

**COUNTRY REPORT FOR THE IPSASB**  
**SOUTH AFRICA**  
**OCTOBER 2005**

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

The following documents are currently open for comment:

The exposure drafts on proposed Standards of GRAP, with a closing date for comment of 31 January 2006, on:

*3.1 Revenue from Exchange Transactions*

*3.2 Agriculture*

*3.3 Non-Current Assets held for Sale and Discontinued Operations*

Invitations to comment on discussion papers on:

*3.4 Heritage Assets; and* (Comment due date 31 October 2005)

*3.5 Intangible Assets* (Comment due date 31 October 2005)

A draft *Guideline on Accounting for Public-Private Partnerships* (Comment due date 30 November 2005)

**2. Auditing and Assurance Standards Board**

The following exposure drafts are currently open for comment:

<i>Title</i>	<i>Comment Date:</i>
IFAC ED Special Reports	17 Oct 2005

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

The following exposure drafts are open for comment:

<b><i>Title</i></b>	<b><i>Comment Date</i></b>
ED 204 - Amendments to IAS 37(AC 130) Provisions, Contingent Liabilities and Contingent Assets and IAS 19(AC 116) Employee Benefits	7 October 2005
ED 203 - Amendments to IAS 27(AC 132) Consolidated and Separate Financial Statements	7 October 2005
ED 202 - Amendments to IFRS 3(AC 140) - Business Combinations	7 October 2005

South African Statements of GAAP are fully harmonized with IFRS. The international text is used and a South African wrap around is added.

#### **4. Auditing Profession Bill**

The bill was published on 30 August 2005 and the comment period closed on 30 September 2005.

In South Africa the auditing profession is currently regulated under the Public Accountants' and Auditors' Act, Act No. 80 of 1991 ("PAA Act"). The need has arisen to replace this Act and to improve the integrity of South Africa's financial sector and financial reporting by introducing a more comprehensive and modern legislative framework for overseeing and regulating the auditing profession.

The Bill must be read together with the Companies Act Amendment Bill 2005.

The Companies Act Amendment Bill entrenches and safeguards the independence of auditors within the corporate environment.

The Bill seeks to—

- (a) contribute towards the protection of the public interest in the Republic of South Africa in respect of audit services rendered by registered auditors;
- (b) establish a juristic person to be known as the Independent Regulatory Board for Auditors that will be responsible for overseeing and regulating the auditing profession;
- (c) prescribe standards for auditor ethics in the promotion and maintenance of internationally comparable standards of professional ethics by registered auditors;
- (d) prescribe standards for auditing in the development and maintenance of internationally comparable auditing standards in the Republic in a manner that is responsive to the expectations of business, financial institutions and the general public.

**IFAC INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARDS BOARD**  
**IFAC IPSASB MEETING – November-December 2005**

**COUNTRY REPORT – AUSTRALIA**  
(Prepared 17 October 2005)

In general, this Country Report only notes events since the last Report was prepared for the July 2005 IPSASB 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).

Projects for which substantial progress has been made are outlined in the following.

***IPSASB and AASB***

The AASB is continuing to monitor the IPSASB projects. In reaction to the recent issue of four Exposure Drafts by the IPSASB, the AASB issued a media release – a copy of which is attached to this Report.

***GAAP/GFS Convergence***

The AASB is continuing to implement the Financial Reporting Council's strategic direction to give urgent priority to GAAP/GFS harmonisation. It has issued ED 142 *Financial Reporting of General Government Sectors by Governments* for comment by 21 October 2005.

As reported in the last Country Report, the AASB has deferred decisions on the extent to which its decisions on General Government Sector (GGS) financial reporting should be adopted into financial reporting by whole of governments, Public Non-Financial Corporations (PNFC) sectors, Public Financial Corporations (PFC) sectors, government departments, statutory bodies, local governments, universities, government business enterprises and other public sector entities.

***Review of AASs 27, 29 & 31 and a Strategy for Public Sector Standards***

Following consideration of the advances made in financial reporting by entities subject to AAS 27 *Financial Reporting by Local Governments*, AAS 29 *Financial Reporting by Government Departments* and AAS 31 *Financial Reporting by Governments* since those standards were first issued, the Board decided to propose their withdrawal and leave all other generically applicable accounting standards, amended where necessary, to apply in their own right. To this end, the Board is in the process of finalising a Strategy Paper outlining a strategy for the orderly withdrawal of AASs 27, 29 & 31 and an ongoing strategy for dealing with public sector issues. In withdrawing AASs 27, 29 & 31, the Board is aiming to avoid creating a vacuum of guidance, particularly relating to definition, recognition and measurement issues.

Given the age of AASs 27, 29 & 31, the Board will also take the opportunity to review the extent to which governments, government departments and local government should continue to be subject to requirements that differ from requirements applicable to other not-for-profit entities and for-profit entities contained in Australian Accounting Standards where those requirements result in like transactions and events being accounted for and reported

differently. Differences will be removed, where appropriate and timely, to improve the overall quality of financial reporting. Furthermore, to the extent AASs 27, 29 & 31 have not kept up with contemporary accounting thought, it is timely that they be reviewed.

Because AASs 27, 29 & 31 address a range of issues that are not explicitly addressed in other standards, the Board is in the process of considering how those issues should be dealt with.

Priority technical topics to be considered by the Board include:

- Non-exchange revenue (see the next major section of this Report);
- Land under roads (see further comments below);
- Restructures of administrative arrangements (see further comments below);
- Accounting for restructures of local governments;
- Liabilities arising from public policies of government;
- Local governments, government departments and governments as reporting entities; and
- Net cost of services format of the income statement.

#### *Land Under Roads*

The Board intends retaining, but not extending, the current transitional relief from the recognition of land under roads.

#### *Restructuring of Administrative Arrangements*

The Board decided that, consistent with the current generally accepted treatment of restructures of commonly controlled entities, a transfer arising as a consequence of a restructure of administrative arrangements should be treated as a distribution to owners by the transferor and a contribution by owners by the transferee. The Board also decided that it is not necessary to explicitly address the measurement basis to be adopted for the transferred assets and liabilities because AASB 3 *Business Combinations* does not address this issue for a restructure of entities under common control. In addition, the Board decided to propose that AASB 1004 *Contributions* be amended to specify the proposed accounting requirements relating to restructures of administrative arrangements from both transferee and transferor perspectives.

Other technical topics to be considered by the Board in due course in light of the withdrawal of AASs 27, 29 & 31 include:

- Administered items (see further comments below)
- Definition of not-for-profit entity
- Control of an entity
- Measurement of contributions by owners as owners
- Service concessions
- Heritage assets
- Classification according to function or activity, disaggregated information and segment reporting
- Budget reporting
- Related party disclosures
- Other disclosures: restricted assets, non-compliance and performance indicators.

### *Disclosure of Administered Items*

The Board agreed that an accounting standard dealing specifically with administered items should be developed. Since the last Country Report, the Board decided in relation to administered items:

- (a) that, given the accountability of government departments, it is appropriate to continue to treat government departments as separate reporting entities and to retain the distinction between controlled and administered items;
- (b) to distinguish those items that are administered from those that are held solely on a custodial basis and that those items held solely on a custodial basis should be disclosed less prominently than administered items in the financial reports of the custodian/administering entity; and
- (c) to adopt the principles used in the whole of government financial statements of which the administering entity is a part for the purpose of preparing financial information about administered items. Accordingly, administered controlling equity investments will be subject to the consolidation principles adopted in the whole of government financial statements. Similarly, administered joint control/significant influence equity investments will be subject to the equity accounting principles adopted in the whole of government financial statements.

### *Revenue Recognition by Not-for-Profit Entities*

The Board considered a draft Exposure Draft on *Proposed Australian Guidance to accompany AASB 1004 Contributions*. The Board discussed the interaction of AASB 1004, AASB 118 *Revenue*, AASB 120 *Accounting for Government Grants and disclosure of Government Assistance*, the government grant requirements in AASB 141 *Agriculture* and the various international projects that address government grants and non-exchange revenue. In particular, the Board considered the interaction of the requirements of AASB 1004 and AASB 118 when an amount received or receivable is associated with a service contract. The Board noted that in these circumstances, the amount may not meet the definition of “contributions” in AASB 1004 because it contains a performance obligation under a service contract, and accordingly would be accounted for in accordance with AASB 118. The Exposure Draft will be finalised out-of-session, and issued for a short comment period.

### *IASB Convergence (by 2005)*

Since “finalising” the 2005 set of standards, the AASB has been making amendments to those standards to keep up with changes made by the IASB and to deal with implementation issues that have arisen in the Australian reporting environment. An example of an implementation issue is the restricted fair value option introduced by the IASB into IAS 39. The AASB decided that, on sector neutral grounds, public sector entities should be subject to the same restricted option that applies to private sector entities.

The AASB is continuing to monitor all of the IASB’s projects and makes comment on IASB papers at relevant stages of their development. The AASB is progressing three research projects on behalf of the IASB (Intangible Assets, Joint Ventures and Extractive Activities) and is actively assisting with two active projects (Insurance phase 2 and Revenue Recognition).

### ***Non-Financial Liabilities***

In July 2005, the AASB issued Exposure Draft 140 that is the Australian equivalent of the IASB *Exposure Draft of Proposed Amendments to IAS 37 Non-financial Liabilities (formerly known as Provisions, Contingent Liabilities and Contingent Assets) and IAS 19 Employee Benefits*. These proposed revisions are a result of the IASB's short-term convergence project with the FASB as well as decisions made as part of the Business Combinations Phase II project. The AASB is recommending that the proposals in the IASB ED be adopted without amendment except for the usual materiality and application paragraphs that are inserted in all Australian equivalents to IASB pronouncements. Consistent with the requirements of the existing AASB 137 (the Australian equivalent to the existing IAS 37), the ED's proposals are intended to apply to the for-profit, not-for-profit and public sectors. As noted earlier in this Report, the AASB is currently considering the withdrawal of the existing AASs 29 & 31 (containing commentary that effectively exempts governments and government departments from recognising liabilities for the provision of non-exchange social benefits). The AASB will therefore consider the inclusion or exclusion of the provision of non-exchange social benefits from the scope of a revised AASB 137 (these liabilities are presently excluded from the scope of IPSAS 19).

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

The UIG deals with accounting issues of relevance to the private sector and/or the public sector. Interpretations agreed by the UIG are subject to approval by the AASB before they can be issued. The authoritative status of UIG Interpretations is established through AASB 1048 *Interpretation and Application of Standards*, which lists the UIG Interpretations that are to be applicable from 1 January 2005, divided into two sets, those equivalent to IASB Interpretations and those that are not. This 'service standard' needs to be re-issued whenever UIG Interpretations are issued or revised. Accordingly, AASB 1048 was reissued in September 2005 to incorporate all UIG Interpretations issued to then, and to delete the reference to UIG Interpretation 3 *Emission Rights*, which was withdrawn in September by the AASB following the IASB's withdrawal of IFRIC Interpretation 3.

Since the previous Country Report, the UIG has issued one Interpretation: 1001 *Consolidated Financial Reports in relation to Pre-Date-of-Transition Dual Listed Company Arrangements*. This is a domestic Interpretation with no IFRIC equivalent.

The issue of distinguishing not-for-profit entities and for-profit entities is important because there are some different requirements in AASB Accounting Standards as between NFP and FP entities. Auditors-General have produced a paper on the distinction, and the Heads of Treasuries Accounting and Reporting Advisory Committee has also produced another paper similar in substance to that of the Auditors-General. These papers were to be reviewed to consider whether the UIG should address the issue, as it is not restricted to the public sector, however in the meantime the AASB decided that it should reconsider the definition of "not-for-profit entity", and so the UIG will not address this issue.

The UIG was considering adding fair value measurement requirements to the existing Interpretation 1038 *Contributions by Owners Made to Wholly-Owned Public Sector Entities*. At present, there is a range of potential measurement bases under existing Standards in Australia. However, with the AASB's insertion of the IFRS-equivalent scope exclusion from AASB 3 *Business Combinations* in relation to entities under common control, and the

decision to propose withdrawal of the public-sector specific Standards AAS 27, AAS 29 and AAS 31, the UIG will not now address this matter.

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

### ***Current Status***

As reported in the July 2005 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 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 seek harmonisation of GFS and GAAP.

HoTARAC (Heads of Treasuries Accounting and Reporting Advisory Committee - essentially the chief accountants from each jurisdiction) meets to discuss and consider accounting and financial reporting matters, and strives to achieve comparability in accounting and reporting across jurisdictions.

### ***Commonwealth Government***

As reported in the July 2005 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 responsible for reviewing accounting policies for all GAAP and GFS reporting.

### ***State & Territory Governments***

Each State and Territory Government is autonomous and therefore has similar arrangements residing in their Departments of Treasury & Finance.



14 October 2005

## International Public Sector Accounting Standards Board Exposure Drafts

The AASB notes that the International Public Sector Accounting Standards Board (IPSASB), the international body responsible for issuing International Public Sector Accounting Standards (IPSASs), has recently issued the four Exposure Drafts:

- ED 25 *Equal Authority of Paragraphs in IPSASs*;
- ED 26 *Improvements to International Public Sector Accounting Standards*;
- ED 27 *Presentation of Budget Information in Financial Statements*; and
- ED 28 *Disclosure of Financial Information about the General Government Sector*.

The IPSASB has requested comments on ED 25 and ED 26 by 31 January 2006 and on ED 27 and ED 28 by 10 February 2006. Copies of the EDs are available to download at [www.ifac.org](http://www.ifac.org), free of charge.

In noting the proposals in ED 25 and ED 26, Professor David Boymal (AASB Chairman) stated that “ED 26 proposes updating 11 IPSASs, which were originally based on IASB standards, to reflect the changes made to the improved IASB standards that were issued by the IASB in December 2003. It is expected that any outcome from ED 25 and ED 26 will have limited short term implications in an Australian context, given the work the AASB has done recently in issuing and maintaining on a timely basis Australian equivalents to IFRSs that are applicable to both private sector and public sector entities.”

In noting the proposals in ED 27, Professor Boymal commented that “Depending on the outcome of ED 27, the IPSASB work has the potential to significantly influence the direction the AASB takes in relation to budgetary reporting.” He noted that this is possible, despite the budgetary reporting requirements recently proposed in AASB ED 142 *Financial Reporting of General Government Sectors by Governments* differing significantly from those in IPSASB ED 27.

In noting the proposals in ED 28, Professor Boymal observed that the ED is pertinent to the AASB’s GAAP/GFS convergence project. He commented that “The proposals in AASB ED 142 go significantly further than the proposals in IPSASB ED 28. Consistent with the FRC strategic direction, the AASB will continue to progress its project, but will be interested to see the outcome of the IPSASB’s work. Although in the short term ED 28 is unlikely to have a significant impact on the Australian project, in the longer term there may be some impacts.”

Professor Boymal went on to say “It is the AASB’s intention to submit comments to the IPSASB on each of the EDs. While encouraging AASB constituents to respond to all four EDs, it particularly encourages constituents to respond to ED 27 on budgetary reporting. Copying those responses to the AASB on a timely basis (before 15 January 2006) will enable the AASB to consider those responses in formulating its own response.”

### Further enquiries

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MEDIA RELEASE

**IFAC INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARDS BOARD  
IFAC IPSASB MEETING – NOVEMBER 2005**

**COUNTRY REPORT - MALAYSIA**

Public Sector Accounting Standards

The Accountant General's Department is responsible for issuing of Public Sector Accounting Standards (PSAS) in Malaysia. The objectives of these Standards are to prescribe the basis for presentation of general purpose financial statements in order to ensure comparability and also to comply with the Federal Constitution and Financial Procedure Act 1957 which are being enforced. As of to date, six Public Sector Accounting Standards have been issued and they are as follows:

PSAS 1 - Government Accounting Policies  
PSAS 2 - Presentation of Financial Statements  
PSAS 3 - Consolidated Revenue Accounts  
PSAS 4 - Consolidated Trust Accounts  
PSAS 5 - Consolidated Loans Accounts and  
PSAS 6 - Investments

Currently, we are working on two new accounting standards that are cash and memorandum accounts. These two new standards are expected to be issued in December 2005.

These Standards apply to public sector entities except Local Governments, Statutory Bodies and Government Link Companies which are adopting Financial Reporting Standards issued by Malaysian Accounting Standards Board.

**International Public Sector Accounting Standards (IPSAS) Under the Accrual Basis of Accounting**

A committee was set up last year to explore and evaluate the requirements of the IPSASs (Financial reporting under the accrual basis of accounting) presently in force so as to ensure compliance to these standards if Accountant General's Department adopts the accrual basis of accounting in the future. As of to date, the following IPSASs have been reviewed by the committee, the findings and recommendations have been forwarded to the top management for approval of the possible future adoption:

IPSAS 1 – Presentation of Financial Statements  
IPSAS 2 – Cash Flow Statements  
IPSAS 3 – Net Surplus or Deficit for the Period, Fundamental Errors and Changes in Accounting Policies  
IPSAS 4 – The Effect of Changes in Foreign Exchange Rates  
IPSAS 5 – Borrowing Costs  
IPSAS 6 – Consolidated Financial Statements and Accounting for Controlled Entities  
IPSAS 7 – Accounting for Investment in Associates  
IPSAS 8 – Financial Reporting of interests in Joint Ventures  
IPSAS 9 – Revenue from Exchange Transactions  
IPSAS 10 – Financial Reporting in Hyperinflationary Economies  
IPSAS 11 – Construction Contracts  
IPSAS 12 – Inventories  
IPSAS 14 – Events after the Reporting Date  
IPSAS 15 – Financial Instruments: Disclosure and Presentation  
IPSAS 17 – Property, Plant and Equipment  
IPSAS 20 – Related Party Disclosures

## General Financial & Management Accounting System (GFMAS)

The Accountant General's Department is in the process of re-engineering and developing its accounting system which is 17 years old. The new accounting system also known as General Financial & Management Accounting System (GFMAS) being developed will be able to capture accounting transactions and prepare financial statements based on accrual basis of accounting.

Among the characteristics of the GFMAS are listed as follows:

- Cash accounting with capability of accrual reporting
- Streamlining transactions towards accrual processing
- Data warehousing
- Single point of entry
- Distributed processing.

Modules that are being developed under GFMAS are as follows:

- General Ledger (GL)
- Accounts Receivable (AR)
- Accounts Payable (AP)
- Controlling (CO)
- Cash Management (CM)
- Fund Management (FM)
- Asset Management (AM)
- Treasury Management (TR)
- Loan Management (LM)
- Human Resource & Payroll (HR/PAY)
- Material Management (MM)
- Government-Advance & Loans Monitoring System (G-ALMOS)
- Government-Unclaimed Moneys Management Integrated System (G-UMIS)
- Government-Securities Management Integrated System (G-SMIS)

GFMAS will be implemented across 35 accounting offices. The GFMAS Project Management team is adopting the Accelerated System Application Program (ASAP) methodology to manage the implementation activities and deliverables of the project.

The ASAP methodology covers 5 stages namely:

Stage 1: Project Preparation

Stage 2: Business Blueprint

Stage 3: Realization

Stage 4: Final Preparation

Stage 5: Go Live & Support (Rollout)

Stage 1-Project preparation

The core activities of this project include:

- Establish project teams
- Conduct kick-off meeting to confirm the project scope
- Develop Project Charter
- Perform review on all technical requirements of the project

This stage symbolizes the initiation of the GFMAS project and was completed at the end of February 2005 and documents containing project kick off, Project Charter and Project Plan were received from consultant Teliti-Innovation Alliance.

## Stage 2-Business Blueprint

The objective of this stage is to obtain a clear precise understanding of the detail functional requirement of different modules to be implemented in GFMAS.

The major activities during this stage are as follows:

- Develop System functional requirements
- Develop System's data conversion and authorization strategy
- Identify training needs
- Determine reporting requirements
- Determine interface requirements
- Initiate change readiness Assessment

This stage was completed on 11 April 2005 with the signing-off of the Business Blueprint by the Accountant General's Department.

## Stage 3: Realization

The project teams are focusing on the configuration of the SAP modules using agreed functional requirements. The core activities that are being carried out at this stage include:

- Configure SAP modules/develop customized modules
- Develop forms, reports and interfaces
- Establish profiles for authorization
- Implement data conversion and migration plan
- Setup training environment
- Conduct awareness program
- Develop change infrastructure; conduct change management activities relating to communication and role definition

This stage of the project is expected to be completed at the end of December 2005.

## Stage 4: Final Preparation

Among the core activities to be carried out at this stage include;

- Develop cut-over and go-live plan
- Develop standard operating procedures
- Develop offline procedures
- Conduct end-user training for users at the pilot site
- Complete the preparation of the production environment
- Conduct communication and acceptance program

This stage of the project is expected to be completed at the end of December 2005.

## Stage 5: Go Live & Support (Rollout)

The final stage of the project relates to the roll out of the GFMAS application, which is divided into two phases. The pilot phase will involve 3 sites. Upon completion of the pilot roll out, GFMAS application will be implemented to the other 32 sites across the nation over a period ending October 2006.

## IFAC COUNTRY REPORT: UNITED KINGDOM

### A. ACCOUNTING STANDARDS BOARD DEVELOPMENTS

#### 1. New Accounting Standards

##### Operating and Financial Review

As reported to the July meeting, on 10 May 2005 the UK Accounting Standards Board (UKASB) issued Reporting Standard (RS) 1 'The Operating and Financial Review' (OFR). Whilst the RS has a strong private sector focus, it will have an impact on narrative reporting in the UK public services. The Financial Reporting Advisory Board (FRAB) convened by the UK Ministry of Finance will be considering the impact of the new RS on the current OFR requirements for central government.

CIPFA has begun a project which considers how comparable narrative reporting requirements might be applied across the whole of the UK public sector and other public benefit sectors. A discussion paper will be published in November with a follow-up paper in early 2006.

##### Corresponding Amounts

On 10 October 2005 the UKASB issued Financial Reporting Standard FRS 28 'Corresponding Amounts', following the March 2005 exposure of FRED 35 (noted in the July 2005 Country Report).

This builds on recent changes to UK company law and largely replicates previous legal requirements on corresponding amounts.

In summary:

- corresponding amounts are to be shown for items in primary financial statements and notes;
- corresponding amounts which are not directly comparable with the current financial year shall be adjusted;
- most exemptions in the UK Companies Act 1985 are maintained; and
- corresponding amounts are not required for earliest period presented where financial statements for two or more consecutive periods are presented together.

#### 2. Exposure drafts: Business Combinations

In July 2005, the UKASB issued four Financial Reporting Exposure Drafts (FREDs), as follows:

- FRED 36 'Business Combinations (IFRS 3) and Amendments to FRS 2 Accounting for Subsidiary Undertakings (parts of IAS 27 Consolidated and Separate Financial Statements)'.
- FRED 37 'Intangible Assets (IAS 38)'.
- FRED 38 'Impairment of Assets (IAS 36)'.
- FRED 39 'Amendments to FRS 12 Provisions, contingent liabilities and contingent assets and Amendments to FRS 17 Retirement benefits'.

These exposure drafts are in pursuit of the UKASB's international convergence agenda, and would bring UK guidance into agreement with the outputs from Phase I and Phase II of the IASB's Business Combinations project

FREDs 37 and 38 mainly reflect convergence with Phase I of the project, and would bring UK guidance into line with already published guidance in IAS 36 and IAS 38.

FREDs 36 and 39 reflect convergence with outputs from Phase II of the project, under which in June 2005 the IASB released exposure drafts of amended standards for IFRS3, IAS 27 and IAS 37 'Provisions, Contingent Liabilities and Contingent Assets' (plus conforming amendments to IAS 19 'Employee Benefits'). The UKASB exposure runs in parallel with this consultation and shares a 28 October 2005 deadline.

The UKASB notes that the proposals in FREDs 36-39 raise a number of issues, some of which may not be improvements to existing UK standards. These include:

- full recognition of goodwill, even if less than 100% of a business is acquired;
- goodwill to be measured at cost less impairment, and amortisation is not permitted;
- liabilities to be recognised even where it is probable that no outflow will be required to settle the obligation. The measurement of the liability to be adjusted by the probability of an outflow.

The drafts revisit issues which are of longstanding concern to the UK public sector. The IASB exposure only allows for the acquisition method of accounting, when (in our view) merger accounting is often the more appropriate option, particularly for re-combinations of entities under common control, on which the IASB exposure is silent. Further, the draft focuses very strongly on 'exit values' at observable market prices, whereas 'exit' is often not an option in the public sector context.

Furthermore, recognition of a wider range of probability weighted liabilities may cause particular problems for governments, which find themselves in the position of default guarantors against risks which private sector entities would not accept, and for which 'exit values' may not be meaningful.

### **3. UKASB Exposure Draft "Statement of Principles: Proposed Interpretation for Public Benefit Entities"**

On 11 August 2005, the UKASB published its Exposure Draft 'Statement of Principles for Financial Reporting: Proposed Interpretation for Public Benefit Entities', inviting comments by 30 November 2005

The aim of the proposed Interpretation is to operate alongside the UKASB's 1999 Statement of Principles, expanding on how the principles underlying UK financial reporting should be interpreted in the context of public benefit entities, and providing a coherent framework of reference to be used in the development of guidance for public benefit entities.

The draft builds on an earlier UKASB Discussion Paper, exposed for comment in 2003. Many of the ideas in that paper are reflected in the new draft. Some proposals have, however, been further developed including those relating to:

- Liabilities for commitments to provide public benefits;
- Presentation of the residual interest and disclosure of restrictions over assets;
- Voluntary gifts;
- Capital contributions (establishing a financial interest in the residual interest);
- Capital grants (for financing the purchase or construction of a fixed asset).

The main issues considered in developing the new draft were:

- Defining class of user for the financial statements of public benefit entities;
- The interpretation of the definition of a liability;
- The nature of business combinations;
- Contributions that should be treated as additions to residual interest;
- When capital grants should be recognised as gains;
- Whether notional transactions should be recognised;
- Whether voluntary gifts of assets or services should be recognised as a gain;
- How restrictions and intentions to limit the future application of assets should be reflected in disclosure about the assets and residual interest.

This is a key document for the UK public benefit sector, and also has a bearing on some of the issues currently being considered by IPSASB. For example, the UKASB interpretation takes a different approach to the recognition of voluntary services, reflecting whether they would otherwise be purchased if not provided voluntarily. Furthermore, the treatment of restricted assets is based upon consideration of ‘control of condition’ rather than whether there has been a sacrifice of resources.

CIPFA and the UKASB are running a joint Round Table event to promote discussion and inform the consultation on 2 November 2005.

#### **4. UKASB Discussion Paper on ‘Heritage Assets’**

The IPSASB in conjunction with the UKASB is developing a joint Discussion Paper on accounting for heritage assets, with a subcommittee of IPSASB members providing input from an international perspective.

The UKASB has identified issues of particular concern to UK constituents and has developed a paper which deals with those issues. The exposure draft of the UK Discussion Paper will be released shortly and will be discussed at the November IPSASB meeting.

CIPFA and the UKASB will be jointly running a further Round Table event to promote discussion and inform the UK consultation.

## **5. UKASB pensions project**

The UKASB is undertaking a research project, which will consider financial reporting issues relating to pensions in the light of

- significant changes to UK legal and regulatory environment since the development of the UK standard.
- the move to International Financial Reporting Standards (IFRS).
- possible IASB and US FASB review of standards on pensions in the reasonably near future.

This will also feed into a pensions project being undertaken jointly by the European Financial Reporting Advisory Group (EFRAG) and European National Standard-Setters (NSS), on which the UKASB is to take the lead development role.

To assist in this research, expert perspectives on pensions accounting will be provided by a new Pensions Advisory Panel in the UK, and a European working group.

It is expected that the research will be published in the course of 2006, and the UKASB hopes that it will contribute to the development of improved international accounting standards.

The UKASB will not be diluting UK guidance in advance of IFRS developments. Additional guidance will be produced for termination benefits. Any other developments are expected to follow the IFRS timetable, although this will be reviewed in the light of the research project and its policy on converging UK standards with IFRS.

## **6. UKASB Policy Statement on future strategy – follow-up**

As noted in the July Country Report, in March 2005 the UKASB published a draft Policy Statement 'Accounting Standard-setting in a Changing Environment: The Role of the Accounting Standards Board' setting out views on its future role.

Some responses to the discussion paper raised concerns about communications. In particular, some commentators had no clear understanding of whether or how the views they expressed during exposures and other consultations were taken into account.

The UKASB will be hosting a round table session to take the discussion paper forward and to allow the issues regarding communications to be aired. Representatives from each of the UK Consultative Committee of Accountancy Bodies institutes will be among those invited.

## **7. UKASB responses to IASB's proposed 'Technical Correction Policy'**

On 3 October 2005 the UKASB issued a 'Notice to Constituents' drawing attention to the IASB's first Draft Technical Correction (DTC1) to be made under its draft policy on technical corrections. Under the IASB's draft policy, technical corrections to an international accounting standard would be made after a 30 day comment period, and would generally be effective immediately.

The UKASB had previously responded to the IASB's consultation on the technical corrections policy, suggesting that while a fast track process would be useful, its scope should be restricted to exclude amendments to the unambiguous requirements of a standard, particularly those that are mandatory and affect the amounts in the primary financial statements.

The IASB will be considering responses to both DTC1 and the draft corrections policy at its November 2005 meeting.

## **8. UKASB staff comment on conceptual framework**

In May 2005, the IASB and US FASB published 'Revisiting the Concepts' as part of a joint project to develop an improved conceptual framework for financial accounting and reporting.

On 3 August 2005, the Technical Directorate at the UKASB provided comments on the project, setting out the views of UKASB technical staff (rather than the Board members) and expressing a willingness to assist in the project. The staff response included a number of comments of particular relevance to the public sector, as follows:

- The framework is being developed only for private sector business entities. Only at a later stage will private sector not-for-profit entities be considered. The prospect of application to public sector entities is even more remote.
- UKASB staff considered this to be a serious omission in the light of the very substantial economic activity in this sector.
- Furthermore, this narrow focus would send an unfortunate message to standards setters in other countries, particularly less developed countries where private investors have a less important role than in the United States
- IASB and FASB plans are understood to exclude the assessment of 'stewardship' from the explicit objectives of financial reporting

## **B. AUDITING PRACTICES BOARD DEVELOPMENTS**

### **1 Proposed Revised ISAs (UK & Ireland)**

On 20 July 2005 the UK Auditing Practices Board (UKAPB) released three exposure drafts for comment by 3 October 2005, as follows:

- ISA (UK and Ireland) 700 'The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements'
- ISA (UK and Ireland) 701 'The Independent Auditor's Report on Other Historical Financial Information'
- ISA 800 'The Independent Auditor's Report on Summary Audited Financial Statements'

The exposure of ISA (UK and Ireland) 700 'The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements' takes forward the corresponding ISA 700 which was issued by the International Auditing and Assurance Standards Board (IAASB) in December

2004, too late for inclusion in the ISAs (UK & Ireland) issued in 2004.

The other draft standards reflect similar exposure drafts issued by the IAASB in June 2005, for comment by 28 October 2005.

The exposure of ISA 800 may be problematic because of difficulties which may arise from differing legal frameworks for summarised financial statements, and the UKAPB's 'Invitation To Comment' asks respondents whether they consider that this is an area which should be regulated by ISAs. There may be implications for the UK public sector, where summary financial statements are increasingly being published.

## **2 Bulletins**

### 2005/07 Integrity, Objectivity and Independence - Guidance for Reporting Accountants undertaking engagements in connection with an Investment Circular

This bulletin was issued in July 2005

The UKAPB's Ethical Standards for Auditors (ESs) establish the basic principles and essential procedures with which auditors are required to comply in audits of financial statements. The purpose of Bulletin 2005/7 is to provide interim guidance to reporting accountants to assist compliance with the requirements of UK Standards on Investments Circular Reporting (SIRs).

## **C. LOCAL GOVERNMENT**

No significant developments to report.

## **D REGISTERED SOCIAL LANDLORDS**

No significant developments to report

## **E CHARITIES SECTOR**

No significant developments to report

## **F FINANCIAL REPORTING COUNCIL**

### **1 True and Fair View**

On 9 August 2005, the UK Financial Reporting Council (UKFRC) issued a paper 'The Implications of New Accounting and Auditing Standards for the 'True and Fair View' and Auditors' Responsibilities'. The paper responds to suggestions that UK adoption of international standards will erode the importance of the concept of the 'true and fair view' in financial reporting and auditing. It concludes that although there will be changes to the format and content of company accounts and audit reports:

- the concept of the 'true and fair view' remains a cornerstone of financial reporting and auditing in the UK

- there has been no substantive change in the objectives of an audit and the nature of auditors' responsibilities; and
- the need for professional judgement remains central to the work of preparers of accounts and auditors in the UK.

The UKFRC paper invites views on this analysis, and also invites comment how financial reporting and auditing frameworks in the UK should evolve in the future.

## **2 Revised Turnbull Guidance**

On 13 October 2005 the UKFRC published an updated version of 'Internal Control: Guidance for Directors on the Combined Code', also known as the Turnbull guidance. The new guidance will take effect for financial years beginning on or after 1 January 2006. Only limited changes have been made to the guidance itself, while a new preface has been added to emphasise the need for companies to keep their application of the guidance under review and to provide shareholders with meaningful information in their annual report.

The Combined Code and associated Turnbull guidance very substantially influence public sector reporting and governance arrangements in the UK public sector. The (limited) changes may therefore have some implications for public sector bodies.

### **Liz Cannon**

Technical Advisor, United Kingdom

**United States Country Report**  
**Prepared for the IFAC Public Sector Accounting Standards Board**  
**October 2005**

**Recent Activity of the Federal Accounting Standards Advisory Board (FASAB)**

*SFFAS 30.* In August 2005, the FASAB released Statement of Federal Financial Accounting Standards (SFFAS) 30, *Inter-Entity Cost Implementation: Amending SFFAS 4*, Managerial Cost Accounting Standards and Concepts. This standard requires full implementation of the inter-entity cost provision in SFFAS 4. SFFAS 4 requires that reporting entities report the full costs of outputs in general purpose financial reports. The full cost of an output should include the costs covered by other reporting entities. These costs are referred to as “inter-entity costs.” SFFAS 4 recognized the difficulties in attaining this goal and provided for gradual implementation of inter-entity costing. This standard establishes a date certain for implementation of the inter-entity cost provision. The standard is effective for reporting periods beginning after September 30, 2008 with earlier implementation encouraged.

*SFFAS 29.* In July 2005, the FASAB issued SFFAS 29, *Heritage Assets and Stewardship Land*. This standard reclassifies heritage assets and stewardship land information as basic information, except for condition information, which is classified as required supplementary information. It also requires additional reporting disclosures about entity stewardship policies and an explanation of how heritage assets and stewardship land relate to the entity’s mission. The standard is effective for reporting periods beginning after September 30, 2005 with the exception of certain reporting requirements that are to be phased-in. The standard provides for a phase-in of disclosure requirements being reported as basic information such that the standards will be fully implemented for reporting periods beginning after September 30, 2008.

*Technical Agenda Options Invitation to Comment.* In July 2005, the FASAB issued an Invitation to Comment (ITC) titled, *Technical Agenda Options*. The ITC requests feedback on options for adding additional projects to the FASAB’s technical agenda. Although the Board has identified four topics—the federal entity, leases, conceptual framework acceleration and the appropriate source for GAAP—as subjects of possible projects, it is requesting assistance in setting priorities for them and in identifying any other projects that respondents would consider to be a higher priority.

*Fiduciary Activities Exposure Draft.* In June 2005, the FASAB released a revised exposure draft (ED) titled, *Accounting for Fiduciary Activities*. This revised ED defines and establishes reporting requirements for fiduciary activities of the federal government. The revisions were made in response to a number of issues raised by respondents to the April 2003 ED on the same topic. In a “fiduciary activity,” as defined in the proposed standard, a federal entity collects or receives and subsequently manages, protects, accounts for, invests, and/or disposes of cash or other assets in which non-federal individuals or entities have an ownership interest that the federal government must uphold. The revised ED clarifies the definition of fiduciary activities, reduces the number of acceptable approaches to accounting for these activities, and requires certain disclosure in the notes to the financial statements. In addition to the proposed standards, the revised ED seeks comment on two alternative views.

## **Recent Activity of the Governmental Accounting Standards Board (GASB)**

*Sales and Pledges Receivable Exposure Draft.* In September 2005, the GASB released an ED titled, *Sales and Pledges of Receivables and Future Revenue*. The proposed statement is designed to clarify existing guidance on accounting for sales and pledges of receivables and future revenues. Specifically, the proposal will address whether certain transactions should be regarded as a sale or a collateralized borrowing. Such transactions are likely to comprise the sale of delinquent taxes, certain mortgages, student loans, or future revenues such as those arising from tobacco settlement agreements. In addition to clarifying guidance on accounting for sales and pledges of receivables and future revenues, the proposal will: (1) Require enhanced disclosures pertaining to future revenues that have been pledged or sold; (2) Provide guidance on sales of receivables and future revenues within the same financial reporting entity; and (3) Provide guidance on recognizing other assets and liabilities arising from the sale of specific receivables or future revenues.

*Comprehensive Implementation Guide.* In October 2005, the GASB issued *Comprehensive Implementation Guide – 2005*. It represents a consolidation of Implementation Guides issued through June 30, 2005. The guide not only codifies the questions and answers from the original guides covering Statements 3, 9, 10, 14, 25–27, 31, 34 (and related Statements), and 40, it contains updated answers to recognize the effects of subsequently issued standards through Statement 46 and includes questions related to new GASB pronouncements that are not the subject of stand-alone guides issued after June 30, 2005.

*GASB Statements No. 43 and 45 Implementation Guide.* In August 2005, the GASB published a *Guide to Implementation of GASB Statements 43 and 45 on Other Postemployment Benefits*. The Guide assists preparers and auditors of governmental financial statements and those that advise them as they implement the GASB's recently issued standards on accounting and reporting for healthcare and other non-pension benefits provided to retirees. These benefits are commonly referred to as *other postemployment benefits* or *OPEB*.

*SEA User Guide.* In July 2005, the GASB published, *Government Service Efforts and Accomplishments Performance Reports: A Guide to Understanding*, as a part of its continuing research project on service efforts and accomplishments (SEA) reporting. The Guide is intended to assist citizens and others in using SEA performance reports issued by state and local governments.

*Note Disclosure User Guide.* In June 2005, the GASB published a new volume in its User Guide Series titled, *What Else You Should Know about a Government's Finances: A Guide to Notes to the Financial Statements and Supporting Information*. The Guide, written for non-accountants, is a plain-language introduction to the information that accompanies a state or local government's annual financial statements.

## **Recent Activity of the Financial Accounting Standards Board (FASB)**

*Earnings Per Share Exposure Draft.* In September 2005, the FASB issued a revised ED titled, *Earnings per Share*. Specifically, the proposed changes would clarify earnings per share computations involving certain instruments, such as mandatorily convertible instruments and

contractual obligations that may be settled with cash or by issuing shares. The ED is a revision of the December 2003 proposed Statement of the same name, which was issued as part of the Board's ongoing efforts with the International Accounting Standards Board (IASB) to bring about convergence between U.S. and international accounting standards.

*Assets and Liabilities Invitation to Comment.* In September 2005, the FASB issued an ITC titled, *Selected Issues Relating to Assets and Liabilities with Uncertainties*. The purpose of the ITC is to solicit feedback that may be helpful in analyzing some of the issues that have a bearing on the role of probability and uncertainty in defining, recognizing, and measuring assets and liabilities. That role currently varies among FASB standards and Concepts Statements, as well as between the FASB and the IASB. Future deliberations in this area will involve reconsideration of concepts in FASB Concepts Statements No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*, and No. 6, *Elements of Financial Statements*, and the IASB Framework for the Preparation and Presentation of Financial Statements, and may result in revisions to the existing definitions of elements, concepts for recognizing (derecognizing) them, and attributes for measuring them. Consideration of probability and uncertainty will be one aspect of the deliberations on these matters, and responses to the ITC will enter into that consideration.

*Exposure Drafts to Amend Statement 140.* In August 2005, the FASB released three proposed statements that would amend Statement 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. Details regarding each follow.

*Accounting for Transfers of Financial Assets.* This ED is a revision of the June 2003 ED, *Qualifying Special-Purpose Entities and Isolation of Transferred Assets*. The revised ED reflects what the Board learned from constituents' comments in the earlier effort and deals with some new issues. Specifically, the proposed Statement seeks to (a) clearly specify the circumstances that require the use of a qualifying special-purpose entity (SPE) in order to derecognize all or a portion of financial assets, (b) provide additional guidance on permitted activities of qualifying SPEs, (c) eliminate the prohibition on a qualifying SPE's ability to hold passive derivative financial instruments that pertain to beneficial interests held by a transferor, and (d) revise the initial measurement of interests related to transferred financial assets held by a transferor.

*Accounting for Servicing of Financial Assets.* This ED would amend Statement 140 with respect to the accounting for separately recognized servicing rights. The Board added this project to its agenda in response to constituents' requests to simplify the accounting and to mitigate the effect of having different measurement attributes for related financial instruments. Specifically, the proposed Statement would (a) require all separately recognized servicing rights to be initially measured at fair value, if practicable, (b) permit an entity to choose between two measurement methods for each class of separately recognized servicing assets and liabilities, and (c) require additional disclosures for all separately recognized servicing rights.

*Accounting for Certain Hybrid Financial Instruments.* This ED would amend Statements 133, *Accounting for Derivative Instruments and Hedging Activities*, and 140 to eliminate a temporary exemption from Statement 133 for certain securitized interests and to simplify the accounting for hybrid instruments. Specifically, the proposed Statement would (a) permit fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation, (b) clarify which interest-only strips and principal-only strips are not subject to the requirements of Statement 133,

(c) establish a requirement to evaluate beneficial interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation, (d) clarify that concentrations of credit risk in the form of subordination are not embedded derivatives, and (e) eliminate restrictions on a qualifying SPE's ability to hold passive derivative financial instruments that pertain to beneficial interests that are themselves or that contain a derivative financial instrument.

*Uncertain Tax Positions.* In July 2005, the FASB issued an ED of a proposed interpretation titled, *Accounting for Uncertain Tax Positions*. The ED seeks to reduce the significant diversity in practice associated with recognition and measurement in the accounting for income taxes. It would apply to all tax positions accounted for in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. Specifically, the ED requires that a tax position meet a "probable recognition threshold" for the benefit of the uncertain tax position to be recognized in the financial statements. This threshold is to be met assuming that the tax authorities will examine the uncertain tax position. The ED contains guidance with respect to the measurement of the benefit that is recognized for an uncertain tax position, when that benefit should be derecognized and other matters.

*Business Combinations.* In June 2005, the FASB issued an ED titled, *Business Combinations – a replacement of FASB Statement No. 141*. The proposal was issued as part of a joint effort with the IASB to improve the accounting and reporting of business combinations. The objective of the project is to develop a single high-quality standard for accounting for business combinations that could be used for both domestic and cross-border financial reporting. The proposed standard would replace the existing requirements of the IASB's IFRS 3, *Business Combinations*, and the FASB's Statement No. 141, *Business Combinations*. The proposals in the ED retain the fundamental requirement of IFRS 3 and Statement 141 to account for all business combinations using a single method—where one party is always identified as acquiring the other. The principal changes being proposed include a requirement to measure the business acquired at fair value and to recognize the goodwill attributable to any noncontrolling interests (previously referred to as minority interests) rather than just the portion attributable to the acquirer. The proposals would also result in fewer exceptions to the principle of measuring assets acquired and liabilities assumed in a business combination at fair value. Additionally, the proposals would result in payments to third parties for consulting, legal, audit, and similar services associated with an acquisition being recognized generally as expenses when incurred rather than capitalized as part of the business combination.

*Consolidated Financial Statements.* Concurrently with issuing its ED on business combinations (see above), the FASB (and the IASB) issued an ED titled, *Consolidated Financial Statements, Including Accounting and Reporting of Noncontrolling Interests in Subsidiaries – a replacement of ARB No. 51*. This proposed Statement would replace Accounting Research Bulletin No. 51, *Consolidated Financial Statements*. It also would establish standards for the accounting and reporting of noncontrolling interests (sometimes called *minority interests*) in consolidated financial statements and for the loss of control of subsidiaries. This proposed Statement would carry forward, without reconsideration, the provisions of ARB 51, as amended, related to consolidation purpose and policy and certain of the provisions related to consolidation procedure. It would not change the requirement in ARB 51 that all companies in which the parent has a controlling financial interest be consolidated. This proposed Statement also would amend FASB

Statement No. 128, *Earnings per Share*, to specify the computation, presentation, and disclosure requirements for earnings per share if a parent has one or more partially owned subsidiaries.

*FASB Staff Positions.* The following final FASB staff positions (FSP) were issued since June 2005 (all are available on the FASB Web site at [www.fasb.org](http://www.fasb.org)):

FSP FAS 123(R). *Practical Accommodation to the Application of Grant Date as Defined in FASB Statement No. 123(R)* (October 18, 2005)

FSP FAS 13-1. *Accounting for Rental Costs Incurred during a Construction Period*, (October 6, 2005).

FSP FAS 123(R). *Classification and Measurement of Freestanding Financial Instruments Originally Issued in Exchange for Employee Services under FASB Statement No. 123(R)* (August 31, 2005)

FSP APB 18. *Accounting by an Investor for Its Proportionate Share of Accumulated Other Comprehensive Income of an Investee Accounted for under the Equity Method in Accordance with APB Opinion No. 18 upon a Loss of Significant Influence* (July 12, 2005)

FSP SOP 78-9. *Interaction of AICPA Statement of Position 78-9 and EITF Issue No. 04-5* (July 14, 2005)

FSP FAS 150. *Issuer's Accounting under Statement 150 for Freestanding Warrants and Other Similar Instruments on Shares That Are Redeemable* (June 29, 2005)

### **Recent Activity of the AICPA Accounting Standards Executive Committee (AcSEC)**

In September 2005, AcSEC issued SOP 05-1, *Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection with Modifications or Exchanges of Insurance Contracts*. This Statement of Position (SOP) provides guidance on accounting by insurance enterprises for deferred acquisition costs on internal replacements of insurance and investment contracts other than those specifically described in FASB No. 97. The SOP defines an internal replacement as a modification in product benefits, features, rights, or coverages that occurs by the exchange of a contract for a new contract, or by amendment, endorsement, or rider to a contract, or by the election of a feature or coverage within a contract. This SOP is effective for internal replacements occurring in fiscal years beginning after December 15, 2006, with earlier adoption encouraged.

### **Recent Activity of the AICPA Auditing Standards Board (ASB)**

*Internal Control Matters.* In September 2005, the ASB issued an ED of a proposed Statement on Auditing Standards (SAS) titled *Communication of Internal Control Related Matters Noted in an Audit*. When issued in final form the proposed SAS will supersede SAS No. 60, *Communication of Control Matters Noted in an Audit*. It is the second ED issued by the ASB on this topic. The first was issued in March 2003. Since that first ED, the ASB determined that additional changes were needed, including conforming changes to reflect certain definitions and related guidance in Public Company Accounting Oversight Board (PCAOB) Auditing Standard (AS) No. 2, *An Audit of Internal Control Over Financial Reporting Performed in Conjunction With an Audit of Financial Statements*. The changes were significant enough for the ASB to decide that re-

exposure was needed. The proposed SAS is being issued to enhance the auditor's ability to identify and communicate to management and those charged with governance significant deficiencies and material weaknesses in internal control identified in a financial statement audit. Some of the proposed changes include:

- Recognition that the body to which internal control matters is communicated may take different forms. For example, a board of directors, a committee of management, or an owner in an owner-managed entity.
- Incorporation of the terms *control deficiency* and *material weakness* used in PCAOB AS No. 2, and replacement of the term *reportable condition* with the term *significant deficiency* and its related definition in PCAOB AS No. 2.
- Identification of specified control deficiencies that ordinarily would be considered at least significant deficiencies and also identification of specified circumstances that should be regarded at least a significant deficiency and a strong indicator of a material weakness.

The following auditing interpretations were issued by the ASB and are available on the AICPA Web site at: <http://www.aicpa.org/members/div/auditstd/announce/index.htm>.

*Auditing Fair Values.* In July 2005, the ASB issued two Interpretations of SASs pertaining to auditing fair values titled, *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities*; and *Auditing Interests in Trusts Held by a Third-Party Trustee and Reported at Fair Value*. The Interpretations clarify that in circumstances in which the auditor determines that the nature and extent of auditing procedures should include testing the measurement of investments in securities (or interests in a trust that holds investments in securities), simply receiving a confirmation from a third party (including a trustee) does not in and of itself constitute adequate audit evidence with respect to the valuation assertion. The Interpretations address, among other matters, issues faced by auditors of Not-for-Profit Organizations reporting at fair value (a) investments in conformity with Appendix A of chapter 8 of the Audit and Accounting Guide *Not-for-Profit Organizations* or (b) a beneficial interest in conformity with paragraph 15 of FASB Statement No. 136, *Transfers of Assets to a Not-for-Profit Organization or Charitable Trust That Raises or Holds Contributions for Others*.

### **Recent Activity of the Public Company Accounting Oversight Board (PCAOB)**

In July 2005, the PCAOB adopted certain ethics and independence rules addressing tax services, contingent fees, and certain related general ethics and independence standards. The Board also adopted an auditing standard on reporting on whether a previously reported material weakness continues to exist. This standard, PCAOB Auditing Standard No. 4, *Standard on Remediation of Material Weaknesses, Rules on Auditor Independence and Tax Services*, establishes requirements and provides direction that applies when an auditor is engaged to report on whether a previously reported material weakness in internal control over financial reporting continues to exist as of a date specified by management. The rules and standard will not take effect unless approved by the Securities and Exchange Commission. Background information is available on the Board's Web site at <http://www.pcaobus.org> under Rulemaking Docket 017 and Docket 018.

### **Recent Activity of the U.S. Government Accountability Office (GAO)**

No activity.

DATE: 20 October 2005

TO: Members of the International Public Sector Accounting Standards Board

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).

### On-Going Projects

#### Performance Reporting

*Status: One Day Performance Reporting Forum held 28 September 2005 in Toronto, Canada*

Held in partnership with the Canadian Comprehensive Auditing Foundation (CCAF), the Forum was attended by approx 70 people, the main objective being to get feedback on the draft Statement of Recommended Practices – ‘SORP’ (see below). Attendees included people with specific experience in government performance reporting including among others, Deputy Ministers, local government treasurers and Chief Accounting Officers, Auditors’ General and Provincial Comptrollers. Comments received will be incorporated in the draft.

At the time of writing this report comments from the Forum were still being incorporated into the draft – however, the salient issues raised to date have been the:

- need to provide guidance that helps users operationalize the principles;
- desire to allow practice to develop and progress aided by the non prescriptive nature of the guidance; and
- need for leadership in getting the SORP implemented.

Overall, the performance reporting project is designed to develop a set of basic principles (culminating in a SORP) that will guide the future development of performance reporting. The principles for the project are based on the nine principles of the CCAF as set out in its publication entitled "Reporting Principles - Taking Public Performance Reporting to a New Level".

The draft SORP offers guidance on the qualitative characteristics of performance information and provides a framework for preparing a public performance report. It is not part of GAAP. The Board is scheduled to approve a Public Exposure Draft of the SORP in December.

### Local Government Financial Statement Reporting Model

*Status: Local Government Reporting Model – Two Statements of Principle (SOPs) approved*  
*Local Government Tangible Capital Assets – Closing date for Associates Exposure Draft and draft Public Sector Guideline expired.*

#### *Local Government Reporting Model*

The SOPs establish a framework for local government financial reporting who at present are required to follow modified accrual reporting. PSAB believes that as a starting point, it should consider the applicability of the full accrual based senior government reporting model approved in October 2002. As such, the SOPs introduce and explain the conceptual and significant reporting differences as a result of transitioning to a full accrual basis of reporting from the existing approach.

Comment closing date for the SOPs is January 16, 2006.

#### *Local Government Tangible Capital Assets*

The most significant impact for local governments in moving to the proposed full accrual model will be accounting for their tangible capital assets (TCAs). Therefore, as a prerequisite to approving the SOPs, PSAB had already been focusing on the specific issue of accounting for TCAs having in June approved an Associates Exposure Draft (AED) and draft Public Sector Guideline (PSG) - both for Associate comment on the matter. Closing date for both documents was September 7, 2005.

The AED essentially broadens the scope of Section PS 3150 *TANGIBLE CAPITAL ASSETS* to include local governments. In broadening the scope, some complementary amendments to 3150 were also proposed.

The draft PSG is intended to promote disclosure of fixed asset information and act as a vehicle to encourage local governments to begin collecting information.

Local government responses have generally been supportive of the need to account for TCAs (as such paving the way for PSAB to approve the SOPs), with one of the salient concerns being the practicalities associated with their inaugural recognition (identification, measurement, etc).

Next step for both documents is approval for public exposure scheduled for December 2005.

### Financial Instruments

*Status: Closing date for comments on interim guidance in draft Public Sector Guideline (PSG) about to expire. Statement of principles under development.*

Approved in June 2005 with a comment closing date of October 21, 2005, the draft PSG focuses on providing interim reporting guidance for governments with entities that have implemented the commercial financial instruments standards.

Commercial oriented entities that form part of the government's reporting entity (most notably, Government Business Enterprises - GBEs) are required to follow private sector GAAP. New private sector standards on financial instruments may result in these entities reporting 'other comprehensive income' (OCI). (OCI comprises revenues, expenses, gains and losses recognized in comprehensive income but excluded from net income).

The government's share of the net assets and income of a GBE is reported in government financial statements via the modified equity method.

Given PSAB is yet to fully explore the implications/application of fair value reporting in government financial statements, as well as concerns about including OCI in the government's statement of operations, the draft PSG proposes that governments:

- Measure their investments in a GBE based on the reported net asset position of the GBE (including OCI); and,
- Exclude OCI from the determination of surplus or deficit for the period, instead reporting any OCI separately in reconciling the change in accumulated surplus or deficit for the period.

Meanwhile, work continues on the development of principles to guide PSAB as it continues to develop standards for the reporting of financial instruments. The new financial instrument standards of the CICA Accounting Standards Board are being taken into consideration.

A first statement of principles dealing with the recognition and measurement of derivative financial instruments is scheduled to be approved by PSAB in December 2005.

### Segmented Reporting

*Status: Closing date for comments on Public Exposure Draft (PED) expired.*

Approved in June 2005 with a comment closing date of September 23, 2005, the PED focused on disclosure of additional information about segments of the government reporting entity in their summary financial statements. The objective of the disclosures is to help users better understand the different types of activities that governments engage in.

*Canada Country Report – Cape Town – November 2005*

The salient issue for the project so far has been the usefulness of allocating assets and liabilities by segment – there is concern about the potential for arbitrary allocation (eg: allocating public debt) and its subsequent meaningfulness.

Unlike the earlier Statement of Principles, the PED does not require recognition of assets and liabilities by segment though does acknowledge its potential usefulness.

At the time of writing this report comments on the PED were still being analyzed – however, there is general support for the principles in the Exposure Draft.

A final Handbook Section is scheduled to approved by PSAB in December 2005.

### Government Transfers

*Status: Closing date for comments on Associates Draft 2 (AED2) expired.*

AED2 was approved in June 2005 with a comment closing date of September 30, 2005 (October 14, 2005 – French respondents). At the time of writing this report comments on AED2 were in the process of being analyzed, however, some of the salient issues/themes noted to date in those comments reviewed are:

- Strong input from the local government community – a demographic traditionally less active in responding to PSAB's exposed documents. Accounting for Government Transfers will have a significant impact on them. In particular the accounting for capital transfers received has assumed more importance for this community as PSAB's proposals requiring them to account for and report their capital assets near completion; and
- Some respondents continue to hold strong preferences on this topic and have not changed their views even though the AED2 approach allowed more for the application of professional judgment than previous proposals had done.

AED2 was another attempt to build increased consensus in the government community on one key issue - accounting for multi-year government grants (including capital grants); diverse and strongly held views continue to exist.

Views essentially stem from two lines of thought – adherence to the conceptual framework (in particular strict adherence to the definitions of asset and liability) versus applying the concept of 'matching' with possible deferred amounts resulting on the balance sheet. Those on both sides of the controversy generally believe that substance over form is best achieved by following their approach.

At a general level, AED2 does not prohibit the recognition of assets and liabilities resulting from multi-year grants. Instead it prescribes their immediate recognition as an expense/revenue by the transferor/recipient unless it can be shown that the nature and extent of the stipulations associated with the grant mean that it meets the definition of an asset/liability. The onus is on the parties involved to satisfy the definitions rather than the proposed standard prescribing when an asset/liability would arise.

This is a less prescriptive more ‘principles-based’ approach compared to proposals in the first AED (AED1), which proposed a concept called “exchange-type transfers”.

A government that paid a transfer meeting the definition of an exchange-type transfer in advance of the recipient meeting the transfer stipulations acquired an asset. That asset comprised a right to compel another party to provide services or acquire or develop service capacity in accordance with the transferor’s terms. This concept was narrowly defined and very prescriptive and thus did not garner support in the government community. AED2 relies more on the use of professional judgment and diligent application of the asset and liability definitions.

A public exposure draft is currently scheduled to be approved by PSAB in March 2006, with final standards expected to be approved in September 2006.

### Revenue

*Status: Awaiting developments on IPSASB Exposure Draft*

This project is leveraging and building upon the work being done on this topic by the IPSASB.

As such, PSAB is awaiting the outcome of the IPSASB’s anticipated review of the draft ED on Revenue from Non-Exchange Transactions (Comprising Taxes and Transfers) at its November 2005 meeting.

Upon being released for comment PSAB will review the ED identifying any issues for Canada. It will distribute the ED with comments asking its Associates group to provide input to both PSAB and the IPSASB on the ED - input that will also be useful for the Canadian project. A Canadian advisory group will be recruited to provide PSAB with input on the appropriateness of the proposed international standard for Canadian governments. As PSAB is already working on a revised standard for government transfers (see elsewhere in this report) the material sent out for comment in Canada as a proposed Canadian accounting standard will likely concentrate on the proposed principles for taxes.

The CICA PSA Handbook does not currently include a definition of revenue for governments (though a proposed definition applicable to all governments was approved in September 2005 for public exposure as part of the Local Government Reporting Model project – see project discussion above) though a general revenue recognition principle is included in the general standards of financial statement presentation for both senior and local governments.

Further, the CICA PSA Handbook does have specific Sections regarding restricted assets and revenues (Section PS 3100) and government transfers (Section PS 3410) – both of which are currently being revised as part of the government transfers project – see above).

However, the existing standards do not specifically address many other types of government revenue, such as income and property taxes. Canada's revenue project will address this gap.

## **New Projects**

### Introduction to the CICA Public Sector Accounting Handbook

*Status: Project Proposal Approved*

Approved in September 2005, the project will revise the Introduction to the CICA PSA Handbook. The main objectives of the project will be to:

1. improve the usefulness of the PSA Handbook by making the Introduction more comparable with the Introductions to the CICA HANDBOOK-ACCOUNTING and CICA HANDBOOK-ASSURANCE – most notably with respect to how those Handbooks reflect their respective Sections on hierarchies for generally accepted accounting principles/generally accepted auditing standards; and
2. re-evaluate existing guidance in the Introduction as to what basis of accounting some categories of entities that are part of the 'public sector' should be applying in preparing their own general purpose financial statements – for a number of reasons:
  - The Accounting Standards Board (AcSB) has recently approved a draft Strategic Plan for comment. In brief, for those public sector organizations who at present are directed by the Introduction to PSA Handbook to follow standards in the CICA HANDBOOK – ACCOUNTING, there could be implications for their reporting requirements – as such the PSAB project will investigate those implications;
  - PSAB's new reporting entity standards (GOVERNMENT REPORTING ENTITY, Section PS 1300) effective on April 1, 2005 results in the inclusion of many new organizations in the government reporting entity. This is particularly true for the provincial and territorial governments.

With some exceptions, many of these new organizations for the provincial and territorial governments are from the SUCH (schools, universities, colleges and hospitals) who upon consolidation must conform their accounting policies with those of the government - which can pose some practical difficulties. As such, the notion of 'one GAAP for all in the public sector' has gained interest; and

- When the Introduction was originally drafted, PSAB did not have a full accrual reporting model – this is no longer the case. The evolution in public sector reporting has raised the question of the public sector model's applicability to government organizations who in the past, were directed to apply either the full accrual profit or not-for profit accounting standards in the private sector CICA HANDBOOK - ACCOUNTING.

Subsequent Events

*Status: Project Proposal Approved*

*Awaiting developments on the equivalent CICA Accounting Standards Board (AcSB) project*

Approved in June 2005, the project was initiated primarily in response to proposals released in March 2005 by the AcSB to update existing standards. A panel of the AcSB is currently deliberating on responses to the March 2005 Re-Exposure for consideration by the AcSB in the fourth quarter of 2005 with an effective date for interim and annual periods ending on or after June 30, 2006.

The AcSB project responds to user expectations and will seek to harmonize standards with the improved IAS 10. Key issues being considered are:

- extending the reporting period for subsequent events to a later date;
- disclosing that date; and,
- reconsidering the subsequent events date when financial statements are reissued.

The AcSB received a significant number of public sector responses to its proposals, a significant number of which requested that PSAB commence a project to review its equivalent standard. Once the final AcSB proposals are determined, PSAB's task force will consider their applicability to the public sector.

Coincident with these projects, the CICA Auditing and Assurance Standards Board is expected to propose revisions to auditing standards as a result of the AcSB project.

Having already sought the views of its Associate community on key aspects of the AcSB proposals as they effect commercial oriented public sector entities, the project approval helps ensure PSAB is well placed to act on developments on the matter as required.