

HARMONISATION

OF

**GENERALLY ACCEPTED
ACCOUNTING PRINCIPLES
(GAAP)**

AND

**GOVERNMENT FINANCE STATISTICS
(GFS)**

MARCH 2004

ACCOUNTING BRANCH

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1 OVERVIEW

What is happening?

Current Australian whole-of-government reporting arrangements require the preparation of two sets of financial reports, that is, financial reports in accordance with Generally Accepted Accounting Principles (GAAP), and reports in accordance with Government Finance Statistics (GFS). Although the ACT principally focuses on its GAAP reporting, most Australian jurisdictions use their GFS reporting as their headline reporting, particularly for budget presentation. This dual reporting regime causes considerable confusion for financial report users, as the headline budget information is not comparable across jurisdictions.

As a result of these problems, the Australian Accounting Standards Board (AASB) is currently revising the government Australian Accounting Standards to harmonise GAAP and GFS financial reporting. The objective of this harmonisation is to achieve a single set of Government reports that are auditable and comparable between jurisdictions. This harmonisation will affect whole-of-government and agency financial reporting.

When is it happening?

It is anticipated that the harmonised government standards will be operative for financial years commencing on or after 1 July 2005. This means that the harmonised government standards will take effect at the same time as the new Australian International Financial Reporting Pronouncements.

Also, to ensure comparability between budgets and actuals, the 2005-06 Budget will need to reflect the new harmonised government accounting standards.

What magnitude of change is presently envisaged?

Exposure drafts of the proposed harmonised government standards have yet to be released and are not expected until July 2004. However, based on preliminary AASB decisions, the most significant change will be new financial statement formats, particularly the Statement of Financial Performance.

The AASB is considering disclosing revenue and expenses resulting from the re-measurement of assets and liabilities separately on the Statement of Financial Performance. Revenue and expenses resulting from re-measurements include the net gains / losses from the disposal of assets, amounts arising from asset revaluations and asset impairment expenses. Under the proposed new format, agencies would report a net operating result before re-measurements and another net operating result after re-measurements.

It is envisaged that agencies will need to amend their chart of accounts and financial reports to accommodate the new reporting format, commencing from 1 July 2005.

What do I need to do now?

At present, agencies need only keep abreast of GAAP / GFS harmonisation information provided by the Accounting Branch or included in relevant external publications e.g. the monthly CPA magazine. During 2004-05 agencies will likely be impacted by the GAAP / GFS harmonisation process through preparation of budget financial statements in accordance with the changed format and chart of accounts restructuring to apply from 1 July 2005.

What will the Accounting Branch provide?

The Branch will communicate with agencies information regarding required changes via its website, the quarterly Financial Information Bulletin Service (FIBS), Treasury Memoranda and through training sessions. Model Financial Statement will be provided for 2005-06 that are compliant with the GAAP / GFS harmonised format and disclosure requirements.

2 BACKGROUND

Current Australian whole-of-government reporting arrangements require the preparation of two sets of financial reports, that is, financial reports in accordance with Generally Accepted Accounting Standards (GAAP), and reports in accordance with Government Finance Statistics (GFS).

Both frameworks exist to provide financial information to interested parties and decision makers. There is substantial overlap between the principles, practices and measurement methods adopted by both frameworks. However, the reasons for adopting those principles, practices and measurements sometimes differ between these frameworks. The GAAP framework focuses on accountability and resource allocation. In comparison, the GFS framework focuses on the economic impact the government sector has on the other sectors of the economy.

Although the ACT principally focuses on its GAAP reporting, most Australian jurisdictions use their GFS reporting as their headline reporting, particularly for budget presentation. As a result, this dual reporting regime causes considerable confusion for financial report users, as the headline budget information is not comparable across jurisdictions. Also, users have expressed concern that GFS basis data has not been uniformly subject to audit clearance.

In December 2002, as a consequence of lobbying by the Heads of Treasuries, the Australian Accounting Standards Board (AASB) was directed to “pursue as an urgent priority the harmonisation of GFS and GAAP financial reporting.” The objective of this harmonisation is to achieve a single set of Government reports that are auditable and comparable between jurisdictions (within Australia and internationally).

3 GOVERNMENT FINANCE STATISTICS (GFS) EXPLAINED

3.1 GFS Objectives

GFS financial reporting requirements are determined by the International Monetary Fund, with input from many other world organisations such as the United Nations. GFS principles are based on the principals contained in the United Nation's System of National Accounts. GFS measures the financial activities of governments to enable the impact of those activities to be assessed on other sectors of the economy, as well as meeting other statistical requirements. GFS financial reporting requirements have been developed specifically to accommodate differences in the activities of governments compared to activities in the private sector.

Another key objective of the GFS is to ensure that all governments present their budgets and end of year results on a uniform and comparable basis. In Australia, the Commonwealth, States and Territories undertake GFS reporting at the whole-of-government level. Some of the key users of GFS financial reports are the Australian Bureau of Statistics (ABS) and the Australian Loan Council.

3.2 GFS Financial Statements

As illustrated in Figure 1 “GFS Reporting Framework”, four primary financial statements are produced under GFS:

- *Operating Statement (also referred to as a Statement of Government Operations)* – presents details of revenue and expense transactions, as well as the net acquisition of non-financial assets. The GFS Operating Statement contains two headline measures. *GFS net operating balance* is revenue less expenses and represents government savings. The *GFS net lending* is the GFS net operating balance minus net capital investment. GFS net lending measures the gap between government savings and investment in non-financial assets. As such, it approximates the contribution of the government sector to the balance on the current account in the balance of payments;
- *Statement of Other Economic Flows* – reflects changes to stocks (assets and liabilities) that do not result from a transaction. Other economic flows arise from changes to stocks caused by price movements such as revaluations and circumstances relating to the destruction of assets, for example, by bushfire;
- *Balance Sheet* – reflects stocks of assets, liabilities and *net worth*. Net worth is an economic measure of wealth and reflects the contribution of government to the wealth of Australia. Net worth is calculated as assets less liabilities. Movement in net worth during a financial year equals the net operating balance plus the change due to other economic flows; and
- *Cash Flow Statement* – identifies how cash is generated and applied during the financial year.

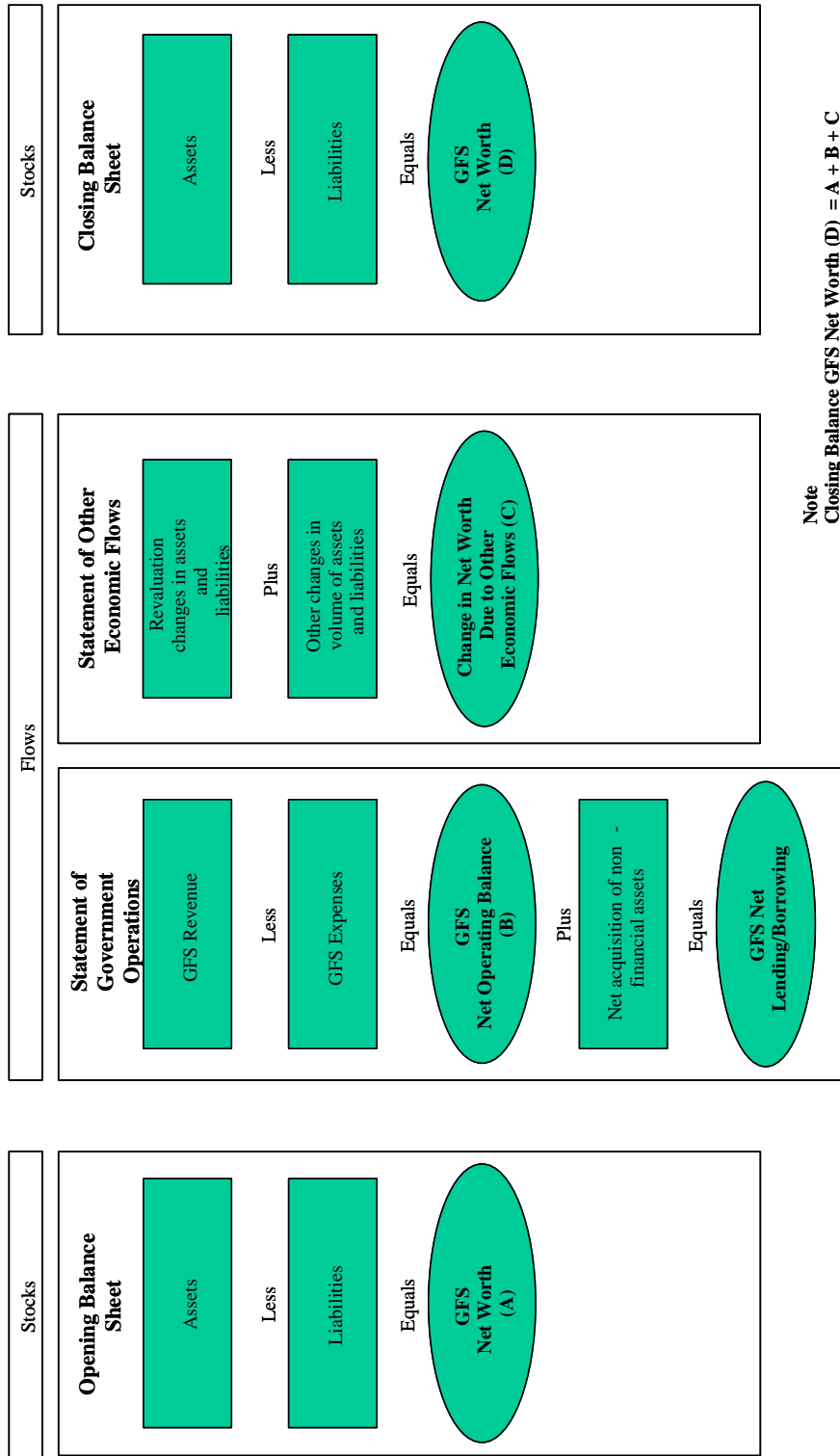
3.3 Key Conceptual Difference– Other Economic Flows

GFS makes a distinction between revenue and expense transaction flows resulting directly from economic activities, and other economic flows resulting from, among other things, asset price movements. Transactions are perceived as reflecting policy and managerial decisions, while other economic flows arise more passively – often without active decision-making.

Accounting Standards do not make the GFS distinction between transaction and other economic flows. Instead, Accounting Standards consider that entity management is responsible for the effective management of all resources, including transactions and movements in market values. Current GAAP does not specifically isolate market value movements in financial reports.

3.4 Figure 1: GFS Reporting Framework

GFS Reporting Framework



4 PROCESS FOR HARMONISING GAAP AND GFS

4.1 What does harmonisation mean?

The AASB has been directed to harmonise GAAP and GFS reporting into “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 AASB has interpreted this direction as follows:

- Harmonisation is to apply to all public sector entities:
 - whole-of-government reporting by State, Territory and Commonwealth governments;
 - reporting by entities within the General Government Sector (GGS), such as Departments; and
 - local governments.
- Harmonisation does not mean the replacement of existing GAAP with GFS. Rather, the principle is “convergence to a high quality standard” with consideration being given to definition, recognition, measurement, presentation and/or disclosure requirements. This is a point of contention with some jurisdictions, as some jurisdictions consider that the outcome of this harmonisation project should be financial statements that materially match the financial information, or at least the key financial totals, published by the Australian Bureau of Statistics. This issue has yet to be fully resolved; and
- Harmonisation does not require the AASB to develop standards for budgetary reporting.

4.2 How will harmonisation affect existing Australian Accounting Standards?

Harmonisation will be achieved through the amendment of the existing Government Australian Accounting Standards. The standards will be amended in three phases:

- Phase 1: AAS 31 “Financial Reporting by Governments” - this phase includes the consideration of issues relating to whole-of-government sector reporting;
- Phase 2: AAS 29 “Financial Reporting by Government Departments” - in conjunction with amending this standard for GAAP / GFS harmonisation, the AASB will also review the existing provisions of the standard. One issue to be reviewed is whether the application of AAS 29 should be extended to apply to all General Government Sector entities; and
- Phase 3: AAS 27 “Financial Reporting by Local Governments”.

4.3 AASB Process and Timing

Jurisdictions identify the issues

The first step to achieving harmonisation is the identification of all the conceptual and technical differences that currently exist between the two frameworks. In this respect the AASB is leveraging off the work undertaken by a Heads of Treasury Accounting and Reporting Advisory Committee (HOTARAC) working party. The working party has examined both frameworks and prepared conceptual, technical and logistical papers, identifying issues and proposing solutions. This work is now complete.

Consultation on the issues

In November 2003, the AASB established a Project Advisory Panel to examine the issues and proposed solutions put forward by the working party. The Panel is comprised of government financial report preparers, financial report users and technical specialists. The purpose of the Panel is to provide advice to the AASB on the issues and possible solutions. Initial Panel input was completed early February 2004 and this information is currently being collated.

Exposure Draft

Based on the advice received from the Project Advisory Panel, the AASB will make in-principle decisions on key harmonisation issues. An exposure draft for AAS 31 “Financial Reporting by Governments” will then be prepared based on these decisions. It is anticipated that an exposure draft on AAS 31 will be available for formal public consultation in July 2004. An exposure draft on AAS 29 “Financial Reporting by Government Departments” will follow later in 2004.

Operative Date for harmonised standards

It is anticipated that the revised government standards will be operative for reporting years commencing on or after 1 July 2005. This means that agencies will be applying the new GAAP / GFS standards at the same time as the new Australian International Financial Reporting Pronouncements (AIFRPs).

4.4 Harmonisation issues

While there are many similarities in treatment and presentation under the two systems, there are some fundamental differences. A Heads of Treasury Accounting and Reporting Advisory Committee (HOTARAC) working party has examined both frameworks and has concluded:

- some differences will be resolved with the selection of particular accounting treatment options allowed under the new Australian International Financial Reporting Pronouncements e.g. agencies must select the accounting standard option to expense all borrowing costs, to achieve harmonisation with the GFS expensing treatment;
- some differences will be resolved by the new format of the Statement of Financial Performance currently being developed by the International Accounting Standards Board (see 4.5 Format of Financial Statements);

- some differences will be resolved by anticipated changes in GFS e.g. it is anticipated that GFS will amend its treatment for allowances for bad and doubtful debts to be more consistent with GAAP treatment ; and
- where there are any remaining differences, it is proposed that either GFS treatment be adopted in the Government AAS trilogy (that is, AAS's 27, 29 and 31) or GAAP treatment be adopted with GFS disclosures in the relevant notes. This is one of the major areas of contention with the AASB. The AASB is reluctant to adopt GFS treatments where the GFS treatment breaks fundamental generally accepted accounting principles. The appropriate treatment for the payment of dividends is one of these remaining differences, as GAAP accounts for the payment as an equity transaction and GFS accounts for the payment as an expense.

4.5 Format of Financial Statements

Statement of Financial Performance

The International Accounting Standards Board is currently undertaking a performance reporting project, to revise the format of the Statement of Financial Performance. This project recognises that the 'bottom-line' is not necessarily a useful number due to some large values appearing on the Statement of Financial Performance related to the re-measurement of assets and liabilities.

The project proposes disclosing revenue and expenses resulting from the re-measurement of assets and liabilities separately on the Statement of Financial Performance. Revenue and expenses resulting from re-measurements include net gains / losses from the disposal of assets, amounts arising from asset revaluations and asset impairment expenses. Under the proposed new format, agencies would report a net operating result before re-measurements and another net operating result after re-measurements.

As demonstrated in Figure 2 "GAAP – Proposed Comprehensive Reporting Framework", this new Statement of Financial Performance format assists with GAAP / GFS harmonisation as:

- revenue and expenses before re-measurements is broadly equivalent to the GFS Operating Statement; and
- re-measurement revenue and expenses is broadly equivalent to GFS other economic flows.

The AASB has indicated that it will early adopt the new Statement of Financial Performance format in the government accounting standards in order to facilitate the harmonisation process.

Attachment A includes a proforma of the new Statement of Financial Performance format, as recommended by the working party.

Statement of Financial Position

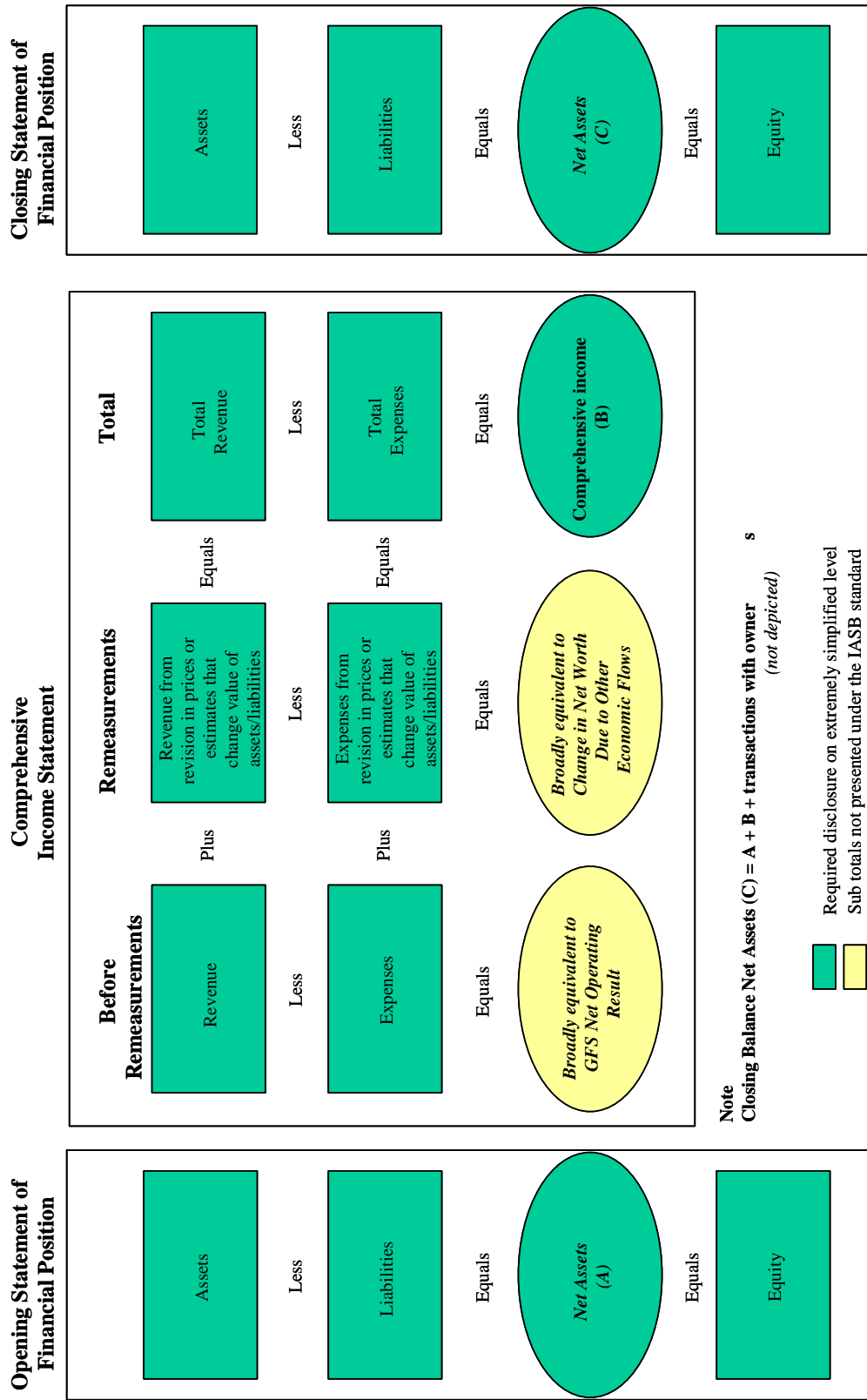
The GFS Balance Sheet focuses on the economic impact the government sector has on the other sectors of the economy by classifying assets and liabilities as ‘financial’ and ‘non-financial’. In comparison, accounting standards require assets and liabilities to be classified as current and non-current.

To facilitate harmonisation, the working party has recommended that assets and liabilities be classified as ‘financial’ and ‘non-financial’ with the total current and non-current figures separately disclosed at the bottom of the Statement of Financial Position.

Attachment A includes a proforma of the new Statement of Financial Position format, as recommended by the working party.

4.6 Figure 2: GAAP – Proposed Comprehensive Reporting Framework

GAAP – Proposed Comprehensive Reporting Framework



5 ACT IMPLEMENTATION PLAN

5.1 Role of the Accounting Branch

The Accounting Branch has a key role in the implementation of any GAAP / GFS harmonised Australian Accounting Standards in the Territory. The Accounting Branch will identify significant changes in financial reporting requirements resulting from harmonisation, update the Model Financial Statements to be consistent with the new requirements and will assist agencies with addressing specific issues of application.

Since 2003 the Accounting Branch has participated in a working party with other Australian jurisdictions to identify the harmonisation issues and propose solutions to the AASB. This role will continue until the AASB releases the new GAAP / GFS harmonised Government Accounting Standards in 2004.

During the next two and a half years (until June 2006), the Branch will undertake the following tasks:

- Keep agencies appraised on an on-going basis of the changes to accounting standards, using the Accounting website and the quarterly Financial Information Bulletin (FIBS);
- Issue Treasury Memoranda advising agencies of processes regarding implementation of GAAP / GFS harmonisation;
- Conduct financial reporting training;
- Update the Accounting Policy Manual for changes resulting from the harmonisation; and
- Update the Model Financial Statements for changes resulting from the harmonisation.

It will be the responsibility of individual agencies to identify the impact of the advised changes in government accounting standards to the specific circumstances of their agency and implement the necessary changes to the agency's accounting system, processes and reports.

5.2 Annual financial statements

It is currently anticipated that the government GAAP / GFS harmonised standards will take effect from 1 July 2005. This means that the 30 June 2006 financial statements will be the first financial statements prepared in accordance with the new statement formats. The commencement of the GAAP / GFS harmonised standards will coincide with the adoption of International Accounting Standards.

5.3 Budgets

To ensure comparability between budgets and actuals, the 2005-06 budget should also reflect GAAP / GFS harmonisation presentation. Providing the new accounting standards are released on time, it is presently intended that the 2005-06 Budget be prepared in accordance with the changed reporting format.

5.4 Key implementation dates (Table 1)

Stages	Timing	Action
Preparation	Current	AASB considering the issues and making tentative decisions.
	June 2004	Accounting Branch to provide harmonisation training to agencies, based on known AASB decisions.
	By end of July 2004	AASB to have issued an Exposure Draft on AAS 31 "Financial Reporting by Governments" incorporating GAAP / GFS harmonisation.
	End of Sept / October 2004	AASB to have issued AAS 31 "Financial Reporting by Governments" incorporating GAAP / GFS harmonisation.
	October / November 2004	Accounting Branch to release a Treasury Memo advising agencies the implications of GAAP / GFS harmonisation.
Analysis Of Application Issues	Late 2004	Agencies and FABM to factor any significant harmonisation impacts into the Budget Process for 2005-06.
	February 2005	Accounting Branch to release changes to the Accounting Policy Manual (APM) if required, reflecting GAAP / GFS harmonisation.
	February / June 2005	Agencies and FABM to assess changes required to financial accounting systems to accommodate the new reporting format e.g. chart of accounts.
	May 2005	Accounting Branch to provide harmonisation training to agencies.
Full Implementation	1 July 2005	Agencies to commence financial reporting using GAAP / GFS harmonisation
	January / February 2006	Accounting Branch to release Model Financial Statements for 2005-06.
	May 2006	Accounting Branch to provide Financial Reporting Training to agencies.
	30 June 2006	Agencies' first financial reporting using GAAP / GFS harmonisation.

6 WHAT SHOULD I BE DOING NOW

Table 1 “Key Implementation Dates” identifies three stages in the ACT Harmonisation Implementation Plan.

6.1 Preparation stage

During the ‘Preparation Stage’ from now until the end of October 2004, agencies need to keep up-to-date with developments in GAAP / GFS harmonisation via updates to our website, announcements by the AASB and articles in relevant external publications e.g. the monthly CPA magazine.

6.2 Analysis of application issues

During the second phase of the implementation, commencing November 2004, agencies will be required to:

- factor harmonisation impacts into the 2005-06 Budget, which is likely to commence late 2004; and
- assess the changes require to chart of accounts and financial reports to accommodate the new reporting format.

6.3 Full implementation stage

The final phase is full implementation of harmonisation commencing 1 July 2005 for financial year reporting agencies. Full implementation is likely to require agencies to:

- commence using a new chart of accounts; and
- commence financial reporting using harmonisation formats and disclosures.

ACRONYMS

AAS	Australian Accounting Standard Existing standards followed by governments and the not-for-profit sector e.g. AAS 29 "Financial Reporting By Government Departments".
AASB	Australian Accounting Standards Board The AASB is responsible for issuing Australia's accounting standards.
AIFRP	Australian International Financial Reporting Pronouncements AIFRPs comprise: (a) accounting standards issued by the AASB that are equivalent to standards issued by the IASB, being AASBs 1-99 corresponding to the IFRS series and AASBs 101-199 corresponding to the IAS series; and (b) UIG Abstracts issued by the AASB corresponding to the international interpretations issued by IFRIC and the former SIC.
ED	Exposure Draft Exposure drafts are proposed standards released for comment by the AASB or IASB e.g. ED 125 "Financial Reporting by Local Governments".
GAAP	Generally Accepted Accounting Principles. The conventions, rules and procedures that define accepted accounting practices.
GFS	Government Finance Statistics Measures the financial activity of governments to enable the impact of those activities to be assessed on other sectors of the economy. All governments must produce this information for the Australian Bureau of Statistics.
GGS	General Government Sector Agencies which provide non-market goods and services primarily for collective consumption of the community. These agencies are mainly funded by government appropriations.
IASB	International Accounting Standards Board The IASB is a multi-national board responsible for issuing international financial reporting standards.
SNA	System of National Accounts The System of National Accounts is a framework for the collection and compilation of economic data for all sectors of the economy to facilitate macro-economic analysis, decision taking and policy making.

ATTACHMENT A: PROPOSED NEW FINANCIAL STATEMENT FORMAT

Australian Capital Territory Consolidated Total Territory Statement of Financial Performance and Fiscal Impact

	2004-05	2005-06	2006-07	2007-08	2008-09
	Est.Outcome	Budget	Var	Budget	Budget
	\$'000	\$'000	%	\$'000	\$'000
Revenues Before Re-measurements					
Taxes Fees and Fines					
User Charges - Non ACT Government					
Grants from the Commonwealth					
Interest					
Revenue from Associates and Joint Ventures					
Other Revenue					
Resources Received Free of Charge					
Total Revenues Before Re-measurements					
Expenses Before Re-measurements					
Employee Expenses					
Superannuation					
Supplies and Services					
Depreciation and Amortisation					
Borrowing Costs					
Cost of Goods Sold					
Grants and Purchased Services					
Other Expenses					
Expenses of Associates and Joint Ventures					
Total Expenses Before Re-measurements					
Net Operating Result Before Re-measurements					
Re-measurements					
Financial Instruments Net Gains/(Losses)					
Superannuation Actuarial Net Gains/(Losses)					
Disposal of Assets Net Gains/(Losses)					
Impairment of Assets					
Property Plant and Equipment Revaluation					
Other Adjustments					
Other Non-Owner Related Equity Movements					
Share of Net Result from Associates and Joint Ventures					
Accounted for Using the Equity Method					
Total Re-measurements					
Net Result After Re-measurements					

KEY FISCAL AGGREGATES

Net Operating Result Before Re-Measurements	
Measurement Differences Between GAAP and GFS	
GFS Net Operating Balance	
<i>Less</i> Acquisitions less Disposals of Non-financial Assets	
<i>Less</i> Depreciation	
<i>Plus</i> Change in Inventories	
<i>Plus</i> Other Transactions in Non-Financial Assets	
Total Net Acquisitions of Non-Financial Assets	
GFS Net Borrowing / Lending	

ATTACHMENT A: CONTINUED

**Australian Capital Territory
Agency
Statement of Financial Performance**

	2004-05	2005-06		2006-07	2007-08	2008-09
	Est.Outcome	Budget	Var	Budget	Budget	Budget
	\$'000	\$'000	%	\$'000	\$'000	\$'000
Revenues Before Re-measurements						
Taxes Fees and Fines						
User Charges - Non ACT Government						
Grants from the Commonwealth						
Interest						
Revenue from Associates and Joint Ventures						
Other Revenue						
Resources Received Free of Charge						
Total Revenues Before Re-measurements						
Expenses Before Re-measurements						
Employee Expenses						
Superannuation						
Supplies and Services						
Depreciation and Amortisation						
Borrowing Costs						
Cost of Goods Sold						
Grants and Purchased Services						
Other Expenses						
Expenses of Associates and Joint Ventures						
Total Expenses Before Re-measurements						
Net Operating Result Before Re-measurements						
Re-measurements						
Financial Instruments Net Gains/(Losses)						
Superannuation Actuarial Net Gains/(Losses)						
Disposal of Assets Net Gains/(Losses)						
Impairment of Assets						
Property Plant and Equipment Revaluation						
Other Adjustments						
Other Non-Owner Related Equity Movements						
Share of Net Result from Associates and Joint Ventures						
Accounted for Using the Equity Method						
Total Re-measurements						
Net Result after Re-measurements						

ATTACHMENT A: CONTINUED

**Australian Capital Territory
Statement of Financial Position**

	Est. Outcome as at 30/06/05 \$'000	Planned as at 30/06/06 \$'000	Var %	Planned as at 30/06/07 \$'000	Planned as at 30/06/08 \$'000	Planned as at 30/06/09 \$'000
ASSETS						
Financial Assets						
Cash						
Receivables						
Investments						
Other Financial Assets						
Total Financial Assets	<hr/>					
Non-Financial Assets						
Investments						
Inventories						
Property, Plant and Equipment						
Intangibles						
Capital Works in Progress						
Other						
Total Non-Financial Assets	<hr/>					
TOTAL ASSETS	<hr/>					
LIABILITIES						
Payables						
Interest Bearing Liabilities						
Finance Leases						
Employee Benefits						
Other Provisions						
Other						
TOTAL LIABILITIES	<hr/>					
NET ASSETS	<hr/>					
REPRESENTED BY FUNDS						
EMPLOYED						
Accumulated Funds						
Reserves						
TOTAL FUNDS EMPLOYED	<hr/>					
Current Assets	<hr/>					
Non-Current Assets	<hr/>					
TOTAL ASSETS BY MATURITY	<hr/>					
Current Liabilities	<hr/>					
Non-Current Liabilities	<hr/>					
TOTAL LIABILITIES BY MATURITY	<hr/>					