

**IFAC PUBLIC SECTOR COMMITTEE  
IFAC PSC MEETING - November 2003**

**COUNTRY REPORT – AUSTRALIA**  
(Prepared 17 September 2003)

This Country Report only notes events since the last Report was prepared for the July 2003 PSC meeting. For a more comprehensive description of some of the projects on the AASB's work program, see the web site [www.aasb.com.au](http://www.aasb.com.au).

Current AASB projects that have particular implications for public sector entities for which no substantial progress has been made since the July 2003 Country Report was prepared include:

- Prospective Financial Information
- Fair Value and Deprival Value
- Statement of Financial Performance/Performance Reporting
- Related Party Disclosures

***GAAP/GFS Convergence***

The AASB has made substantial progress on implementing the Financial Reporting Council's strategic direction to give urgent priority to GAAP/GFS harmonisation. The AASB has modified its plan for implementing the revised strategic direction (see [www.aasb.com.au](http://www.aasb.com.au)) by breaking it into three (rather than two) phases:

- Phase 1: Whole of government and sector reporting
- Phase 2: Entities within the General Government Sector (including government departments)
- Phase 3: Other public sector entities (including local governments, universities and GBEs).

Subject to resource availability, it is intended that issues relating to financial reporting by Phase 2 entities (including non-convergence issues such as disclosures about administered items and compliance with appropriations) will be progressed concurrently with the convergence project with a view to issuing a standard applicable to such entities shortly after the convergence solution for Phase 1 entities is issued.

The AASB has received a comprehensive submission from Heads of Treasuries on a wide range of convergence issues. It notes that some issues will be resolved through the adoption of IASB standards in Australia by 1 January 2005 and the performance reporting project that anticipates a comprehensive single performance reporting statement that splits total performance into its two significant parts (whether on the emerging IASB basis of before remeasurements/remeasurements or on the GFS basis of transactions/other economic flows). Other issues will not be "naturally" resolved, but HOTS accepts that current GAAP should be retained for general purpose financial reporting for some of those issues (such as the treatment of dividends and defence weapons platforms). However, on other issues HOTS advocates a change to GAAP, and therefore a difference between for-profit GAAP and not-for-profit public sector GAAP. In considering an underlying guiding principle for dealing with GAAP/GFS convergence issues, the AASB has formed the preliminary view that consistent with its policy of issuing sector neutral standards GAAP definition, recognition

and measurement principles should be retained, with disclosures to meet GFS needs. The AASB will consult with its Project Advisory Panel on whether there are compelling reasons for it to depart from this guiding principle in relation to particular issues including:

- (a) the status of GGS stand-alone financial reports prepared on a partial consolidation basis
- (b) the status and prominence of GGS financial information in the context of whole of government financial reporting
- (c) the format of the statement of financial performance and the location of disclosures of “below the line” items such as GFS net lending/borrowing.

The Board expects to finalise a consultation paper that will include its preliminary views on the issues raised in the HOT’s submission ready for circulation to Project Advisory Panel members in November 2003.

The AASB’s GAAP/GFS convergence implementation plan currently anticipates May 2004 as the date by which an Exposure Draft will be finalised – it is likely that this timing will be moved back as it will take more than one AASB meeting for the AASB to finalise its preliminary views.

### ***Review of AAS 27 “Financial Reporting by Local Governments”***

The AASB has approved in principle the Exposure Draft that contains proposals that will replace AAS 27. It is expected that it will be issued in October 2003, with a comment period ending 27 February 2004.

The most substantive part of the ED will be guidance (commentary only) on revenue and expense recognition. As reported in the last country report, the AASB has made decisions about the treatment of revenue whereby the current distinction in AAS 27 between reciprocal and non-reciprocal transactions will be removed and replaced with extensive guidance on applying the definition of assets and, consequently, the definitions of contributions by owners, liabilities and revenue. Broadly, the scope of the work the AASB has done in this area is equivalent to the scope of the work being done by the PSC’s Non-Exchange Revenue Steering Committee.

### ***Review of AAS 29 “Financial Reporting by Government Departments”***

See the comment above under GAAP/GFS Convergence.

## ***Public Infrastructure Arrangements***

### ***Local Issues***

As reported in the July 2003 Country Report, the HOTs agreed a Position Paper that detailed a policy based principally on the UK approach as reflected in Application Note F *Private Finance Initiative and Similar Contracts to Financial Reporting Standard FRS 5 Reporting the Substance of Transactions Application*. At that time it was expected that Victoria would apply Application Note F to FRS 5 to some existing arrangements for the 2002-2003 reporting period. This did not happen. It is now expected that all jurisdictions will formally implement their policy to apply Application Note F to FRS 5 via a Financial Reporting Direction (as part of the Ministerial Directions, issued by the Minister for Finance) or some

similar mechanism for the 2003-2004 reporting period. Guidance material (additional to that developed in the UK) is being developed in two stages for completion in December 2003.

### *International Issues*

As reported in the July 2003 Country Report, an *Accounting for Service Concessions* project team wrote a report for consideration by the IASB at the April 2003 National Standard Setters (NSS) meeting. The report identified an urgent need to supplement existing IASB literature on recognition, measurement and disclosure with guidance explaining how it should be applied in practice in accounting for service concessions and recommended that this phase of the project be managed by IFRIC. The report recommends that a draft Interpretation be issued as soon as possible in 2003 and the IFRIC Interpretation be mandatory for 2005. Service Concessions is an agenda item for consideration for the first time at the IFRIC September 2003 meeting.

### *Impairment of Assets*

As reported in the July 2003 Country Report, the AASB added material relevant to impairment of assets (exposed in ED 109 *Request for Comment on: IASB ED 3 Business Combinations; IASB ED of Proposed Amendments to IAS 36 Impairment of Assets and IAS 38 Intangible Assets*) that addresses specific issues affecting not-for-profit entities such as measurement of impairment (that is, determining recoverable amount of an asset as its written down current cost). At its July 2003 meeting the AASB decided that it would provide additional guidance in the Australian equivalent to IAS 36 on the determination of an asset's value in use where a not-for-profit entity has an asset that is not primarily dependent on net cash inflows. (The Board also agreed to monitor the IPSAS project on Impairment of Assets and to consider the use of PSC terminology and commentary in the Australian equivalent to IAS 36 – for example, use of the term “depreciated replacement cost” rather than “written down current cost”.)

### *Self-Generating and Regenerating Assets (SGARAs)*

The AASB considered at its September 2003 meeting submissions on ED 114 “Request for Comment on IAS 41 Agriculture” and responses received from a post-implementation review of the requirements of AASB 1037 / AAS 35 “Self-Generating and Regenerating Assets” that also addressed convergence issues with IAS 41 “Agriculture” at their September 2003 meeting. The AASB decided that the Australian equivalent to IAS 41 will adopt all of the requirements of IAS 41. However, it has been proposed in the Framework / Revenue project, that public sector entities will not be subject to the government grant provisions in IAS 41 (see the comments above under Review of AAS 27 for a discussion of what the AASB is doing in relation to revenue recognition in the public sector). The disclosures currently required by AASB 1037 and AAS 35 paragraphs 7.1(a) and 7.1(b) concerning the disclosure of physical quantity categories of SGARAs and restrictions on SGARAs will be included in the standard.

The AASB will be providing feedback to the IASB on the post-implementation review, that will include specific recommendations on improving IAS 41 in areas where the requirements in AASB 1037 / AAS 35 are superior. The AASB intends to offer reviewing IAS 41 as a project on behalf of the IASB.

### ***Employee Benefits***

The AASB considered at its September 2003 meeting the pre-ballot IASB draft of ED “Amendments to IAS 19 *Employee Benefits*”. The proposed standard is expected to be operative for reporting periods beginning on or after 1 January 2006.

The AASB continued to endorse the tentative decisions made by the IASB in respect to employee benefits, including the proposed removal of the corridor approach for recognising actuarial gains and losses associated with defined benefit plans.

### ***IASB Convergence (by 2005)***

The AASB is continuing its program of aligning Australian accounting standards to the IASB standards that will be applicable on or after 1 January 2005 (see the AASB Plan for Adopting IASB Standards by 2005 on [www.aasb.com.au](http://www.aasb.com.au)). As part of this program, the AASB has recently issued the following Exposure Drafts:

- ED 110 “Request for Comments on IAS 7 Cash Flow Statements”
- ED 111 “Request for Comments on IAS 23 Borrowing Costs”
- ED 112 “Request for Comments on IAS 29 Financial Reporting in Hyperinflationary Economies”
- ED 113 “Request for Comments on IAS 30 Disclosures in the Financial Statements of Banks and Similar Financial Institutions”
- ED 114 “Request for Comments on IAS 41 Agriculture”
- ED 115 “Request for Comment on IAS 19 Employee Benefits”
- ED 116 “Request for Comment on IAS 2 and IPSAS 12 Inventories”
- ED 117 “Request for Comment on IASB ED 4 Disposal of Non-current Assets and Presentation of Discontinued Operations”
- ED 118 “Request for Comment on IAS 11 Construction Contracts”
- ED 119 “Request for Comment on IAS 14 Segment Reporting” – for-profit sector only
- ED 120 “Request for Comment on IAS 16 and IPSAS 17 Property, Plant and Equipment”
- ED 121 “Request for Comment on IAS 31 Financial Reporting of Interests in Joint Ventures”
- ED 122 “Request for Comment on IASB ED 5 Insurance Contracts”
- ED 123 “Request for Comment on IASB ED of Proposed Amendments to IAS 39 Financial Instruments: Recognition and Measurement – Fair Value Hedge Accounting for a Portfolio Hedge of Interest Rate Risk”

Broadly, the AASB equivalents of IASB standards will, subject to AASB due process, adopt the IASB standards word-for-word. Specific guidance for not-for-profit entities will be “embedded” in the AASB standards (for example, to address non-cash flow generating assets issues in relation to inventories, and property, plant and equipment for impairment purposes), clearly identified as only applying to not-for-profit entities. Where available and suitable in an Australian context, the not-for-profit entities text will be based on relevant IPSASs. Furthermore, the AASB standards may limit the options likely to be retained in IASB standards, and may also include requirements (such as disclosures) that are additional to the disclosures in IASB standards.

In relation to IAS 20 “Accounting for Government Grants and Disclosure of Government Assistance”, the Board intends to propose that IAS 20 be applied by for-profit entities but that the existing Australian requirements continue to apply to not-for-profit (including public sector) entities. As noted above under the heading “Review of AAS 27 “Financial Reporting by Local Governments””, the AASB intends providing commentary clarifying the existing Australian requirements relating to revenue recognition, including guidance on the accounting for government grants.

## **URGENT ISSUES GROUP (UIG)**

The UIG deals with accounting issues of relevance to the private sector and/or the public sector. Consensus views agreed by the UIG are subject to veto by the AASB before they can be issued as Abstracts.

Since the July 2003 Country Report was prepared, the UIG has issued one Abstract, which is relevant to entities in the public sector:

- Abstract 54 “Superannuation Disclosures by Employers”.

Abstract 54 clarifies the requirements in AASB 1028 “Employee Entitlements” for disclosures by employers who sponsor defined benefit superannuation plans. The Abstract requires employers to disclose, for each such plan and in aggregate: accrued benefits; the net market value of the plan assets; the difference between those two items; and vested benefits, all as disclosed in the most recent financial report of the superannuation plan. In addition, an employer should also disclose more recent information, where available, of the amount of any of the above items, its basis and date of preparation.

The UIG also has now begun to consider some implementation guidance concerning accounting for income taxes under the Australian system of tax consolidation, which may be relevant to some public sector entities. Abstract 52 “Income Tax Accounting under the Tax Consolidation System” covers the general accounting requirements for entities applying the tax consolidation system, under which the parent entity has responsibility for the tax consequences of the transactions of its wholly-owned subsidiaries in the tax-consolidated group. The parent entity recognises both current and deferred taxes arising in relation to those subsidiaries.

## **COMMONWEALTH GOVERNMENT, STATES AND TERRITORIES**

### ***Current Status***

As reported in the July 2003 Country Report, most Australian jurisdictions prepare budgets and budget outcomes using an accrual GFS basis. Victoria and the ACT use GAAP. The Commonwealth uses both GFS and GAAP, but accrual GFS predominates.

In addition, the Commonwealth government prepares its budget on an accrual basis and prepares general purpose reports at the whole of government level and for individual reporting entities on an accrual accounting basis. All States/Territories prepare general purpose financial reports for the whole of government and for departments and agencies on an accrual basis.

Consequently, all jurisdictions support full harmonisation of GFS and GAAP.

***Commonwealth Government***

As reported in the July 2003 Country Report, the Commonwealth Government's Accounting Policy Branch, established within its Department of Finance and Administration, sets accounting and financial reporting policy for Commonwealth reporting entities. In addition, it is now also responsible for reviewing accounting policies for all GAAP and GFS reporting.

DATE: 22 September 2003  
TO: Members of the Public Sector Committee  
RE: Country Report – Canada

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## **INTRODUCTION**

This report contains details on the status of public sector accounting activities of the Canadian Public Sector Accounting Board (PSAB). As well, it provides a brief update on projects of the Accounting Standards Board (AcSB).

If any member would like to receive any of the documents discussed, please contact the Canadian representatives.

## **PSAB**

### *Financial Statement Discussion and Analysis (FSD&A)*

Given the complexity of a government's operations, myriad of objectives and the diverse nature of the users of government financial statements, no one indicator such as surplus or deficit can adequately explain a government's financial position or results.

FSD&A (equivalent to MD&A in the private sector) will be issued as a statement(s) of recommended practice (SORP) and will not form part of GAAP. The SORP provides a general framework for the development of FSD&A information – it is not intended to be prescriptive. A Public Exposure Draft was approved by PSAB in April 2003 and issued in July. Comments are requested by September 26, 2003.

### *Funds and Reserves*

At its June 2003 meeting, PSAB approved a draft PUBLIC SECTOR GUIDELINE PSG-5, FUNDS AND RESERVES for public exposure. The draft Guideline, issued in July 2003, provides guidance on presenting information related to stabilization funds or financial reserves and will apply to federal, provincial and territorial governments (senior governments).

Stabilization funds or financial reserves take a variety of forms and can be described as a “tool” for managing government finances. This project aims to clarify existing standards in the CICA Public Sector Accounting Handbook (CICA PSA Handbook) as to whether these funds can be displayed on the statement of financial position.

Key discussion points of the guideline were discussed in Canada's country report of June 25, 2003.

Comments on the draft Guideline were requested by September 15, 2003. PSAB hopes to approve a final Guideline at its October 2003 meeting.

### *Generally Accepted Accounting Principles (GAAP)*

This project clarifies that the CICA PSA Handbook is the primary source of GAAP for the public sector.

The primary sources of GAAP are those accounting pronouncements that must be referred to first in determining the treatment for an accounting issue. Only if the primary sources are silent on a particular accounting issue, would a preparer seek to find an alternative or 'other source' of GAAP to address the accounting issue in question.

A Statement of Principles was issued in August 2003 with comments requested by October 17, 2003.

### *Government Reporting Entity*

In May 2003, PSAB approved revisions to CICA PSA Handbook, GOVERNMENT REPORTING ENTITY (GRE), Section PS 1300 regarding the definition of the GRE (see Canada's country report of 25 June, 2003 for information about the revisions).

Having defined the GRE, the views of PSAB's associates were sought on the most appropriate method of including government organizations in the summary financial statements of the GRE. Under the new definition, there will be new organizations included in the government's financial statements that previously were not. Some concerns were raised as to how these organizations should be accounted for.

Two options were discussed – full consolidation of all government organizations except for government business enterprises, which are accounted for on a modified equity basis, (status quo), and expanding the exceptions for modified equity to include the SUCH sector (schools, universities, colleges and hospitals).

There are mixed views on the most appropriate method of accounting. Full consolidation ensures that the full nature and extent of the resources a government controls are included in the financial statements and is consistent with international trends. In the long run many constituents favor this approach.

However, some constituents are concerned about the practicality of fully consolidating SUCH sector organizations partly due to the volume of these organizations.

The Board will be asked to consider whether modified equity accounting could be applied for SUCH sector organizations that are newly included in the government reporting entity for a specified transitional period, for example 3 years. After the transitional period all government organizations except for government business enterprises would be full consolidated.

A public exposure draft is being presented to PSAB in October 2003 for approval.

### *Government Transfers*

This project will review existing CICA PSA Handbook Section PS 3410 GOVERNMENT TRANSFERS with the objective of:

- Improving consistency in interpretation of the section; and
- Addressing new issues that have been raised since the section was first approved.

The most controversial issue for the project relates to accounting for multi-year funding arrangements, in particular those that have arisen near the financial statement reporting date.

In June 2003, PSAB considered a draft Associates' Exposure Draft (AED) which proposed the immediate recognition of multi-year funding in expenses when the transfer is authorized. This approach was substantially consistent with the GASB 33 standard (*Accounting and Financial Reporting for Non-exchange Transactions*) used by state and local governments in the US.

Further, the draft AED proposed that multi-year funding be deferred by the transferring government when explicit time requirements are stipulated. The timing of recognition by the recipient government would similarly be affected by the fulfillment of any external restrictions on the funding (e.g., time requirements or purpose restrictions).

For various reasons PSAB did not approve the draft AED – the Board was not convinced the proposed approach would resolve the issue and was concerned that it might create other problems. For example, there was concern that immediate recognition was in conflict with the underlying principles of the conceptual framework of the CICA PSA Handbook.

Consequently a paper was prepared outlining the three approaches being considered for accounting for multi-year funding by a transferring government - to be used as a discussion document for three senior government conferences held in August and September 2003.

Though feedback was received from these conferences, the continuing controversy over this issue has resulted in a Forum of senior members of government being organized in late October 2003 in Toronto. The forum will debate the issue of multi-year funding within the context of the conceptual framework of the CICA PSA Handbook.

### *Liabilities, Contingent Liabilities and Commitments*

This project is in response to limitations and issues with existing definitions in the CICA PSA Handbook. 'Contingent assets' have been excluded from the scope of the project.

Comments on the project's statement of principles (SOP) have been analysed with the major issues raised relating to the principles focus on the definition of a contingent liability and the associated disclosure requirements. There was concern that the definition

of a contingent liability was too inclusive as it included liabilities that could not be measured with the disclosures too onerous.

A further issue raised was the need for additional guidance for interpreting the proposed definition of a liability. The proposed definition includes 'constructive and equitable obligations'.

A Public Exposure Draft is scheduled to be presented to PSAB for approval in October 2003.

#### *Sale-Leaseback Transactions*

As a result of the approval of the new government reporting model for senior governments, there is a need to revise PSAB guidance on sale-leaseback transactions.

The over-arching principle of the project is that the economic reality of the sale-leaseback transaction should be reported. The project also focuses on compliance with the asset/liability approach when accounting for gains/losses incurred in sale-leaseback transactions.

A draft guideline is scheduled to be presented to PSAB for approval in October 2003.

#### *Accounting in Senior Government Budgets – Research Report*

The objective of this study is to provide a "state of the union" comparative and descriptive look at the accounting bases and policies used by Canadian federal, provincial and territorial governments in their budgets and appropriations as compared to their summary financial statements. The accounting relationships between these three sets of documents and how the budgets are reconciled to the financial statements in order to provide the budget to actual comparisons required by the CICA PSA Handbook would be key issues.

The information garnered from this research could be used as the basis for additional research on consolidated accrual budgeting.

The study is continuing and is expected to be published in 2004.

#### *NEW PROJECTS*

The following projects were approved by PSAB in April 2003 and were briefly introduced and discussed in the June 25, 2003 Canada country report.

Task forces for each project are currently being organized.

*Local Government Financial Statement Reporting Model*  
*Financial Instruments*  
*Performance Reporting*  
*Revenues*

**AcSB***Employee future benefits – exposure draft approved*

In July 2003, the AcSB approved a project proposal to fast-track improvements to the disclosure requirements of Handbook Section 3461, *Employee Future Benefits*. This project considers input received from a users' roundtable discussion as well as the US Financial Accounting Standards Board (FASB)'s deliberations on its limited-scope pension disclosures project and the International Accounting Standards Board (IASB)'s improvements to IAS 19, *Employee Benefits*.

In September 2003, the AcSB approved, subject to written ballot, an exposure draft on amendments to the disclosure requirements of Section 3461. This exposure draft is expected to be issued in October 2003 with a 30-day comment period. The proposed changes are to be effective for fiscal years ending on or after December 31, 2003. A FASB Exposure Draft, issued September 15, 2003 for comment by October 27, 2003, is available at [www.fasb.org](http://www.fasb.org).

*Consolidation of variable interest entities – effective date deferred*

The AcSB considered several concerns arising from financial statement preparers' efforts to implement Accounting Guideline AcG-15, *Consolidation of Variable Interest Entities*. In view of the significance of the issues brought to its attention, including the need for regulators to determine what changes, if any, are needed to regulatory requirements, the AcSB decided to defer the effective date of the Guideline to annual and interim periods beginning on or after November 1, 2004, except for certain disclosure requirements. The AcSB decided that enterprises with variable interest entities should disclose the information specified in paragraph 28 of the Guideline for periods beginning on or after January 1, 2004. As well, the AcSB has requested that a task force be established to work on the significant issues brought to its attention.

The AcSB noted that the FASB had requested its staff to develop material that might modify FASB Interpretation No. 46; the AcSB will continue to monitor such activity as well as ongoing efforts to resolve implementation issues.

*Financial instruments – review of exposure draft comment letters*

In September, the AcSB commenced its review and analysis of comments received on the March 2003 Exposure Drafts *Hedges* and *Financial Instruments – Recognition and Measurement*.

The AcSB confirmed that staff should draft Handbook Sections based on the format of the Exposure Drafts, which were based on similar international material. The AcSB agreed to examine instances where choices exist in the Canadian proposals that are not available under US GAAP to determine if any need to be eliminated.

The AcSB discussed two issues relating to hedge accounting. The AcSB concluded that, in light of significant costs and efforts presently being undertaken to implement AcG-13, Hedging Relationships, for fiscal years beginning on or after July 1, 2003, it would not be appropriate, at this time, to make changes to accommodate fair value hedge accounting for a portfolio hedge of interest rate risk, as is presently being considered by the IASB (see [www.iasb.org.uk](http://www.iasb.org.uk)), or to preclude hedge accounting using non-derivative financial instruments.

The AcSB will continue re-deliberations at future meetings, taking into account comments received as well as discussion at roundtables scheduled for the end of September and early October in Calgary, Edmonton, Montreal, Toronto and Vancouver.

*Revenue recognition – discussion of concepts*

In August, the AcSB discussed revenue recognition issues recently considered by the FASB and IASB under their joint project. The current focus is on contractual rights and obligations with the FASB and IASB having tentatively agreed that:

- unconditional rights and obligations can give rise to assets and liabilities if they are enforceable and have future economic consequences for the reporting entity;
- the rights and obligations created by a contract prior to performance ('pre-performance') are unconditional and are like put and call options;
- the unit of account for pre-performance assets and liabilities is the contract as a whole where the legal remedy for breach of that contract would be a net payment made by one party to the other. Net settlement arises when the subject of the contract is fungible and can be replaced in the market;
- the unit of account for pre-performance assets and liabilities is the actual asset and liability created by performance of the contract where the subject is unique and cannot be replaced in the market;
- pre-performance assets and liabilities should be measured at fair value and changes in their values should be recognized as revenues or expenses; and
- post-performance assets and liabilities (the assets and liabilities traditionally recognized on execution of a contract) should initially be recognized at fair values.

The project team's most recent work, to be discussed by the AcSB in October, tests specific fact patterns against the conceptual model.

*Stock-based compensation and other stock-based payments – transitional provisions to mirror US*

The transitional provisions in Handbook Section 3870, Stock-Based Compensation and Other Stock-Based Payments, have been revised to provide the same alternative methods of transition as are provided in the US for voluntary adoption of the fair value based method of accounting. These provisions may be applied retroactively or prospectively. However, the prospective application is only available to enterprises that elect to apply

the fair value based method of accounting for fiscal years beginning before January 1, 2004.

The AcSB has agreed that share-based transactions should be measured on a fair value basis, and has confirmed its intention to amend Section 3870 to require that all transactions whereby goods and services are received in exchange for stock-based compensation and other payments result in expenses that should be recognized in financial statements, and that this requirement would be applicable for financial periods beginning on or after January 1, 2004.

The AcSB also agreed to permit enterprises other than public enterprises, co-operative enterprises, deposit-taking institutions and life insurance enterprises to defer the expense recognition requirements of Section 3870 until fiscal years beginning on or after January 1, 2005.

*Reporting financial performance – discussion of concepts*

The AcSB discussed IASB and UK ASB proposals to handle issues raised in field visits and roundtables, including those held in Canada, as well as the progress of FASB's parallel project. The AcSB will issue a document for comment in Canada no earlier than the first quarter of 2004. Information on IASB's deliberations may be found at [www.iasc.org.uk](http://www.iasc.org.uk) and FASB reports on the status of its project at [www.fasb.org/project/fin\\_reporting.shtml](http://www.fasb.org/project/fin_reporting.shtml)



DATE: 19 September 2003

MEMO TO: MEMBERS OF THE IFAC PUBLIC SECTOR COMMITTEE

FROM: KEVIN SIMPKINS  
NEW ZEALAND REPRESENTATIVE

SUBJECT: **UPDATE ON RECENT DEVELOPMENTS IN NEW ZEALAND**

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## **Introduction**

This memorandum updates Members of the IFAC Public Sector Committee (PSC) on recent developments in New Zealand, specifically relating to:

- Generally Accepted Accounting Practice;
- Auditing and Professional Standards;
- Central Government;
- Local Government; and
- Other Developments.

## **Generally Accepted Accounting Practice**

### *ASRB Release 8*

In light of the decision to adopt International Financial Reporting Standards (IFRS) in New Zealand the Accounting Standards Review Board (ASRB) is preparing ASRB Release 8. The purpose of this Release is to outline the ASRB's functions, the nature of approved financial reporting standards, the ASRB's expectations as to the content of financial reporting standards, and the criteria the ASRB employs in evaluating proposed financial reporting standards and amendments to approved financial reporting standards which are submitted to it for approval in accordance with the Financial Reporting Act (the Act). The ASRB is intended to serve a key role in the achievement of a fundamental purpose of the Act, which is to maintain the quality of financial reporting in New Zealand. The ASRB has decided that the following guidelines should be observed in adapting an IFRS for issue as a NZ IFRS:

- a. The IFRS disclosure requirements cannot be reduced for profit-oriented specified entities<sup>1</sup>;
- b. Additional disclosure requirements can be introduced for all specified entities;
- c. The IFRS recognition and measurement requirements for profit-oriented specified entities cannot be changed;

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<sup>1</sup> "Specified entities" are those entities that will become subject to legal requirements on financial reporting.

- d. Recognition and measurement requirements can be amended for public benefit entities, with a rebuttable presumption that amendments will be made for differences between IFRS and the corresponding IPSAS or existing FRS, based on the IPSAS or FRS as applicable;
- e. Introduction of guidance materials for public benefit entities should be based on the same principles as apply to introduction of recognition and measurement requirements as outlined in 'd.' above; and
- f. Elimination of options in IFRS is permitted for all specified entities, on a case-by-case basis. Where an IFRS permits options that are not allowed in existing FRS, a strong argument would need to be made in order for the Board to agree to the retention of such options in the NZ IFRS. In reaching a view on this issue the Board will be mindful of the approach adopted by the Australian Accounting Standards Board (AASB).

All changes made to an IFRS as part of the conversion process from IFRS to NZ IFRS will be through the use of boxed text.

Compliance with NZ IFRS by a profit-oriented entity will ensure compliance with IFRS. However, where a public benefit entity prepares its financial report in compliance with NZ IFRS, the financial report simultaneously complies with IFRS only if the alternative requirements (if any) on measurement and recognition are not applicable to the entity and if any reduction in disclosure requirements have not been taken advantage of. If additional requirements on measurement and recognition, or reduced requirements on disclosure, are applicable to the public benefit entity, then compliance with NZ IFRS does not result in simultaneous compliance with IFRS.

#### *Adoption of International Standards in New Zealand*

The Financial Reporting Standards Board (FRSB) has established a Conversion Working Group to assist it in adopting IFRS. The Group is chaired by Ken Warren, Chief Accounting Advisor to The Treasury, and a member of the PSC's Non-Exchange Revenue Steering Committee. The Conversion Working Group is considering all IASB standards, identifying the key differences between these standards and New Zealand FRSs, and making recommendations to the FRSB. In particular, the Working Group is identifying for each international standard any issues that the FRSB should raise with the IASB for the next review of the standard and is considering whether any additional requirements and guidance are required to ensure that the standards can be applied by public benefit entities (not-for profit entities and service-oriented public sector entities). The approach the FRSB plans to take in adopting IFRS is set out in a paper "Process for Adopting IFRS in New Zealand" and is available on the Institute's web site.

To date the FRSB has issued for comment:

- ED NZ IAS 1 *Presentation of Financial Statements*
- ED NZ IAS 23 *Borrowing Costs*
- ED NZ IAS 2 *Inventories*
- ED NZ IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*
- ED NZ IAS 7 *Cash Flow Statements*
- ED NZ IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*
- ED NZ IAS 10 *Events After the Balance Sheet Date*

The FRSB has recently approved for issue exposure drafts (EDs) of the New Zealand version (NZ IAS) of the following international accounting standards:

- ED NZ IAS 17 *Leases* (together with NZ Interpretation SIC-15 *Operating Leases – Incentives and NZ Interpretation SIC-27 Evaluating the Substance of Transactions in the Legal Form of a Lease*)
- ED NZ IAS 33 *Earnings per Share*
- ED NZ IAS 40 *Investment Property*.

These EDs will be posted to the Institute's website at [www.icanz.co.nz](http://www.icanz.co.nz) during September 2003. The closing date for comments is **30 November 2003**.

The FRSB also approved ED NZ IAS 14 Segment Reporting but decided to defer its issue until after consulting with not-for-profit entities. The proposed exposure draft on Segment Reporting consists of two sections:

1. The first section based on IAS 14 will apply to profit oriented entities; and
2. The second section based on IPSAS 18 will apply to public benefit entities.

IPSAS 18 was developed specifically for public sector entities and the purpose of the consultation is to ensure that the provisions of IPSAS 18 can be applied by the not-for-profit sector and to identify whether any adjustments will be needed.

The Working Group is continuing to develop discussion papers and exposure drafts based on:

- IFRS 1 *First Time Adoption of IFRS*
- IAS 26 *Accounting and Reporting by Retirement Benefit Plans*
- IAS 30 *Disclosures in the Financial Statements of Banks and Similar Financial Institutions*
- IAS 16 *Property Plant and Equipment*
- IAS 19 *Employee Benefits*

Constituent's views will be sought on all international standards to be adopted in New Zealand. Exposure Drafts of each international standard will be published on the Institute's web site. The EDs comprise, in each case, the international standards (as proposed to be improved) with additional guidance for public benefit entities incorporated into the EDs in shaded boxes. The discussion paper accompanying each ED includes a table that summarises the key differences between the ED and the corresponding New Zealand financial reporting standard (FRS).

The FRSB has also approved for issue the following international EDs:

- IFRIC Draft Interpretation D2 *Changes in Decommissioning, Restoration and Similar Liabilities* and an accompanying Discussion Paper. The discussion paper will be available on the Institute's website at [www.icanz.co.nz](http://www.icanz.co.nz) with a link to the IFRIC Draft Interpretation, which is available on the IASB website. Comments are due to the FRSB by **15 October 2003** and to the IASB by **3 November 2003**.
- IASB ED of proposed amendments to IAS 39 *Financial Instruments: Recognition and Measurement*, which permits hedge accounting to be used more readily for a portfolio hedge of interest rate risk (sometimes referred to as 'macro hedging'). The accompanying discussion paper will be available on the Institute's website at [www.icanz.co.nz](http://www.icanz.co.nz) with a link to the ED, which is available on the IASB website. Comments are due to the FRSB by **31 October 2003** and to the IASB by **14 November 2003**.

### *Insurance Contracts*

The FRSB considered ED FRS-34A: *Life Insurance Activities* (ED FRS-34A) and ED FRS-35: *Financial Reporting of Insurance Activities* (ED FRS-35A) together with the relevant discussion papers. The EDs propose amendments to FRS-34: *Life Insurance Business* and FRS-35: *Financial Reporting of Insurance Activities* as a consequence of ED NZ IASB 5 *Insurance Contracts*. As the two existing standards are substantially the same as the Australian equivalents, the draft EDs will be compared to the amendments being proposed to the Australian standards and will be exposed for comment thereafter.

ED NZ IASB 5 *Insurance Contracts* and the accompanying discussion paper are available on the Institute's website at [www.icanz.co.nz](http://www.icanz.co.nz). The closing date for comments is **24 October 2003** to the FRSB and **31 October 2003** to the IASB.

### *Business Combinations*

The FRSB has also established a working group to consider business combinations. The main issues considered to date are:

- definition of control with particular focus on its application to public benefit entities; and
- reporting date differences within a group. The IASB is proposing a maximum difference of 3 months between the reporting date at which the consolidated financial statements are prepared and the reporting of any subsidiary entity. In New Zealand reporting dates for certain entities are set in legislation and may differ significantly from the parent and group reporting date. For example in New Zealand the schools sector has a statutory reporting date of 31 December and the Crown has a reporting date of 30 June – a six month reporting date difference.

### *Financial Instruments*

A working group has been established to consider the financial instruments and related standards:

- IAS 32 Financial Instruments: Disclosure and Presentation
- IAS 39 Financial Instruments: Recognition and Measurement
- IAS 21 The Effects of Changes in Foreign Exchange Rates
- IAS 29 Financial Reporting in Hyperinflationary Economies.

There are unlikely to be any significant changes necessary to adopt these standards in New Zealand. New Zealand currently has an equivalent standard to IAS 32, but does not have an equivalent standard to IAS 39. A significant effort will be required to educate constituents on the requirements of IAS 39.

### *Tax*

The FRSB has established a working group to consider IAS 12 Income Taxes. Adoption of IAS 12 will significantly change the approach to accounting for income tax in New Zealand. The main focus will be to educate constituents on the new approach.

The working group has met once and is waiting for the IASB improvements before issuing an ED in NZ. It is hoped that a NZ ED IAS 12 will be issued for comment by 2004.

## Auditing and Professional Standards

### *Independence in Assurance Engagements*

In September 2003 the Institute's Council approved Code of Ethics: *Independence in Assurance Engagements*. COE Independence is based on the section 8 of the IFAC Code of Ethics and applies to all members conducting assurance engagements, including members conducting assurance engagements in the public sector. (Note however that the Auditor-General has in the past and will continue to impose more stringent requirements for public sector auditing).

### *Auditing Standards*

The Professional Practices Board has agreed to develop a discussion paper on the implications of adopting International Auditing Standards and to undertake consultation with key stakeholders regarding adoption of ISAs in New Zealand. The PPB confirmed its decision to issue for comment in New Zealand exposure drafts issued by the International Auditing and Assurance Standards Board and has approved for issue:

- ED/AS 206A *The Auditors Responsibility to Consider Fraud in an Audit of Financial Statements* (proposed ISA 240)
- ED/AS 300 *Planning the Audit* (proposed ISA 300).

<b><i>Other PPB EDs Currently on Issue</i></b>	<b><i>Comment Date (2003)</i></b>
ED/AGS-103 <i>Audit Issues Relating to the Electronic Presentation of Financial Reports</i>	30 September
ED/AS-545 <i>Auditing Fair Value Measurements and Disclosures</i>	30 October
ED/TS-1 <i>Tax Compliance Services</i>	30 November

## Central Government

The Minister of Finance announced in a recent speech that the Treasury is beginning to plan the implementation of international standards to the Crown financial statements and to consider the implications for public sector entities such as State-owned Enterprises (GBEs).

The Crown will adopt NZ IFRS as part of the 2007 Budget meaning that the first audited set of Crown financial statements will be as at 30 June 2008. It was decided not to adopt NZ IFRS earlier than 2007 because of the proposed performance reporting standard that is likely to propose significant changes to reporting financial performance and because a number of international standards are likely to change as they are further revised as part of the IASB convergence program.

The Crown Financial Statements for the year to 30 June 2003 will be published next week. These will full consolidate all controlled entities.

## **Local Government**

Local authorities are also beginning to consider the implication of moving to adopt international standards and are likely to follow the lead of the Crown and move to adopt in 2007/08.

Local authorities are in the process of preparing their Long Term Council Community Plans (LTCCP). These plans are required to be prepared in accordance with GAAP. These plans include 10 years of “prospective” financial information. One issue regarding the adoption of international standards is that potentially the 10-year prospective financial information may need to be presented on different bases with part of the financial information being presented in accordance with current NZ GAAP and the balance of the information in accordance with international standards. The use of different bases means that the information may not be comparable and therefore more difficult for users to make sense of.

## **Other Developments**

### *Sustainable Development Reporting (SDR)*

The Institute of Chartered Accountants has established a Sustainable Development Reporting Committee (SDRC) to lead the work program outlined in the report of the SDR Taskforce.

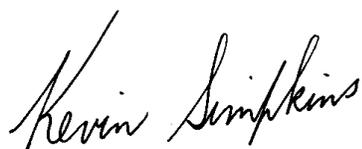
Research contracts have been let to BDO Australia to develop two research bulletins:

- (1) a research bulletin considering the fit of the current conceptual framework for the external reporting of financial and non-financial information with sustainable development measures being externally reported and the evolving information and accountability expectations of users in relation to financial reports; and
- (2) a research bulletin exploring and developing additional guidance on the audit/verification of sustainable development reports, bearing in mind available guidance and emerging international guidance.

The research bulletins are scheduled for completion in late 2003, while a discussion paper which explores defining sustainable development in the context of general purpose financial reporting is also on the same timeline.

The SDRC is also working to define sustainable development in the context of general purpose financial reporting.

If you have any questions about any of these matters please feel free to raise any issues with me.



Kevin Simpkins  
**NEW ZEALAND REPRESENTATIVE**

## COUNTRY REPORT FOR THE IFAC PSC

### SOUTH AFRICA

**September 2003**

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#### 1. **Accounting Standards Board (ASB)**

The following documents were reviewed by the ASB at its last meeting:

- A draft Framework for the preparation and presentation of financial statements. Comments made by the ASB will be incorporated and it is hoped that the document will be approved for exposure at its next meeting.
- A request to issue a local exposure draft concurrently with the international exposure draft on impairment of assets. The request was approved and the exposure draft will be released shortly.
- Nine exposure drafts of the revised Statements of Generally Accepted Municipal Accounting Practice (GAMAP) and a draft preface. The exposure drafts will be implemented by local government as an interim measure until the ASB issues accounting standards that are applicable to all tiers of government. Five existing Statements of GAMAP has been withdrawn as the accounting requirements in these documents have been overtaken by developments internationally and nationally and are no longer appropriate.

#### 2. **Auditing Standards Committee**

The following exposure drafts based on exposure drafts issued by the International Audit and Assurance Board, applicable to audits in the private and public sectors are open for comment:

<i>Title</i>	<i>Comment Date:</i>
IFAC ED Review of Interim Financial Information	15 September 2003
IFAC ED Fraud in Audit	31 October 2003
IFAC ED Audit Planning	31 October 2003

### 3. **South African Institute of Chartered Accountants (SAICA)**

The following exposure drafts are open for comment:

<i>Title</i>	<i>Comment Date:</i>
ED 163 Framework for the Preparation and Presentation of Limited Purpose Financial Statements	31 October 2003
ED 164 Disposal of Non-current assets and presentation of discontinued operations	10 October 2003
ED 165 / ED 5 Insurance Contracts	17 October 2003
ED 166 Fair value hedge accounting for a portfolio hedge of Interest rate risk	31 October 2003
ED 168 Proposed Circular on Implementation Guidance for AC 133: Financial Instruments – Recognition and Measurement	10 October 2003

### 4. **Local Finance Management Bill**

The Local finance management Bill was tabled on 11 September 2003 in Parliament. The Bill covers for the local sphere of government the same issues that the Public Finance Management Act (Act 1 of 199) covers for the national and provincial spheres.

#### **Constitutional Amendments**

The Bill also involved two significant rounds of amendments to the Constitution. The first amendment passed in 2001 amended section 230 of the Constitution, which deals with municipal borrowing, by adding a new section 230A to permit municipal borrowing and long-term contracts. A second amendment was effected early this year to section 139 of the Constitution on provincial intervention in municipalities, by allowing for a process of mandatory intervention in the event of a serious financial crisis in a municipality where the ability to provide basic services are impaired.

Both these amendments were necessary, not only to resolve municipal financial crises, but also to protect municipalities and to reduce the risk premium for municipalities when they borrow funds. It protects municipalities whilst they are resolving their problems, to enable them to continue providing services. It also provides certainty to lenders and investors about action that can be taken against a municipality that do not meet their financial obligations. In this respect, provincial governments will have to rise to the challenge of assisting or intervening earlier when municipalities experience financial problems, rather than ignoring the problem. Compliance by provincial governments to monitor municipal finances, and to act when problems are first identified, is critical for good governance in South Africa.

National government is committed to facilitating a municipal borrowing market, and will take steps to ensure that all spheres of government act on their constitutional responsibilities. This commitment will enable government to maximize delivery, and allow municipalities to lower their costs of borrowing for capital expenditure and to attract investors. The monthly reporting system in the Bill offers a powerful mechanism to both the municipal council and province to assist them in their monitoring role, on a monthly or quarterly basis. This early warning system is already being used very successfully in the monitoring of provincial finances.

The bill does not only permit municipalities to borrow and provide mechanisms for resolving financial problems in a municipality, it goes much further. It also attempts to modernize the approach to budgeting and financial management in municipalities.

### **Budget Reforms**

The Bill will introduce budget reforms to municipalities over the next few years. As with the PFMA, the approach to financial management gives effect to the principle of ensuring effective accountability for the policy and implementation processes. The Mayor will be responsible for policy and outcomes, and the

Municipal Manager responsible for outputs and implementation. Whilst the Municipal Manager is accountable to the Mayor or Executive, both are also accountable to the Municipal Council, which must approve the policy proposals and budget, and play an oversight role over their implementation and outputs.

The Bill spells out clearly the role of Councillors, Mayors, Municipal Managers and other officials in their engagement with the municipal budget and its implementation, procurement or supply chain management and municipal entities. It spells out the policy-guiding role that the Mayor plays in the budget process, and in setting performance targets for the Municipal Manager. It makes the Municipal Manager the accounting officer responsible for implementation of policies approved by the Council, and in accordance with the performance contract agreed to with the Mayor.

### **Annual and Monthly Reports**

The Bill imposes tough sanctions against a Municipal Manager or municipality that fails to submit its financial statements within two months after the end of the financial year. This measure is in line with the PFMA, and deals with the legacy of lethargy in submitting financial statements promptly after the end of the financial year.

The annual report will include reports on performance, to be audited in terms of the Systems Act. The annual report will also include details of all intergovernmental grants, ensuring that these are all budgeted for by the municipality, and spent in accordance with the approved budget. The Bill also obliges municipalities to disclose the salaries and remuneration of the Mayor, Municipal Manager, Councillors and senior officials.

Just as important are the provisions requiring monthly and quarterly reports on finances and service delivery. These reports enable the both the Municipal Manager and Mayor to be pro-active in dealing with problems of implementation as they arise. They allow councillors and provincial government to monitor the

performance of the municipality in-year, without waiting for the annual report, which is only published after the end of the financial year. All these reporting mechanisms are in line with international best practice on fiscal and financial reporting.

The Bill ends the practice of undisclosed or unaudited banking accounts or investments by municipalities. It requires each municipality to open bank accounts into which all money received must be paid. The Municipal Manager is made responsible for how these accounts are managed. Municipal investments will be completely transparent, and must be in accordance with the investment framework prescribed by the National Treasury.

The Bill also provides strong measures for dealing with financial misconduct and grossly negligent behaviour.

### **Co-operative Governance**

The Bill gives effect to Chapter 3 of the Constitution dealing with Co-operative Governance. It facilitates greater co-ordination between the spheres of government, especially in the areas of budgeting, planning, policy implementation and auditing process. It also allows for the alignment of the intergovernmental development plan and the budget of a municipality, within a balanced budget framework, including a realistic projection of revenue to be collected. The Bill promotes a more consultative and transparent process for national organs of state providing bulk resources such as electricity and water to municipalities, especially around price setting policies. There is also a process to manage intergovernmental financial disputes.

The Bill will also promote public-private partnerships by allowing municipalities to enter into long-term contracts, subject to a regular review. Municipalities that ensure proper consultative process with the relevant national departments will be exempted from any tariff-capping legislation that may prevent the private sector from entering into long-term contracts with municipalities.

The bill allows for a greater degree of consultation and communication with communities, residents, ratepayers, lending institutions etc. Municipalities must ensure greater accessibility to important documents such as the budget, quarterly and annual reports on their websites, and to all communities they service.