response to comments on the ED) that specifies GAAP/GFS harmonisation recognition, measurement, classification, presentation and disclosure requirements for entities that elect or are required to present GAAP/GFS harmonised general purpose financial statements. Irrespective of whether an entity adopts the Standard, it would be required to disclose whether or not it has adopted the Standard.
 - (b) Approach B: develop a compulsory Standard that specifies GAAP/GFS harmonisation recognition, measurement and disclosure requirements and provides a choice between incorporating GFS classification/presentation into the format of the financial statements or disclosing such information in the notes.

Approach A was mooted at the AASB's December 2009 meeting, whereas Approach B has emerged out of the staff's subsequent reflections. Given the AASB's familiarity with Approach A, the remainder of this paper mainly focuses on Approach B, although many of the issues are pertinent to both approaches.

- 6 A number of factors are relevant in developing a Standard on GAAP/GFS harmonisation for entities within the GGS. Although the issues are not mutually exclusive, they include:
- (a) the extent to which the proposals in ED 174 should be adopted;
 - (b) the extent to which the Standard should be mandatory;
 - (c) the nature of the pronouncement; and
 - (d) the nature of the accompanying Basis for Conclusions.
- This list of issues provides the broad structure for the remainder of this paper.

The extent to which the proposals in ED 174 should be adopted

- 7 The Standard could adopt ED 174 unamended (ie limited to classification, presentation and disclosures) or, consistent with Approach A, amended (to reflect all of the Board's subsequent deliberations in light of constituent comments, including the decision to limit a GAAP recognition and measurement option to align with GFS). There is a spectrum of possible alternatives whereby the Board could adopt some of its subsequent tentative decisions arising from ED 174 (for example, it could adopt those relating to classification, presentation and disclosure and other drafting issues but not adopt those relating to recognition and measurement). Furthermore, the Board could decide to go beyond its decisions on ED 174 and impose disclosure requirements, in addition to and/or instead of classification and presentation requirements. Depending on the Board's decisions, the question arises as to whether it would be necessary to re-expose the draft Standard.
- 8 It is not the intention of this paper to redeliberate all of the issues that were tentatively resolved by the Board at its June 2009 meeting. However, in light of recent discussions and some new perspectives on the issues that were not considered

explicitly at the time, this paper asks the Board to confirm or otherwise some of the Board's earlier decisions.

Recognition and Measurement

- 9 ED 174 specific matter for comment (c) asked whether entities within the GGS should be subject to the principle in AASB 1049 that, where there is a choice in GAAP that aligns with GFS, that choice is mandated. The minutes of the 24-25 June 2009 AASB meeting record:

“The Board decided that if the objective of GAAP/GFS harmonisation were to enhance comparability across and within jurisdictions, and to simplify consolidation processes and audit, a recognition/measurement choice in GAAP that aligns with GFS should be mandated. The Board noted that a presentation-only approach would achieve limited harmonisation. The Board considered options of where to locate such a requirement (whether within AASB 1049 or an entity within the GGS specific Standard), but did not make a decision on that issue. However, the Board concluded that it would not be appropriate to include Aus paragraphs in each Standard that contains an option” (see attachment B, item 3).

Limiting entities within the GGS to a GAAP choice that aligns with GFS (eg the option in AASB 116 *Property, Plant and Equipment* of cost or fair value would be limited to fair value) would be consistent with the Board's decision in relation to WoG and GGS, as reflected in AASB 1049.

- 10 Some argue that such an approach would not be consistent with the Board's policy on transaction neutrality, which implies that if GAAP provides a choice to for-profit private sector entities the same choice should be available to public sector entities. They argue that, although the choice limitation is appropriate at a WoG/GGS level, where a primary driver is user needs for GAAP/GFS harmonisation information, GAAP/GFS harmonisation is not as pertinent for users at the level of an entity within the GGS (eg some argue that GAAP/GFS harmonisation is most relevant at a macro level). Although it could be argued that the limitation on GAAP recognition and measurement options would provide more useful information for users than current GAAP, some argue that is a matter for the Board's *Process for Modifying IFRSs for NFP/PBE* rather than the Board's GAAP/GFS harmonisation project.
- 11 In contrast, others argue that having different accounting policies for consolidated (WoG and GGS) financial statements and for the separate financial statements of controlled entities (entities within the GGS), especially in relation to property, plant and equipment carrying amounts, is likely to be impractical when the former are constrained by GFS requirements. If adequate records are to be kept by the controlled entities to facilitate revaluations at the WoG level, one of the major practical reservations about requiring revaluations in AASB 116, that is, the burden of recording values and keeping them up to date, is effectively removed. In other words, the cost of the benefits of reporting current values will be incurred irrespective of those benefits. For an entity within the GGS in that position the benefits of being required to report fair values will therefore exceed their costs. Empirical studies have shown current values to be information positive. The hesitation in requiring them has come from the cost side of the equation. Usually when a group chooses to revalue assets it would require its controlled entities to adopt a consistent policy. The unusual aspect of the public sector is the requirement through AASB 1049 for consolidated financial statements of a government to align with GFS and so employ revaluations.

- 12 If the Board's previous decisions (as reflected in paragraph 9 above) are to stand, and in view of the argument in paragraph 11, the Board may wish to reconsider its overall assessment of the benefit of issuing a Standard, whether under Approach A or Approach B. Whilst common financial statement formats per se have been argued to be an insufficient reason for a Standard, it could not be said that requiring major entities within the GGS to, for example, revalue property, plant and equipment, would be of minimal consequence. It should also be noted that GFS is expected to be changed to require capitalisation of defence assets as a result of 2008 international System of National Accounts (SNA) amendments. Once this happens, the argument in paragraph 11 will become even more relevant, as there will be few capitalisation differences between GFS and GAAP. However, this means that the corollary of requiring alignment of recognition and measurement requirements for entities within the GGS is that the case for re-exposure might be much greater, particularly if Approach B is adopted (see paragraphs 30 and 31 below).

Materiality

- 13 A factor to consider in deciding how a Standard on GAAP/GFS harmonisation for entities within the GGS should address recognition and measurement issues is the implications of materiality. Although the fair values of property, plant and equipment of many entities within the GGS are likely to be material at a WoG/GGS level, such as those of the Department of Defence, WoG/GGS GAAP/GFS harmonised financial statements could be prepared without the need for many other entities within the GGS to determine fair values of assets, because they are immaterial at the macro level. The fair values are likely to be material for those entities within the GGS, and some constituents are concerned that the costs of determining those values might outweigh the benefits.

Future changes to GFS

- 14 A further factor to consider is the implications of possible future changes to GFS. For example, staff understand that, as alluded to in paragraph 12 above, it is possible, given recent changes to the SNA, that weapons systems will be required to be recognised at fair value. Currently under AASB 1049 they are not required to be measured at fair value. If the recent changes to SNA were to be adopted into GFS, the Department of Defence (an entity within the GGS) would need some time to adopt it in its general purpose financial statements. This issue might not only be relevant in the Board's deliberations on a Standard for entities within the GGS, it might also warrant a review of AASB 1049.
- 15 ***Tentative staff view on recognition and measurement issues:*** on balance, staff think that the Board's June 2009 decision to limit a recognition and measurement choice in GAAP to one that aligns with GFS should be adopted. Staff note that this view would have significant consequences for the quality of financial reporting by entities within the GGS, which may influence the Board's deliberations on whether there is a case for issuing a Standard, and whether that Standard should reflect Approach A or Approach B.

Concerns about *materiality* (see paragraph 13 above) could be addressed by issuing an opt-in Standard under Approach A or by delaying the operative date of the Standard

(and allowing early adoption) under Approach B. If practical issues arise as a result of *future changes to GFS* (see paragraph 14 above), they should be addressed at that time (but prior to the implementation of GFS amendments) rather than pre-empting any future changes now, perhaps through delaying the operative date of the Standard (particularly under Approach B) for specific types of assets (eg weapons systems).

Transitional requirements

- 16 A consequence of including recognition and measurement requirements in a Standard on GAAP/GFS harmonisation for entities within the GGS would be the need to consider transitional requirements. The question is whether to provide some relief from the general principle in AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*, which requires retrospective adoption except to the extent that it is impracticable. The main recognition and measurement impact relevant to this project would be on property, plant and equipment because, as noted in paragraph 9 above, currently AASB 116 allows a choice between cost and fair value whereas GFS would adopt fair value. It is relevant to note that paragraph 17 of AASB 108 states:
- The initial application of a policy to revalue assets in accordance with AASB 116 *Property, Plant and Equipment* or AASB 138 *Intangible Assets* is a change in an accounting policy to be dealt with as a revaluation in accordance with AASB 116 or AASB 138, rather than in accordance with this Standard.
- We interpret the paragraphs relating to ‘comparative information’ (paragraphs 38 to 44) of AASB 101 *Presentation of Financial Statements*, in conjunction with AASB 108, as not requiring comparative information to reflect fair values of property, plant and equipment as at an earlier period. Therefore, the *tentative staff view on transitional requirements relating to recognition and measurement* is that a requirement to limit a GAAP recognition and measurement choice to align with GFS does not warrant specific transitional relief, except:
- (a) to perhaps allow, say, a three-year period over which weapons systems might be recognised (if the amendments to SNA are incorporated into GFS by the ABS) – particularly if Approach B is adopted; and
 - (b) in relation to AASB 1 *First-time Adoption of Australian Accounting Standards*, as noted in paragraph 17 below – irrespective of whether Approach A or Approach B is adopted.
- 17 Because entities within the GGS would have previously adopted AASB 1, *the tentative staff view on transitional requirements relating to AASB 1* is that the same kind of transitional requirements contained in AASB 1049 for WoG should be adopted for entities within the GGS. Paragraphs 66, 69 and 70 of those transitional requirements state:
- 66 **When adopting this Standard for the first time, a whole of government shall change the elections it previously made under AASB 1 ... only to the extent it is necessary to comply with the ABS GFS Manual. The changes to those elections shall be made as if they had been made at the whole of government’s original AASB 1 transition date.**
- 69 The optional relief provided in AASB 1 is not fully available to ... whole of governments due to the effect of paragraph 13 of this Standard. For example, AASB 1 provides an optional exemption relating to fair value or revaluation as deemed cost of property, plant and equipment, intangible assets and investment property. To the extent the ABS GFS Manual requires fair value, this option in AASB 1 is not available.

- 70 The transitional approach in this Standard results in comparative period information being presented in the ... first whole of government financial statements prepared in accordance with this Standard.

Classification and presentation

- 18 Comments on ED 174 were mixed as to the merits of imposing GFS classification and presentation on the format of financial statements. The arguments for such a requirement included the benefits of a ‘clean line of sight’ between the format of the financial statements of the WoG/GGS and the entities within the GGS, and the provision of useful information for users interested in the broad distinction between what an entity controls/can be held responsible for (ie transactions) and what is not controlled and therefore should not be held accountable (ie other economic flows). The arguments against such a requirement included concern that it would be onerous at the level of an entity within the GGS, given the lack of familiarity of those entities with the ABS GFS Manual and that the resulting information is of questionable value to users.
- 19 As noted in paragraph 12, some are of the view the format (classification and presentation) of financial statements of entities within the GGS is an insufficient justification for a Standard (particularly an Approach B Standard), especially because the format that would be prescribed is consistent with existing GAAP. Some go further and argue that, rather than contemplate specifying the format of financial statements (primarily the split between transactions and other economic flows in the statement of comprehensive income), it would be sufficient to require such information to be disclosed in a note to the financial statements to satisfy GAAP/GFS harmonisation principles, thereby balancing the needs of users for ‘traditional’ financial statement formats and for GFS information. This approach has the benefit of allowing requirements for the presentation of financial statements to be developed from the IASB’s Financial Statement Presentation project in a transaction-neutral way rather than being developed specifically for some public sector entities without the benefit of the IASB’s deliberations. However, they also argue that, consistent with existing GAAP, the Standard should not prohibit the information from being presented on the face of the financial statements.
- 20 It should be acknowledged that adopting an approach that provides an option between disclosure and format might not satisfy those who argue that consistency in format is important due to the benefits of a ‘clean line of sight’ between the financial statements of an entity within the GGS and the WoG/GGS. Furthermore, some argue that it is not ideal accounting standard-setting practice to incorporate options into Standards, expressing concern that it might result in the undermining of comparability. They would support Approach A (whereby GFS classification and presentation would be required to be incorporated into the format of the financial statements where an entity/jurisdiction elects to adopt GAAP/GFS harmonisation) noting that at least this approach gives a greater level of comparability for entities adopting GAAP/GFS harmonisation principles. However, others argue that there is precedent for including options within Standards, and providing a choice on this matter is preferable to mandating one or the other given the IASB’s work on financial statement presentation. They also comment that providing an option for classification and presentation is not as significant as providing an option for recognition and measurement. It is relevant to note that AASB 101 *Presentation of Financial*

Statements contains a number of options for entities to make disclosures in the financial statements or in the notes.¹ They go on to argue that it would be expected that jurisdictions would specify the option that entities within the GGS of that jurisdiction should adopt.

- 21 ***Tentative staff view on classification and presentation:*** requiring an entity within the GGS to either disclose² GFS classification and presentation information in a note or on the face of the financial statements would allow an entity (or a jurisdiction) to assess the needs of users of financial statements and therefore identify the best way to convey the information, and would be consistent with the spirit of GAAP/GFS harmonisation. The ‘option’ could be expressed along the lines of:
an entity within the GGS shall disclose GFS classification and presentation information in the general purpose financial statements. The disclosure may be incorporated into the format of the financial statements or made separately in a note.

Disclosures

Disaggregated disclosures

- 22 ED 174 specific matter for comment (d) asked whether it is appropriate to expand the application of paragraphs 15-21 of AASB 1052 *Disaggregated Disclosures* beyond government departments. At its June 2009 meeting, the Board decided to not proceed with the proposal to require entities within the GGS to comply with the principles in AASB 1052 on the basis that AASB 1052 “should be addressed separately. The separate project should include consideration of the merits of the GFS functional classification requirements.” (see 24-25 June 2009 AASB minutes item 7, attachment B, item 4). Some argue that this topic is high priority as it has the potential to result in the provision of information to facilitate comparisons across jurisdictions, and it is this comparison that is more useful to users than the comparability of information contemplated in ED 174.
- 23 ***Tentative staff view on disaggregated disclosures:*** consistent with the Board’s June 2009 decision, issues relating to disaggregated disclosures should be addressed in a separate project. The priority of such a project should be considered in the context of agenda item 5 ‘Work Program’ of the forthcoming Board meeting.

1 For example, paragraphs 99 and 100 of AASB 101 state:
99 An entity shall present an analysis of expenses recognised in profit or loss using a classification based on either their nature or their function within the entity, whichever provides information that is reliable and more relevant.
100 Entities are encouraged to present the analysis in paragraph 99 in the statement of comprehensive income or in the separate income statement (if presented).

2 A cross-cutting issue here is how entities within the GGS should be treated under the emerging differential reporting regime. A matter for the pending Reduced Disclosure Regime (RDR) Exposure Draft (see agenda item 13 of this meeting) is whether the RDR should provide relief from some or all GAAP/GFS harmonisation disclosure requirements, and whether the RDR should be made available to certain entities within the GGS. That matter is outside the scope of this paper.

Budgetary reporting

- 24 ED 174 specific matter for comment (e) asked whether entities within the GGS should be subject to the same kind of budgetary reporting requirements that are specified in paragraphs 59-65 of AASB 1049. In particular, paragraphs 59 and 60 state:

59 Where one or more of the following whole of government or GGS budgeted:

- (a) statements of financial position;
- (b) statements of comprehensive income;
- (c) statements of changes in equity; and
- (d) statements of cash flows;

is or are presented to parliament, the whole of government or GGS, respectively, shall disclose for the reporting period:

- (e) **that original budgeted financial statement or those original budgeted financial statements that were presented to parliament, presented on a basis that is consistent with the basis prescribed for financial statements by this Standard; and**
- (f) **explanations of major variances between the actual amounts presented in that financial statement or those financial statements and corresponding original budget amounts.**

60 Comparative budgetary information in respect of the previous period need not be disclosed.

At its June 2009 meeting, the Board decided to not impose budgetary reporting requirements on entities within the GGS on the basis that “such requirements should be dealt with in a separate project. However, a minority of Board members expressed a strong view that, if GAAP/GFS harmonisation were to be imposed on entities within the GGS, there is no conceptual reason to not subject them to the same budgetary reporting requirements that are imposed on whole of governments by AASB 1049” (see 24-25 June 2009 AASB minutes item 7, attachment B, item 5).

- 25 ***Tentative staff view on budgetary reporting:*** in principle, consistent with aligning the policies of individual entities with consolidated group policies, and to enhance fulfilment of accountability obligations, entities within the GGS should be subject to the same budgetary reporting requirements that apply at the consolidated level.

Intra-WoG transactions and balances

- 26 An additional possible disclosure, not proposed in ED 174 and not arising directly out of deliberations on submissions on ED 174, was identified during the more recent discussions about the benefits put forward for applying GAAP/GFS harmonisation principles to entities within the GGS. In particular, the view expressed is that GAAP/GFS harmonisation at the level of an entity within the GGS facilitates an assessment of an entity’s contribution to the WoG/GGS result. However, countering that argument is concern that intra-group transactions might distort the assessment. To address this concern, consideration could be given to requiring entities within the GGS to disclose information that would enable a user to adjust for intra-group transactions and balances. However, this might be an onerous and impracticable requirement because often a controlled entity would not be able to determine the after-eliminations data easily, if at all, because it is determined at the group level. An alternative disclosure requirement might be for the WoG/GGS (rather than the entity within the GGS) to disclose the contribution of each material controlled entity after eliminations (as a disaggregation).

- 27 ***Tentative staff view on disclosures about intra-WoG transactions and balances:*** irrespective of whether Approach A or Approach B is adopted, the Board should consider requiring the WoG/GGS to disclose the contribution each material controlled entity makes to the group, either as a consequential amendment to AASB 1049 arising from this project or through a proposed amendment to AASB 1049 that arises from the Board's separate project on the post-implementation review of AASB 1049.

For-profit vs not-for-profit entities

- 28 At its June 2009 meeting, the Board decided that for-profit entities within the GGS should not be subject to GAAP/GFS harmonisation requirements on the basis that "GAAP/GFS harmonisation would particularly not meet the needs of users of for-profit general purpose financial statements" (see 24-25 June 2009 AASB minutes item 7, attachment B, item 2). This decision was made in the context of ED 174's proposals, which focused on the format (classification and presentation) of financial statements, rather than recognition and measurement. If the Board decides that GAAP/GFS harmonisation for entities within the GGS should affect recognition and measurement (per the tentative staff view expressed in paragraph 15 above) and that an entity should have a choice as to whether to disclose GFS information or incorporate it into the format of its financial statements (per the tentative staff view expressed in paragraph 21 above), given the benefits to users of such an approach, there may be grounds for the Board to reconsider its June 2009 tentative decision to exclude for-profit entities from GAAP/GFS harmonisation. This would be consistent with a view that the driver for general purpose financial statements of entities within the GGS should be consolidated financial statements prepared consistently with GFS. However, some might argue that, consistent with transaction-neutral principles, for-profit entities within the GGS should not be subject to any GAAP/GFS harmonisation requirements. Some express concerns that it places a for-profit entity within the GGS at a disadvantage to its competitors.

- 29 ***Tentative staff view on for-profit entities:*** our tentative view on this issue depends on the Board's other decisions. In particular, if the Board agrees with Approach B (and therefore the staff view on mandating recognition and measurement and giving an entity the choice of incorporating GFS information into the format of financial statements or disclosures in the notes), we do not think that for-profit entities should be treated differently from not-for-profit entities. Approach A effectively avoids the issue because a for-profit entity within the GGS could elect, unless otherwise directed by the jurisdiction, to not adopt GAAP/GFS harmonisation principles.

Re-exposure

- 30 A question arises that if the Board were to extend the requirements beyond those proposed in ED 174, or otherwise change the proposals, should they be subject to re-exposure. Although recognition and measurement matters were not explicitly proposed, specific matter for comment (c) noted that the AASB would particularly value comments on whether:

"entities within the GGS should be subject to the principle in AASB 1049 that, where there is a choice in GAAP that aligns with GFS, that choice is mandated (see paragraph BC11)"

Of the twelve written submissions on ED 74, seven commented on the issue, four of whom (one of which was the majority of HoTARAC) argued that the approach in AASB 1049 should be adopted for entities within the GGS.

Similarly, ED 174 did not propose to require budgetary information, but instead asked a question about it.

ED 174 did not explicitly seek comment on whether entities should be provided with an option to disclose GFS classification and presentation information in the notes or incorporate the information into the format of the financial statements.

- 31 ***Tentative staff view on re-exposure:*** if Approach B (and therefore our view on each issue above) is adopted, on balance we think that re-exposure would be warranted, particularly given the significant implications of recognition and measurement issues, and the suggestion of changing the format proposals to allow a disclosure alternative, and the limited input from constituents on ED 174. However, if Approach A is adopted, because it would be an opt-in Standard, we do not think that re-exposure would be warranted.

The extent to which the Standard should be mandatory

- 32 The following discussion presumes that, consistent with the broad approach the Board has taken to GAAP/GFS harmonisation issues generally, the highest level of mandating that the Board would contemplate for GAAP/GFS harmonisation by entities within the GGS is the adoption of GFS only to the extent it is not inconsistent with GAAP. Although some of the matters have been touched on earlier in this paper, this section of the paper considers other matters pertinent to Approach A (whether the Standard should only be mandatory where an entity within the GGS elects to assert or is directed to adopt GAAP/GFS harmonisation principles in its general purpose financial statements) versus Approach B (whether the Standard should be mandatory for general purpose financial statements of entities within the GGS [subject to resolution of the RDR issues alluded to in the footnote to paragraph 21 above]). It then considers the manner in which each aspect of GAAP/GFS harmonisation should be addressed in the Standard.

Opt-in (Approach A) or compulsory (Approach B) Standard

- 33 Some have questioned whether the Board would be able to issue a Standard that has a mandatory status that is conditional on an entity or authority electing to opt into the Standard. Our understanding is that such an approach is available to the Board because, under section 227(1) of the *Australian Securities and Investments Commission Act 2001* (ASIC Act), the functions of the AASB include to:
- develop a conceptual framework, not having the force of an accounting standard, for the purpose of evaluating proposed accounting standards and international standards;
 - make accounting standards under section 334 of the *Corporations Act* for the purposes of the corporations legislation;
 - formulate accounting standards for other purposes; and
 - participate in and contribute to the development of a single set of accounting standards for world-wide use having regard to the interests of Australian

corporations that raise or propose to raise capital in major international financial centres.

The AASB is required to advance the main objects of Part 12 of the ASIC Act, Section 224, to:

- facilitate the development of accounting standards that require the provision of financial information that allows users to make and evaluate decisions about allocating scarce resources, assists directors to discharge their obligations in relation to financial reporting, is relevant to assessing performance, financial position, financing and investment, is relevant and reliable, facilitates comparability and is readily understandable;
- facilitate the Australian economy by reducing the cost of capital, enabling Australian entities to compete effectively overseas and having accounting standards that are clearly stated and easy to understand; and
- maintain investor confidence in the Australian economy (including its capital markets).

- 34 Given the AASB's functions include to 'formulate accounting standards for other purposes' (see the third dot point in the first set of dot points immediately above) and that GAAP already accommodates the GAAP/GFS harmonisation principles being contemplated, we think the AASB could (although it is not the staff's preference) adopt Approach A (and thereby issue a Standard, the mandatory status of which is conditional on an entity or authority electing to adopt it). Although there is no precedent for such a Standard in the existing suite of Australian Accounting Standards, within those Standards there are options that, if adopted, have financial reporting consequences. For example, under AASB 116, if an entity elects to adopt the revaluation model, there are consequential disclosure requirements that are not imposed if the entity elects to adopt the cost model. Furthermore, it is relevant to note that the IASB allows (and the AASB is contemplating allowing) non-publicly accountable entities to opt into full IFRSs or *IFRS for SMEs*. In addition, the International Public Sector Accounting Standards Board has issued IPSAS 22 *Disclosure of Information About the General Government Sector*, which only applies where a government elects to disclose financial information about the GGS in the consolidated financial statements under the accrual basis of accounting.

How to address the various aspects of GAAP/GFS harmonisation

- 35 Irrespective of whether Approach A or Approach B is adopted, the Standard might prescribe some or all aspects of GAAP/GFS harmonised reporting. The Standard could be silent on those aspects for which prescription might not be provided, or else non-mandatory guidance could be provided. Accordingly, there is a spectrum of possible approaches, depicted in the following table, showing the approach adopted in ED 174:

	Recognition and measurement (eg adopt fair value option under AASB 116)	Classification and presentation (eg split income and expenses between transactions and other economic flows)	Disclosures (eg budgetary reporting; disaggregated information)	Other disclosures (eg split between transactions and other economic flows; contribution of entity within the GGS to WoG result)
Specify requirements		ED 174		
Provide an option				
Provide non-mandatory guidance				
Be silent	ED 174		ED 174	ED 174

- 36 The main arguments regarding the extent to which the Standard and its components should be mandatory revolve around comparability (which is explicitly referred to in the FRC direction – see paragraph 1 above). Some argue that unless it is compulsory to adopt the Standard (Approach B) and the Standard specifies requirements for all aspects of GAAP/GFS harmonisation, comparability would be compromised. However, a counter-argument is that even if such an approach were adopted by the Board, comparability would be limited given the different ways in which governments structure their administrative arrangements; and because of the different formats jurisdictions adopt for their financial statements (eg net cost of services format compared with the traditional net result format). It is also relevant to note that, as described in the *Framework for the Preparation and Presentation of Financial Statements* (paragraphs 39-42), the comparability qualitative characteristic is described in terms of an entity through time to facilitate assessment of trends and of different entities to facilitate evaluation of relative financial position, financial performance and cash flows. It does not address the comparability of financial information between a group and a controlled entity. Its emphasis is on consistent measurement and display of the financial effect of like transactions and other events. It also emphasises not so much the adoption of the same accounting policies, but disclosure of information about those policies to enable the identification of differences. Paragraph 40 of the *Framework* states that “Compliance with Australian Accounting Standards, including the disclosure of the accounting policies used by the entity, helps to achieve comparability”. It also comments that relevance and reliability should not be sacrificed for comparability.
- 37 Consistent with comments in paragraph 13 above, cost/benefit arguments also arise, particularly in the context of ‘recognition and measurement’ for entities within the GGS that are not material to the WoG/GGS. Some argue that although mandating of recognition and measurement can be justified in a WoG/GGS context (where the principle of materiality means that not all entities within the GGS must adopt the same recognition and measurement approaches), entities within the GGS would be subject to their own, and therefore lower, materiality assessments. They go on to argue that the cost/benefit assessment of GAAP/GFS harmonisation for entities within the GGS should be made at the entity or jurisdiction level, rather than by the standard-setter.

- 38 ***Tentative staff view on the mandatory status of a Standard:*** Approach B should be adopted, whereby the Standard should focus on Tier 1 of the pending differential reporting regime and be compulsory for the general purpose financial statements of entities within the GGS. In relation to each aspect of GAAP/GFS harmonisation, the tentative staff view is as follows:
- (a) recognition and measurement: mandate adoption of a GAAP option that aligns with GFS;
 - (b) classification and presentation: require GFS information to be presented either on the face of the financial statements or in the notes to the financial statements (and provide an illustrative example of the information if an entity elects to provide it on the face);
 - (c) disclosure of budgetary information: require budgetary reporting consistent with the requirements in AASB 1049;
 - (d) disclosure of disaggregated information: be silent; and
 - (e) disclosure of information about an entity's contribution to the WoG/GGS result: require WoG/GGS to disclose the contribution of major entities within the GGS to the overall results.

A challenge for drafting such requirements would be that the general principle of 'adopt an option in GAAP that aligns with GFS' would not be able to be expressed so simply because it would be necessary to distinguish between recognition and measurement options (to be mandated) and classification and presentation options (which would not be mandated).

If instead of (b) immediately above the Board decides that the Standard should specify the format of financial statements to incorporate GFS information, the tentative staff view is that Approach A should be adopted (ie the Standard should be issued on an opt-in basis). This would allow cost/benefit assessments to be made by each entity or jurisdiction on a case-by-case basis, having regard to the needs of users and the impact of materiality on smaller entities. We think this should be monitored for any adverse effects of a lack of comparability by being subject to a post-implementation review around three years following initial adoption.

The nature of the pronouncement

- 39 Irrespective of whether Approach A or Approach B is adopted, the Standard could take the form of:
- (a) a stand-alone Standard specific to entities within the GGS;
 - (b) a Standard that amends other Australian Accounting Standards that have implications for GAAP/GFS harmonisation; or
 - (c) a revised AASB 1049, whether integrating requirements for entities within the GGS throughout it, or adding a supplement to AASB 1049.

The following table summarises the relative pros and cons of each alternative.

Stand-alone Standard	Incorporation into AASB 1049: integrated or supplement	Amending Standard
Provides one place for entities within the GGS to go, without needing to identify the applicable requirements out of a more broadly scoped Standard(s)	Keeps all requirements relating to the single topic of GAAP/GFS harmonisation in one place. A supplement to AASB 1049 would be easier for identifying requirements specific to entities within the GGS rather than integrating the requirements into AASB 1049	Acknowledges that entities within the GGS would need to refer to all relevant Australian Accounting Standards anyway
Not consistent with the Board's policy of issuing topic-based Standards rather than industry-based Standards	AASB 1049 is dominated by WoG and GGS	Inconsistent with the approach taken in AASB 1049
Provides a convenient place to locate any general principles – such as the limitation of a GAAP recognition and measurement option to a GFS requirement	Provides a convenient place to locate any general principles – such as the limitation of a GAAP recognition and measurement option to a GFS requirement	Might result in a significant number of Aus paragraphs throughout existing Standards. If the requirements include the limitation of a GAAP recognition and measurement option to a GFS requirement, Aus paragraphs would need to be incorporated into each Standard that has an optional treatment. Although many Standards do not have explicit options, they may contain implicit options and therefore it would be easier to specify the principle in one place, in a similar way in which paragraph 13 of AASB 1049 deals with it
Easiest to draft, because starting with a clean sheet	Could be difficult to integrate with AASB 1049, but relatively straightforward to add as a supplement (separate section) to AASB 1049. However, there could be a temptation to amend WoG and GGS requirements, which would pre-empt the Board's in-progress Post-implementation Review of AASB 1049 project	If the requirements include the limitation of a GAAP recognition and measurement option to a GFS requirement, it could be difficult to ensure that we have picked up all options (both explicit and implicit) in existing Standards. It might be easier to add a boiler-plate Aus paragraph to each Standard along the lines of "To the extent this Standard contains recognition and measurement options, entities within the GGS ..." However, that was not the approach taken with AASB 1049
Easiest to maintain – although a risk that it might get out of step with AASB 1049	Relatively easy to maintain – and has the benefit of any changes to AASB 1049 would be considered from WoG, GGS and entity within the GGS perspective	Harder to maintain
The Basis for Conclusions would accompany the requirements and be readily available for reference by users of the Standard	The Basis for Conclusions would accompany the requirements, but the Basis for Conclusions on WoG and GGS might detract from the Basis for Conclusions on entities within the GGS	The Basis for Conclusions would remain with the amending Standard, which once compiled into principal standards would not be prominent in the documents entities within the GGS refer to

40 ***Tentative staff view on the nature of the pronouncement:*** on balance, if the Board decides that the Standard should address classification, presentation, disclosures and recognition and measurement (irrespective of whether as mandatory requirements or voluntary guidance), we prefer a stand-alone Standard due to the relative ease of drafting and the expectation that it would be more user-friendly for entities within the

GGs and be accompanied by its Basis for Conclusions. However, if the requirements are limited to classification, presentation and disclosures, we think an amending Standard along the lines of ED 174 would be sufficient.

The nature of the accompanying Basis for Conclusions

- 41 The nature of the Basis for Conclusions that would accompany any Board pronouncement on GAAP/GFS harmonisation for entities within the GGS would depend on the Board's decisions about the issues discussed above. Depending on the Board's decisions on the issues addressed in this paper, we will provide a paper on how best to document the reasons for the Standard being issued and the Board's position for consideration at a future meeting.