

**DON CHALLEN'S RESPONSE TO AASB PROGRESS REPORT ON GAAP/GFS
HARMONISATION**

**Comments on the AASB's Progress Report on GAAP-GFS
Harmonisation for GGS Entities**

Background

In December 2002, the FRC issued a strategic direction that requires the AASB to pursue the harmonisation of Government Finance Statistics and Generally Accepted Accounting Principles as an urgent priority. The FRC's objective was to achieve public sector reports which are auditable, comparable, and in which the outcome statements are directly comparable with the relevant budget statements.

In December 2006, following the finalisation of AASB 1049 *Financial Reporting of General Government Sectors by Governments*, and the commencement of work on financial reporting of the whole-of-government (which, when combined, would complete stage 1 of GAAP-GFS harmonisation), the then AASB Chairman sought the FRC's clarification of the broad strategic direction in terms of the extent to which GAAP-GFS harmonisation should be pursued for other entities within the public sector. The AASB proposed that, as a second stage, it would undertake a project on GAAP-GFS harmonisation for entities within the GGS. At its December 2006 meeting the FRC agreed that, with the completion of stages 1 and 2, the requirements of its public sector strategic direction would be met.

At its February 2008 meeting, the FRC reaffirmed its commitment to the completion of stage 2 (covering entities within the GGS) and requested that the AASB ensures this stage is completed by no later than February 2010.

At its October 2009 meeting, the AASB reflected on the arguments for and against proceeding with stage 2 of the Project and discussed alternative ways to proceed. The AASB Chair has written to the FRC Chair to advise that the Board has concluded that there is insufficient evidence that the proposed Standard would satisfy the needs of the users of GGS entity financial statements. The AASB has advised that instead of imposing GAAP-GFS harmonisation requirements on entities within the GGS, it will develop non-mandatory guidance that could be used if a jurisdiction or GGS entity elected to present harmonised financial statements.

In my view, the AASB's proposed approach is inconsistent with the FRC's objective of achieving harmonised GGS entity reports which are auditable and comparable across both entities and jurisdictions. This Paper has been developed to further articulate my views on this important matter.

What does harmonisation mean

The AASB Progress Report does not fully reflect the purpose of the GAAP-GFS harmonisation project as set out in the FRC's strategic direction. It is also of concern to the public sector that there appears to be a view that there is a different objective between GFS and GAAP, in that GFS has macroeconomic objectives, while GAAP is a reporting framework. 2

The International Monetary Fund has specifically designed GFS as an accounting framework for compilers of government finance statistics, credit analysts and other users of fiscal data.

Aside from some specific transactional treatments, the GFS framework could be seen as an extension of GAAP, which can be used to reveal additional measures and to better classify aggregates into their transactions and remeasurement components. Experience in the Australian public sector clearly shows that users put the reports prepared under the two frameworks to the same uses. This is supported by the comments provided to the AASB by the major user representatives, including the Australian Minister for Finance and Deregulation, CPA Australia, the Australasian Council of Auditors-General and HoTARAC.

The vast bulk of Australian GAAP easily applies to the public sector, and it is clear that preparers of financial reports are familiar with GAAP concepts - this is an advantage that should not be wasted. However, because of its focus on entity performance (including financial position and investing and financing decisions), GAAP does not make the GFS distinction between transactions and other economic flows (remeasurements). The GAAP framework therefore does not specifically isolate market value movements in financial reports, even though this information is of huge benefit to public sector users, as noted above.

GFS provides for the publication of a fourth financial statement, the Statement of Other Economic Flows, to summarise and report other economic flows. As it facilitates the disclosure of market value movements, the inclusion of information from this statement within the GGS entity Income Statement, in a “comprehensive reporting” format, is an important step in achieving harmonisation between GAAP and GFS and meeting the best interests of users.

The useability of a harmonised standard for GGS entities

The AASB has noted its concern at the increased layer of complexity that harmonisation could add to general purpose financial reports. In this regard, the AASB is concerned that there is a limited understanding of GFS outside central agencies, and has noted the potential increased training costs that may result.

However, the approach to harmonisation proposed in ED 174 involves changing a small number of GAAP reporting requirements that currently apply to GGS entities, to adopt a conceptually superior presentation framework, which is consistent with the framework adopted for GGS and whole-of-government reporting under AASB 1049. There will be no need for preparers to attain additional expertise, or become experts in GFS, apart from their pre-existing ability to interpret and follow the requirements of the Australian Accounting Standards.

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The process followed is analogous to the processes that were applied by the AASB to achieve international convergence. In this regard, the challenge for users to understand the difference between transactions and remeasurements is fairly insignificant when compared to previous generational changes in public sector accounting, such as the move from cash to accrual reporting or the introduction of IFRS-based standards.

The community needs to be able to hold government entities accountable for the fiscal decisions they make. The primary means for doing this is each entity's financial statements. The proposed harmonised standard will produce financial statements of GGS entities that are very similar to those of the standard GAAP framework, though they will be GAAP-GFS statements, presented in a "comprehensive reporting" format. These reports, against a conventional set of accounting standards, will meet the requirements of all users, no matter what their level of sophistication. And, as opposed to any special purpose reports which might be prepared, by being subject to scrutiny by our Auditors-General, the value, reliability and public confidence in the financial reports in question will be greatly enhanced.

It is noteworthy that the needs of public sector users were considered in some detail by the AASB in its Progress Report on GAAP-GFS harmonisation provided to the FRC meeting of December 2006. At that time, the AASB concluded that "there is potential for users to be confused if the form and content of the financial reports of entities within the GGS differ from the GGS financial report". In view of this, the AASB advised the FRC that it would undertake a project on GAAP-GFS harmonisation for GGS entities. The AASB's support for GGS entity harmonisation was accepted by the FRC when it affirmed its commitment to stage 2 of the AASB's GAAP-GFS harmonisation project.

Constituents' comments

The AASB website indicates that 10 written submissions were received in respect of ED 174 (the AASB Progress Report refers to 13 submissions, however two organisations are included twice). Of these, five submissions (HoTARAC, ACAG, CPA Australia, Australian Department of Finance and Deregulation and NSW Treasury) were strongly supportive of the ED 174 proposals. Two of the remaining submissions were from preparers (Victorian Department of Human Services and Defence Housing Australia), and did not support the proposals in ED 174. It is understood that the major concerns of Defence Housing are specific to the issue of application to "for-profit" entities, rather than reflecting wholesale opposition to ED 174. Of the remaining written submissions, two were from business consultants and one submission was from an academic. The comments in these submissions were somewhat wide-ranging, but were mainly not supportive of ED 174.

It is also noted that the Minister for Finance and Deregulation wrote to the AASB Chair in September 2009 to indicate his strong support for GGS entity harmonisation, on his own behalf as a user of financial information, and also reflecting the views of his parliamentary colleagues. 4

The AASB also held Roundtables in Melbourne and Canberra in May 2009. It is understood that discussion at the Melbourne Roundtable was mixed, but that no one present strongly opposed the ED 174 proposals. It is also noted that, apart from a HoTARAC representative, none of the participants at the Melbourne Roundtable had made a written submission to the AASB. It is my view that more weight should be placed on views articulated in a written submission than verbal comments made in the informal setting of a Roundtable.

It is understood that discussion at the Canberra Roundtable was slightly more negative, but that the discussions were dominated by Commonwealth preparer representatives, many of whom were “resigned to the change”, rather than in wholesale opposition. Defence Housing again raised its specific concerns about application to “for-profit” entities. It is understood that the majority of the negative views were expressed by academic representatives, most of whom had general concerns about public sector reporting, rather than specific concerns about ED 174. It is also noted that, apart from three participants, the majority of the Canberra participants also had not made written submissions to the AASB.

As noted in the previous section, many of the negative views appear to be based on an incorrect assumption that preparers will have to become experts in GFS, and that ED 174 may lead to increased complexity in financial reporting and increased training of preparers. The reality is that the ED 174 proposals, if enacted, will result in “comprehensive reporting” style statements that are very similar to those of the GAAP framework, apart from the differentiation between transactions and remeasurements (valuation changes).

The written views of authoritative representative bodies, such as ACAG, CPA Australia, HoTARAC and the Minister for Finance and Deregulation, appear to have been discounted by the AASB, notwithstanding that each of these bodies represents significant groups of public sector users. In each of these cases, thorough internal processes ensure that the views expressed in writing are fully supported by, and reflect the considered views of the people/body concerned. It is less appropriate that greater weight appears to have been given to the informal comments provided by participants at its Roundtables, and in the AASB’s other dealings with users, when the vast majority of those people/bodies did not consider that this issue was of sufficient importance for them to make a formal submission to the AASB. 5

Based on a considered assessment of the outcomes of the AASB's consultation process, it is suggested that the constituents' comments indicate the need for enhanced education and awareness raising, rather than the widespread concern that has been noted by the AASB. It appears that such awareness raising could be more than adequately addressed through additional commentary in the proposed Standard, rather than by adopting the non-mandatory guidance approach that has been recommended by the AASB.

The AASB's recommended approach

As noted above, the AASB has decided not to impose GAAP-GFS harmonisation requirements on GGS entities, and instead will develop non-mandatory guidance that could be used if a jurisdiction or GGS entity elected to present harmonised financial statements.

The AASB Progress Report acknowledges that its "preferred approach might not result in as great a level of consistency across jurisdictions" as other alternatives. In my view, this is inconsistent with the FRC's objective to achieve public sector reports which are comparable, both across jurisdictions and with other entities.

A standard is needed to ensure that all GGS Entities in all jurisdictions report in precisely the same way. The AASB's proposal could lead to anarchy, with individual entities deciding whether to adopt the non-mandatory guidance, or to individual jurisdictions being forced to create some order by imposing the non-mandatory guidance by means of instructions from their Minister of Finance. In the former case, it won't be possible to compare entity financial statements within a jurisdiction and certainly not across jurisdictions – except by happenchance. In the latter case, comparability will exist within a jurisdiction but not across jurisdictions, again except by happenchance.

Arguably, the AASB's proposal would produce a worse outcome than we have at present. Currently, the GGS reports are all produced to comply with AASB 1049. All GGS entity reports are produced under GAAP (complying with what used to be AAS 29). At present, all jurisdictions' GGS reports are fully comparable; and all GGS entity reports within and across jurisdictions are fully comparable. We will lose that comparability at the entity level if the AASB proceeds with its non-mandatory guidance proposal. Unfortunately, at present, the GGS entity reports don't have the same look and feel as the GGS reports and you can't "add up" the entity reports in an individual jurisdiction into the GGS reports, but at least at the entity level we have full comparability. This is not an argument for abandoning the making of ED 174 into a standard, but illustrates the significant downside to the approach that the AASB has proposed.

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Imagine a situation in which the financial reports of the Education Departments of the States and Territories cannot be compared or worse, a situation in which the report of the Department of Education and the Department of Health in the same State can't be compared. These outcomes are entirely possible if the AASB's proposal proceeds.

The AASB's preferred approach may also lead to an outcome which is inconsistent with the FRC's objective of achieving auditability as, in the absence of a conventional set of accounting standards, it is likely that Auditors-General will treat harmonised GGS entity reports as special purpose reports, which in my view will significantly reduce the value, reliability and public confidence in those financial reports.

Suggested action

The future of public standard sector accounting in Australia will be shaped by the finalisation of the GAAP-GFS harmonisation project. There are wide ranging implications for public sector users and standard-setters depending on the outcome of stage 2 of the project. Australia possesses a unique opportunity to lead the world in public sector standard-setting by issuing a conceptually superior harmonised standard for GGS entities. However, if GAAP-GFS harmonisation is to be successful, the AASB needs to be guided by the views formally expressed by the key public sector users and be willing to adopt treatments which best meet the unique needs of the public sector.

It is recommended that the FRC should reaffirm its commitment to the completion of GAAP-GFS harmonisation for entities within the GGS, and should request that the AASB proceeds to develop ED 174 into a standard as soon as possible.

D W Challen

FRC Member

Secretary, Tasmanian Department of Treasury and Finance