

Senate Finance and Public Administration Legislation Committee

ANSWERS TO QUESTIONS ON NOTICE

Finance and Administration Portfolio

Department of Finance and Administration

Budget Estimates Hearings 2003-04 – 28 & 29 May 2003

Question: F13

Outcome 1

Topic: 3rd OECD PUMA Symposium, 20-21st February 2003

Hansard Page: F&PA 301

Senator Conroy asked:

For the purposes of what we talked about, the presentation...Mr. Kaufmann, is yours available?

Dr Watt — We are also happy to look at making available what Mr. Kaufmann and Mr. Prior said at the discussions.

Answer:

The papers presented at the Symposium by officers of the Department of Finance and Administration were as follows:

- “Government Finance Statistics (GFS) and Generally Accepted Accounting Principles” presented by Mr. Brett Kaufmann, Assistant Secretary, Accounting Policy Branch;
- “Bulletin of the Financial Reporting Council – 2002/5 of 18 December 2002” presented by Mr. Phillip Prior, First Assistant Secretary, Budget Coordination and Framework Division. This paper included an attachment entitled “Broad Strategic Direction Provided By the Financial Reporting Council to the Australian Accounting Standards Board for 2002-03”.

Both these documents are attached.

BULLETIN
of the
FINANCIAL REPORTING COUNCIL

2002/5 — 18 December 2002

The Financial Reporting Council (FRC) met on 12 December 2002, its sixteenth meeting since it first convened in October 1999. It made two key decisions — the first determining a broad strategic direction for public sector accounting standard setting in Australia and the second making four appointments to the Australian Accounting Standards Board (AASB). The appointments are the subject of a separate announcement.

Broad strategic direction for public sector accounting standard setting

One of the FRC's key functions under the *Australian Securities and Investments Commission Act 2001* is to determine the broad strategic direction of the AASB. At its meeting on 12 December, the FRC agreed to include the following in its broad strategic direction to the AASB for 2002-03:

"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".

Australia has been well served by the body of public sector accounting standards developed over time by the AASB and its predecessor Boards. With Australia at the cutting edge of government financial reporting world-wide, the use of accrual accounting has led to two sets of financial statements appearing in the budget and outcome documents of the Commonwealth, States and Territories — one based on the GFS framework and the other based on Australian GAAP. The differences between them have caused confusion among users of government financial statements.

Accordingly, following submissions made by governments in Australia and other stakeholders with an interest in public sector financial reporting, the FRC has agreed that the AASB should work to harmonise the two existing frameworks to achieve an Australian accounting standard for a single set of government reports. These reports will be comparable between jurisdictions and outcome statements will be directly comparable with the relevant budget statements.

The result will be an improvement in the clarity and transparency of government financial statements.

GFS is the financial reporting framework developed and promulgated by the International Monetary Fund (IMF) as the basis for the production and presentation of government finances with the objective of achieving greater accountability and transparency. The GFS concepts and principles are harmonised with the IMF's System of National Accounts (1993).

The AASB will now draw on the best of GFS principles and existing Australian GAAP — including detailed recognition and measurement rules which are not part of the GFS framework — to develop a new, single reporting framework for government. In doing so, it will issue exposure drafts and consult with constituents in accordance with its normal due process. Subject to

consideration by the AASB, the expectation is that the accounts of government entities not within the general government sector will continue to be prepared on an Australian GAAP basis (and, from 2005, in accordance with standards issued by the International Accounting Standards Board (IASB)).

The FRC recognises that the new framework will not have an immediate international counterpart either in GFS itself or the standards being developed by the International Federation of Accountants—Public Sector Committee (IFAC-PSC). However, while there has been a degree of broad convergence between the private sector standards issued by the IASB, IFAC-PSC standards and GFS, the international convergence of public sector accounting standards is still some way off. The eventual harmonisation target has yet to fully emerge, with IFAC-PSC and the IMF currently considering the scope for greater harmonisation of their respective standards.

The accounting standards to be developed by the AASB within the strategic framework set by the FRC are expected to contribute to leadership thinking at the international level on the harmonisation and eventual convergence of accounting standards for the public sector, to which Australia remains committed.

The full strategic direction provided to the AASB for 2002-03 is attached.

Other issues

Also discussed at the FRC meeting were preparations for the adoption of IASB standards for Corporations Act reporting entities for accounting periods beginning on or after 1 January 2005. Ms Jan McCahey, a Partner with PricewaterhouseCoopers, addressed the meeting on implications and issues arising from the 2005 decision from the perspective of one of the Big 4 accounting firms.

The meeting also discussed the status of responses by the top 100 listed companies to the FRC's approach seeking voluntary financial contributions to the accounting standard setting process.

FRC members also discussed the Government's proposals for an expansion of the activities of the FRC as set out in the CLERP 9 policy paper *Corporate disclosure: Strengthening the financial reporting framework*.

The FRC is the peak body responsible for the broad oversight of the accounting standard setting process for the private and public sectors. It comprises key stakeholders from the business and investing communities, the professional accounting bodies, governments and regulatory agencies.

- Key functions of the FRC are to advise the Government on the accounting standard setting process and the development of international accounting standards, and to determine the broad strategic direction of the standard setter, the Australian Accounting Standards Board.

For further information, please contact the secretariat of the Financial Reporting Council, c/- The Treasury, Langton Crescent, Parkes ACT 2600.

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BROAD STRATEGIC DIRECTION PROVIDED BY THE FINANCIAL REPORTING COUNCIL TO THE AUSTRALIAN ACCOUNTING STANDARDS BOARD FOR 2002-03

In accordance with paragraph 225(2)(d) of *the Australian Securities and Investments Commission Act 2001*, the FRC sets the following broad strategic direction for the AASB for 2002-03:

- (a) The Board's strategy and activities should be consistent with the objectives of accounting standard setting set out in section 224 of the Act, in relation to the characteristics of the financial information to be required by accounting standards, facilitation of the Australian economy and maintenance of investor confidence.
- (b) The AASB should strike an appropriate balance in allocating resources to the development of accounting standards for the private, public and not-for-profit sectors.
 - : The AASB should advise the FRC promptly of any resource constraints on the Board's ability to fulfil its responsibilities.
- (c) The AASB should follow its stated objective of pursuing, through participation in the activities of the IASB, the development of an internationally accepted single set of accounting standards. In working towards this objective, the AASB should:
 - : work towards the adoption in Australia of accounting standards that are the same as those issued by the IASB — and interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC) — to ensure their applicability to Corporations Act entities for accounting periods beginning on or after 1 January 2005;
 - : continue to work closely with the IASB and align its work program with that of the IASB;
 - : continue its present harmonisation program, working towards the adoption of accounting standards in Australia that harmonise with standards issued by the IASB, unless such standards are considered not to be in the best interests of the Australian public and private sectors;

- : promptly issue IASB exposure drafts in Australia for comment by constituents, and limit the need for subsequent issue of an AASB exposure draft to cases justified by the newness and complexity of a standard;
 - : continue to remove non-conformities between existing Australian and IASB standards on a planned basis;
 - : address, on a transparent basis, any transitional issues falling within the Board's mandate that may arise for Australian reporting entities, having regard to the cost of capital objective of the Act;
 - : ensure, as far as possible, that the work of the Urgent Issues Group has close regard to IFRIC pronouncements;
 - : in consultation with the FRC, communicate to constituents an overall strategy for adoption of IASB standards from 1 January 2005 to facilitate constituents' knowledge of and preparedness for the change.
- (d) With regard to public sector reporting, 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.

Government Finance Statistics (GFS) and Generally Accepted Accounting Principles

Introduction

There has been much discussion and debate recently in Australia about GFS and Accounting, their relationship and the quality of Financial Reporting in the Public Sector.

1. Context for Harmonisation proposal

- Financial Reporting Council Strategic Direction
- Australia's Accrual Framework, Development and Implementation

2. Australia's Experiences

- Adoption of commercially based accounting standards – issues
- Cash Monitoring, management and reporting
- Dual GFS and AGAAP Reporting Framework

3. Harmonisation Proposal

- Development of single GFS/GAAP reporting framework
- Harmonisation issues

1. CONTEXT AND BACKGROUND

Financial Reporting Council (FRC) Strategic Direction

- The FRC issue to the AASB its strategic direction in respect to Australia's public sectors in December 2002.

"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.

The strategic direction agreed by the FRC involves including within Australian GAAP applicable to the public sector within Australia, without sacrificing the high level of international comparability which currently exists through GFS reporting."

2. Australia's Framework, Development and Implementation

- Transfer to Accruals
- Agencies – cash receipts and payments
- Aggregate Statements
 - Cash based
 - Budget and actuals for each appropriation item
- Early 1990s
 - Agencies report cash information plus Supplementary Statement of Assets and Liabilities
- 1992-93, 93-94, 94-95
 - Transition to accrual reporting (AAS29)
- 1996-1998
 - Transition to whole of government reporting (AAS31)
 - Agencies implement accrual based FMISs

- 1998
 - Charter of Budget Honesty Act
 - Accrual budget and budget outcome
- 1999-2000
 - Commonwealth budget goes accrual
 - Commonwealth implements accrual GFS
 - Two accrual end of year reports (FBO and AAS31)

2. EXPERIENCES

1) Australian GAAP (ASAAP)

- All Australian governments implemented AGAAP
- Except for standards relating to Reporting by:
 - Local Governments (AAS27)
 - Departments (AAS29)
 - Governments (AAS31)

AGAAP is commercially based

2) AGAAP ISSUES

- AGAAP has a profit seeking orientation core government business is not profit seeking
- Definitions of revenues, expenses, assets and liabilities have a commercial orientation eg assets and future economic benefits
- Definitions are based on Control and Exchange
 - Non-exchange revenue
 - Non-exchange benefit payments
 - Exchange and non-exchange grant programs
 - issues of measuring future benefits and future sacrifice

– Unique Assets

- Defence weapons platforms
- Cultural and heritage buildings, collections, monuments
- Natural heritage assets (natural parks)
- Issues of existence, measurement, useful lives, and recoverability.

2) Cash monitoring, management and reporting

- Despite accruals, cash is king
- Key budget aggregate is cash, therefore
- Daily balance, daily monitoring
- Agency working capital – cash needs
- A need for greater central control and management

3) Dual GFS and AGAAP Reporting

- What are the objectives of GFS and AAS.
- Technical Differences.
- User Concerns
- A Single Framework
- Which GAAP

Concepts and Objectives

Charter of Budget Honesty → GFS and AGAAP

- A framework of **measurement** and **disclosure** to facilitate economic statistical analysis.
- Developed and promulgated by IMF -
- Cash GFS and Accruals GFS
- Based on **IMF's** System of National Accounts –
- **Cash GFS and Accruals GFS** -
- Basis for National Accounts → Statistician

Concepts and Objectives

- A basis for Budget Presentations and Budget Outcome Presentation
 - An economic analysis tool –
 - Operating Statement – Operating Result
 - Balance Sheet – Net Worth
 - Cash Flow Statement – Net Cash
 - Statement of Other Economic Flows
 - Total Other Economic Flows

Concepts and Objectives

- Accrual GFS
 - measures economic transactions
 - current value basis.
- Sectorial Basis
 - General Government (Budget Funded)
 - Public Finance Corporations – RBA EFIC
 - Non Public Finance Corporations – Telstra, Post
- Whole of Government and General Government perspective
- Prepared from entity and consolidated GPFR

Concepts and Objectives

GAAP – GPFR

- Provides a financial management tool – stewardship of resource management
- A set of rules for measuring economic activity – cost or fair value
- A set of rules for presenting economic activity
 - Operating Results / Net Cost of Services
 - Financial Position
 - Net Cash
 - Notes

Concepts and Objectives

- Based on the entity and the concept of control:
 - individual entity (agency)
 - consolidated (government)
- GPFR included in Budget and Budget Outcome Reports
- GPFR – AAS 31 Report

Measurements Budget, Budget Updates, Budget Outcomes

GFS

- Operating Result
- Net Worth
- Net Cash

Treasury

- Fiscal Balance
- Government's contribution to the national economy
- GFS operating result **less** net capital investment (movement in non-financial assets net of depreciation)
- Measures the Government's investment / saving balance and links to the current amount.

GAAP

- Operating Result / Net Cost
- Net Assets / Equity
- Net Cash

Underlying Cash

- Government's cash investment / saving balance.
- Net cash from operating activities.
- Net Cash from investments in non-financial assets.
- Net acquisition of assets under finance leases.

8 Different measurements

Technical Differences

- GFS Operating Result
 - Does not include economic and other adjustments and revaluations.
 - Fix and Interest Rate adjustments.
 - Asset revaluation adjustments.
- Statement of Other Economic Flows
 - Reports the adjustments.
- IASB Comprehensive Income Project.

Technical Differences

	Issue	Accounting Treatment	GFS Treatment
1.	Revisions relating to prior periods	Prior period items are recorded in the current period (unless an entity restates prior period items and restates the prior period financials).	Prior period items are taken directly to the period to which they belong and are reflected in the current period's equity (not worth).
2.	Non-current assets: revaluations and profit or loss on	Asset revaluation increments are taken to the asset revaluation reserve (an equity account) except where they reverse previous decrements and decrements are first offset against the reserve and then taken as an expense in the Statement of Financial Performance. Profit or losses on sale of assets are likely to be treated as part of operating revenue or expenses in the Statement of Financial Performance.	Both asset revaluations and the profit or loss on the sale of assets are treated as price changes and recorded in the Statement of Other Economic Flows.
3.	Borrowing costs on qualifying assets	Borrowing costs on qualifying assets are capitalised with the asset. This increases the annual depreciation charged throughout its useful life.	All borrowing costs are expensed in the Operating Statement in the period incurred.

Issue	Accounting Treatment	GFS Treatment
4. Defence weapons (Czech only)	Treated as capital expenditure. Defence weapons systems are included in assets on the Statement of Financial Position. Depreciation expense on assets is recorded in the Statement of Financial Performance.	Treated as an expense. Defence weapons systems are expensed directly in the Operating Statement in the period acquired.
5. Distributions to owners	The treatment of dividends does not change depending on their funding source. That is, there is consistent treatment regardless of whether the dividend is from within the general government sector or paid as a result of the sale of non-financial assets.	GFS considers the underlying source of the dividend—surpluses, retained surpluses, or capital restructuring. Proceeds from the sale of non-financial assets would be treated as returns of equity and not dividend revenue.
6. Foreign exchange gains and losses	Both realized and unrealized gains and losses are recorded as revenue or expenses in the Statement of Financial Performance either at the date of the transaction or the reporting date. The foreign exchange movements on qualifying assets are capitalized.	Net lending excludes both realized and unrealized foreign exchange gains and losses as they are regarded as price changes and would be reported in the Statement of Other Economic Flows. Non-financial asset sales and purchases are recorded at current values (including any realized foreign exchange gain or loss).

Issue	Accounting Treatment	GFS Treatment
7. Swaps and other derivatives	Recorded as a revenue or expense in the Statement of Financial Performance. Treatment is classified based on the underlying nature of the instrument that it relates to.	Treated as a price change. Therefore it is not included in operating revenues and expenses, but in the Statement of Other Economic Flows (which impacts directly on equity).
8. Government defined benefit superannuation schemes: 1. Employer contributions 2. Interest 3. Actuarial revaluation	All three superannuation components are treated as revenue or expense items in the Statement of Financial Performance.	Employer contributions and interest are treated as expenses in the current period. The actuarial revaluations should be recorded in the period to which it relates (that is, may be recorded in prior period figures) and are generally treated as a market value movement (eg, taken to the Statement of Other Economic Flows).
9. Negative net worth for Commercial Government Operations	Net worth is the residual of assets less liabilities of an entity. It is not affected by the market value of the entity's equity.	Net worth is measured as assets less liabilities less shares and contributed capital (which is the market value of the shares). Where the market value of the shares at a higher value a negative net worth figure is recorded for the entity.

Issue	Accounting Treatment	GFS Treatment
10. Allowances for bad and doubtful debts	Both provisions and write-off of specific debts are treated as part of operating expenses in the current period.	Debts can only be written off where there is mutual agreement. Mutually agreed write-downs are treated as an expense in the Operating Statement. All other write-downs, including provisions and unilateral write-downs, are treated as volume changes and recorded in the Statement of Other Economic Flows. The ABS has suggested that the doubtful debt provision should be removed from any GFS balance sheet.
11. Premiums and discounts on repurchased debt	Premiums and discounts on repurchased debt should be included as a gain or loss item in the Statement of Financial Performance as per IAS 19. Stock must be cancelled under accounting rules as it no longer meets definition of liability.	Repurchase premiums and discounts are treated as price changes at the time the debt is repurchased and recorded in the Statement of Other Economic Flows. The GFS cash flow statement for the Commonwealth includes repurchase premiums or discounts in the year that the repurchased stock is cancelled or matures consistent with the previous Commonwealth method for cash.

Summary of issues and concepts

Table 2 below summarises the key concepts behind the issues that have been raised. It highlights that a number of the differences and issues are due to the same concepts. For example, difference in the treatment of price movements relates to 8 of the issues raised.

Issue	Concept	"Market" Valuations	Value Changes	Government Sector Differentiation	Other
1. Prior period items					Choice of a financial period
2. Asset revaluations					
3. Sale of assets					
4. Borrowing Costs					
5. Defence Weapons					
6. Dividends					
7. Foreign Exchange			(qualifying assets only)		
8. Swaps and Derivatives					Nature of the risk
9. Superannuation					Prior period item
10. Net Worth					
11. Bad Debts					
12. Repurchased Debt					

Users

Budgets, Budget Updates, Budget Outcome, Consolidated Financial Report

- Who are the users:
 - Government (Cabinet, ERC)
 - Central agencies (Treasury, Finance, PM&C)
 - Parliament (Senate Estimates, JCPAA, Senate, Finance and Administration and other committees)
 - IMF, OECD, WorldBank
 - Other Governments

Users

- International Ratings Agencies eg S&P
- Finance analysts
- Finance commentators
- Community

User Concerns

- 2 Financial Reports with 8 measures creates:
 - confusion
 - difficulties in understanding information
 - impairment of relevance of financial reports
- The move to significantly increase transparency and openness has created opaque results

A Single Reporting Framework

- The concerns of users have been recognised by:
 - preparers (Cth Finance and Treasury and HoTs)
 - Governments
 - JCPAA 9Report 388)
 - Auditor-General
 - IFAC PSC
 - OECD
 - FRC

- Response
 - HoT's Decision
 - Budget Estimates and Framework Review
 - FRC and AASB
- Harmonised Position
 - Adopt best of both worlds
 - * Defence weapons
 - * Provisions
 - Convergence

Which GAAP

- To converge or not to converge
- Pros and Cons:
 - IASB FRSs
 - IFAC PSC IPSASs
 - International other (GASB)
 - AGAAP
- International Convergence of GAAP
 - Sector neutral standards
 - Adaptation of GAAP for Public Sector Business model (IFAC PSC)

Conclusion

- There is a strong argument for a Single Reporting Framework
- The Commonwealth, States and Territories desires a convergence
 - Scope
 - Consolidations
 - Auditability
 - Timing of International GAAP Convergence