

FINANCIAL REPORTING COUNCIL: THE USE OF A SECTOR NEUTRAL FRAMEWORK FOR THE MAKING OF AUSTRALIAN ACCOUNTING STANDARDS

Introduction

The Australian Financial Reporting Council (FRC) was established on 1 January 2000 under section 225 of the *Australian Securities and Investments Commission Act 1989*¹ (ASIC Act) for the purpose of overseeing Australia's accounting standard setting process.

One of the key functions of the Financial Reporting Council (FRC) is to provide broad oversight of the processes for setting accounting standards in Australia. Specifically, the FRC is responsible for determining the broad strategic direction for the setting of standards to be followed by the Australian Accounting Standards Board (AASB).

The AASB has functions, as set out in section 227 of the ASIC Act, which include:

- (a) to develop a conceptual framework, not having the force of an accounting standard, for the purpose of evaluating proposed accounting standards and international standards;
- (b) to make accounting standards under section 334 of the Corporations Act for the purposes of the corporations legislation (other than the excluded provisions);
- (c) to formulate accounting standards for other purposes; and
- (d) to participate in and contribute to the development of a single set of accounting standards for world-wide use.

Previous FRC Directions to the AASB

In accordance with its responsibility to provide broad strategic directions to the AASB on the making of accounting standards, the FRC issued two specific directions in 2002:

- The AASB should work towards the adoption in Australia of accounting standards that are the same as those issued by the IASB - and interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC) - to ensure their applicability to Corporations Act entities for accounting periods beginning on or after 1 January 2005;
- The AASB should pursue as an urgent priority the harmonisation of Government Finance Statistics (GFS) and Generally Accepted Accounting

¹ The FRC is continued in existence by section 261 of the *Australian Securities and Investments Commission Act 2001* (the ASIC Act)

Principles (GAAP) reporting. The objective should be to achieve an Australian accounting standard for a single set of Government reports which are auditable, comparable between jurisdictions, and in which the outcome statements are directly comparable with the relevant budget statements.

No further direction concerning the making of accounting standards has been provided by the FRC since 2002.

Research into Sector Neutral Standards

At the FRC meeting held on 20 September 2004, the FRC agreed to engage a consultant to undertake research work on the appropriateness of a sector neutral approach to the making of accounting standards.

In November 2005, Mr Kevin Simpkins was appointed to undertake research into how adequately a sector neutral approach to the development of accounting standards can meet the information needs of users of financial statements and the public interest more generally. The purpose of the research project was to assist the FRC in considering possible modifications to its strategic direction to the AASB, especially in relation to the public and the other not-for-profit sectors. Parties with a strong interest in the issue of sector neutral standards were invited to register with the FRC Secretariat.

Mr Simpkins was Deputy Controller and Auditor-General of New Zealand for three years until May 2005, having previously held other senior positions in the Office of the Auditor-General, Ernst & Young and the New Zealand Institute of Chartered Accountants, where he was Technical Director. He was a member and Deputy Chair of the Financial Reporting Standards Board until 2002 and a member of the (now) International Public Sector Accounting Standards Board until 2003. Mr Simpkins has a long record of involvement in the not-for-profit sector.

In preparing his report, Mr Simpkins consulted with:

- a range of domestic stakeholders, including the AASB, professional accounting bodies, government departments and private sector organisations;
- overseas and international accounting standard setting and oversight bodies; and
- the FRC itself, principally via a Steering Committee established for the purpose of guiding the research.

Mr Simpkins' report was tabled at the FRC meeting held in Sydney on 22 June 2006. The FRC agreed to make the report publicly available via the FRC web site.

Matters for consideration

The FRC is seeking public comment on the following matters related to standard-setting, especially in relation to the public sector and the other not-for-profit sector. Respondents are particularly requested to provide the reasons for their views, whether supportive or critical of the identified issues. The matters on which the FRC is seeking comment, which are reproduced in Part 8 of Mr Simpkins' report, are:

- 1. *In your view, how well are the needs of all users of general purpose financial reports, including users of public sector and other not-for-profit entities in Australia, being met?***
- 2. *Will the current approach of the AASB enable the standard-setter to respond to the more challenging environment of the future and ensure the needs of public sector and other not-for-profit users are appropriately met?***
- 3. *Do you consider that having a conceptual framework that is applicable and appropriate to all entities is a necessary element in Australian standard-setting for all sectors? What approach to establishing a conceptual framework(s) do you consider appropriate?***
- 4. *Different approaches could be used to set standards in Australia. Which approach do you consider the most appropriate:***
 - *to continue to develop a single set of standards;***
 - *to develop two separate sets of standards: one for profit-oriented entities and the other for not-for-profit entities; or***
 - *another approach e.g. three sets of standards (profit-oriented, public sector not-for-profit and other not-for-profit sets) or two sets of standards with other not-for-profit entities being addressed together with profit-oriented entities? (If you prefer this option please describe the approach you prefer)***
- 5. *If, in response to Consultation Issue 4, you considered standards different from those applying to the for-profit sector should be developed for one or more sectors please indicate, for each such sector, what the primary base should be for those standards:***
 - *Government Finance Statistics (GFS);***
 - *International Public Sector Accounting Standards (IPSAS); or***
 - *a range of sources, including International Financial Reporting Standards, IPSAS and GFS, depending on the particular issue being considered?***
- 6. *If a single set of standards continues to be developed in Australia, do you prefer:***
 - *the current approach of the AASB;***

- *a matrix approach, retaining specific standards for types of public sector and possibly also other not-for-profit entities while maintaining a general set of topic based standards applicable to all entities; or*
 - *an approach involving a single set of standards but with non-standard level guidance (such as the Statements of Recommended Practice in the United Kingdom) applicable to particular sectors or groups of entities in sectors?*
7. *Would developing a Statement of User Needs for the public sector and other not-for-profit sectors, based on research, and including an analysis of how any different needs impact financial reporting be useful? If so, please suggest how that Statement of User Needs could be developed and maintained. Do you have any other views on how user input could be enhanced?*
8. *Do you consider that there is enough clarity on the direction that the AASB is taking in establishing requirements for the public sector and other not-for-profit sector, including identifying the base set or sets of standards which will be adopted?*
9. *A number of options to enhance the recognition of different environments and issues in sectors have been identified in the Report. Do you consider any of the options, including those relating to board membership, sub-boards or committees, expectations of board members, staffing or explicit board sign-offs would enhance the ability of the standard-setting process to meet user needs?*
10. *Are there any other matters that you would like to suggest for consideration by the FRC?*

Invitation to comment

Comments should be addressed to:

Mr Jorge del Busto
 Secretary Financial Reporting Council
 c/- The Commonwealth Treasury
 Langton Crescent
 PARKES ACT 2600

or sent by e-mail to jdelbusto@treasury.gov.au

by no later than Tuesday 31 October 2006.

It will be assumed that submissions are not confidential and may be made publicly available. If you want your submission, or any part of it, to be treated as 'confidential', please indicate this clearly. A request made under the *Freedom of Information Act 1982* (Cth) for a submission to be made available will be determined in accordance with the Act.

**A review of the policy of sector-neutral
accounting standard-setting in
Australia**

A report prepared by Kevin Simpkins, independent consultant, for the Financial Reporting Council pursuant to the Council's function to provide broad oversight of the processes for setting accounting standards in Australia. (Section 225(1) of the Australian Securities and Investments Commission Act 2001)

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Summary

Since its establishment in 2000 as the sole accounting standard-setting body in Australia, the Australian Accounting Standards Board (“AASB”) has adopted a sector-neutral approach to the setting of accounting standards. Pursuant to its responsibility to exercise broad oversight of the processes for setting accounting standards in Australia, the Financial Reporting Council (“FRC”) determined to review whether a sector-neutral approach to accounting standard-setting is able to meet the needs of users and the public interest more generally.

Part 1 of this report explains the role of the FRC, the role of the AASB, and the context in which this review was initiated.

Part 2 of the report describes the approach taken to the review. This involved five phases as follows:

- Phase 1 – Preliminary planning and scoping;
- Phase 2 – Stakeholder liaison and research;
- Phase 3 – Detailed research and analysis (including review and analysis of standard-setting approaches and structures in selected countries and at the international level, as well as a review of existing Australian Accounting Standards and Conceptual Framework documents)
- Phase 4 – Develop findings and evaluate options; and
- Phase 5 – Final report.

Part 2 also clarifies matters which were not subject to review, including the adoption of standards based on international financial reporting standards for profit-oriented entities and issues related to standard-setting for different size entities.

For the purposes of the review, three broad sectors have been considered, namely:

- Profit-oriented entities;
- Public sector not-for-profit entities; and
- Other not-for-profit entities.

Part 3 of the report describes the current approach adopted by the AASB to accounting standard-setting for the three sectors being considered. This approach is referred to in the report as the “sector-neutral” approach to accounting standard-setting. This approach primarily involves development of a single set of standards using the standards of the International Accounting Standards Board (“IASB”) as the “foundation” standards to which

material is added to broaden the scope of the standards to those sectors not addressed by the IASB, as well as in relation to other domestic regulatory or other matters.

Part 4 of the report reviews the international accounting standard-setting scene and, in particular, the IASB and the International Public Sector Accounting Standards Board ("IPSASB"). It explores the implications of international developments for Australia concluding that the task for a national standard-setter with responsibility to set standards for all entities in its jurisdiction is becoming increasingly difficult.

Part 5 of the report explores the way in which accounting standards are set for different sectors in four countries – New Zealand, Canada, the United States of America and United Kingdom. In particular the reasons for different requirements in different sectors in each country are discussed as well as how users and their information needs are viewed in relation to different sectors in each country. Current or future developments in standard-setting for different sectors and the strengths and weaknesses of the current approach in each country are considered as well as the relationship between Government Finance Statistics and General Purpose Financial Reporting in each country.

Part 6 reports the views of a selection of Australian stakeholders of accounting standard-setting on issues related to sector-neutrality. While there do not appear to be any issues of concern relating to profit-oriented entities arising from the sector-neutral approach, stakeholders have significant concerns in relation to public sector not-for-profit and other not-for-profit entities. Stakeholders in these sectors emphasised that there are differences between the sectors and that the accounting standard-setting arrangements should respond more to those differences.

Part 7 of the report reviews existing Australian Accounting Standards and Conceptual Framework documents from a sector application perspective. The report identifies a number of issues in relation to the Conceptual Framework documents and concludes that they do not provide a sufficient nor, in some respects, appropriate basis to underpin sector-neutral accounting standards for the future. In relation to Australian Accounting Standards, the report finds that the vast majority of the provisions in current standards apply appropriately and properly to all entities in all sectors. However a number of specific issues are raised from the perspective of both categories of not-for-profit entity. The report concludes that a number of issues remain to be addressed and that the minimalist approach to changes to IFRS is at risk of compromising the credibility of the standard-setting process in the not-for-profit sectors.

Part 8 of the report draws together the earlier work and considers how effective the current approach is in meeting different user needs, explores issues relating to the future of the current approach and identifies and discusses other alternatives to the current approach. The report concludes that there are different users in the different sectors and that they have some different information needs. It concludes that there is, at the very least, potential to

significantly enhance the extent to which the needs of users of public sector not-for-profit entities reports are met. It takes a similar view in relation to the other not-for-profit sector.

The issues emerging in the international standard-setting arena are then considered and the challenges for national setters explored. In particular, the difficulty of maintaining a common conceptual framework is discussed. The report concludes that a common conceptual framework will not be possible so long as the reluctance to make changes to IASB documents evident in the recent past in Australia is maintained.

The report identifies and evaluates other options for standard-setting including:

- two or more different sets of standards,
- options for a not-for-profit series of standards as part of a two sets of standards scenario;
- alternative approaches to a single-set of standards;
- the possibility of more than one board; and
- options to enhance the current approach.

The Financial Reporting Council is inviting comments from stakeholders on a series of consultation questions through a consultation paper issued simultaneously with this report. Those questions have been incorporated in Part 8 for the assistance of readers.

Acronyms used in this document

The following acronyms are used in this document.

AASB	Australian Accounting Standards Board
AASB Framework	AASB Framework for the Preparation and Presentation of Financial Statements
ACAG	Australasian Council of Auditors-General
AcSB	Accounting Standards Board (Canada)
AICD	Australian Institute of Company Directors
AIFRS	Australian Equivalents to International Financial Reporting Standards
ASB	Accounting Standards Board (United Kingdom)
ASRB	Accounting Standards Review Board (New Zealand)
Canadian GAAP	Canadian Generally Accepted Accounting Principles
FASAB	Federal Accounting Standards Advisory Board (USA)
FASB	Financial Accounting Standards Board (USA)
FRA	Financial Reporting Act 1993 (New Zealand)
FRC	Financial Reporting Council (Australia)
FRSB	Financial Reporting Standards Board (New Zealand)
FRSSE	Financial Reporting Standard for Smaller Entities (United Kingdom)
GASB	Governmental Accounting Standards Board (USA)
GFS	Government Finance Statistics (of the International Monetary Fund)
HoTARAC	Heads of Treasuries Accounting and Reporting Advisory Committee
IASB	International Accounting Standards Board
IASB Framework	IASB Framework for the Preparation and Presentation of Financial Statements
IASC Foundation	International Accounting Standards Committee Foundation
IAS	International Accounting Standards
ICAA	Institute of Chartered Accountants in Australia
IFRIC	International Financial Reporting Interpretations Committee
IFAC	International Federation of Accountants
IFRS	International Financial Reporting Standards
IPSAS	International Public Sector Accounting Standards
IPSASB	International Public Sector Accounting Standards Board
NIA	National Institute of Accountants (Australia)
NZ Institute	New Zealand Institute of Chartered Accountants
NZ Framework	New Zealand Framework for the Preparation and Presentation of Financial Statements
NZ GAAP	New Zealand Generally Accepted Accounting Practice
ONS	Office for National Statistics (UK)

PBEs	Public Benefit Entities (New Zealand and United Kingdom)
PSAB	Public Sector Accounting Board (Canada)
SEC	Securities and Exchange Commission (USA)
SNA	System of National Accounts
SORP	Statement of Recommended Practice (United Kingdom)
TFHPSA	Task Force on the Harmonisation of Public Sector Accounting
UK GAAP	UK Generally Accepted Accounting Practice
US GAAP	US Generally Accepted Accounting Principles

Part 1 - Introduction

Background

- 1.1 On 1 January 2000, new accounting standard-setting arrangements came into effect in Australia. These arrangements arise from Part 12 of the Australian Securities and Investments Commission Act 2001 of which one of the main objects is to facilitate the development of accounting standards that require the provision of financial information that:
- Allows users to make and evaluate decisions about allocating scarce resources;
 - Assists directors to discharge their obligations in relation to financial reporting;
 - Is relevant to assessing performance, financial position, financing and investment;
 - Is relevant and reliable;
 - Facilitates comparability; and
 - Is readily understandable¹.
- 1.2 The new institutional arrangements involved two key bodies - the Financial Reporting Council ("FRC") with a function of broad oversight of the processes for setting accounting standards in Australia and the Australian Accounting Standards Board ("AASB") with responsibility for setting accounting standards for the purposes of the corporations legislation and for other purposes in Australia. These arrangements replaced those under which the AASB worked alongside the Public Sector Accounting Standards Board of the accounting profession. Both boards used the services of the staff of the Australian Accounting Research Foundation and issued separate standards although, on most topics, the standards were substantially the same. The Public Sector Accounting Standards Board ceased to exist when the new arrangements came into effect.
- 1.3 At the commencement of the new arrangements the AASB adopted a sector-neutral approach to the setting of accounting standards in Australia and it is that approach which is the subject of this review.

The role of the FRC

- 1.4 The broad function of the FRC in relation to accounting standard-setting is "to provide broad oversight of the processes for setting accounting standards in Australia"². Its specific functions in relation to accounting standards are:

¹ *Australian Securities and Investments Commission Act 2001*, section 224

² *Australian Securities and Investments Commission Act 2001*, section 225(1) (a).

- Appointing the members of the AASB;
- Approving and monitoring the AASB's priorities, business plans, budgets and staffing arrangements (including level, structure and composition of staffing);
- Determining the AASB's broad strategic direction;
- Giving the AASB directions, advice or feedback on matters of general policy and procedures;
- Monitoring the development of international accounting standards and the accounting standards that apply in major international financial centres;
- Furthering the development of a single set of accounting standards for world-wide use with appropriate regard to international developments;
- Promoting the continued adoption of international best practice accounting standards in the Australian accounting standard-setting processes if doing so would be in the best interests of both the private and public sectors in the Australian economy;
- Monitoring:
 - the operation of accounting standards to assess their continued relevance and their effectiveness in achieving their objectives in respect of both the private and public sectors of the Australian economy; and
 - the effectiveness of the consultative arrangements used by the AASB.
- Seeking contributions towards the costs of the Australian accounting standard-setting processes; and
- Monitoring and periodically reviewing the level of funding, and the funding arrangements, for the AASB.³

1.5 The FRC has power to do all things necessary or convenient in connection with the performance of its functions. However, the FRC does not have power to direct the AASB in relation to the development, or making, of a particular standard nor the power to veto a standard made, formulated or recommended by the AASB.⁴

³ *Australian Securities and Investments Commission Act 2001*, section 225(2).

⁴ *Australian Securities and Investments Commission Act 2001*, section 225(5) and (6).

The role of the AASB

- 1.6 The AASB is now Australia's sole accounting standard-setter, having the following specific functions:
- To develop a conceptual framework, not having the force of an accounting standard, for the purpose of evaluating proposed accounting standards and international standards;
 - To make accounting standards under Section 334 of the *Corporations Act* for the purposes of the corporations legislation;
 - To formulate accounting standards for other purposes; and
 - to participate in and contribute to the development of a single set of accounting standards for world-wide use.⁵
- 1.7 The AASB has power to engage staff and consultants, establish committees, advisory panels and consultative groups and do anything else that is necessary for, or reasonably incidental to, the performance of its functions.⁶
- 1.8 The AASB is also specifically authorised to formulate an accounting standard by issuing the text of an international standard. The text of the international accounting standard may be modified to the extent necessary to take account of the Australian legal or institutional environment and, in particular, to ensure that any disclosure and transparency provisions in the standard are appropriate to the Australian legal or institutional environment.⁷
- 1.9 The AASB may make or formulate accounting standards to be of general or limited application. In making and formulating accounting standards the AASB must have regard to the suitability of a proposed standard for different types of entity, may apply different accounting requirements to different types of entity and must ensure there are appropriate accounting standards for each type of entity that must comply with accounting standards.⁸

Strategic directions to the AASB

- 1.10 In 2002 the FRC issued two significant strategic directions to the AASB. The strategic directions are, in summary, to:

⁵ *Australian Securities and Investments Commission Act 2001*, section 227(1).

⁶ *Australian Securities and Investments Commission Act 2001*, section 227(3).

⁷ *Australian Securities and Investments Commission Act 2001*, section 227(4).

⁸ *Australian Securities and Investments Commission Act 2001*, section 229(1) and (2).

- Work towards adoption in Australia of accounting standards that are the same as those issued by the International Accounting Standards Board (“IASB”);
- Pursue as an urgent priority the harmonisation of Government Finance Statistics (“GFS”) and Generally Accepted Accounting Principles reporting. The objective should be to achieve an Australian accounting standard for a single set of government reports which are auditable, comparable between jurisdictions, and in which the outcome statements are directly comparable with the relevant budget statements.

Sector-neutrality in the context of the strategic directions

- 1.11 Since 2002, the AASB has pursued the two key strategic directions. In the case of the direction to work towards adoption in Australia of accounting standards that are the same as those of the IASB, a full set of Australian equivalents to International Financial Reporting Standards (“AIFRS”) were gazetted on 15 July 2004 with those standards having application to periods commencing on or after 1 January 2005.
- 1.12 In relation to the strategic direction concerning GFS, the AASB has concentrated on the General Government Sector⁹ and issued an exposure draft in July 2005.¹⁰
- 1.13 Seeking to harmonise with GFS while at the same time issuing standards which are the same as those of the IASB, has created new challenges for the AASB. In particular it added complexity to the AASB’s policy of developing sector-neutral standards.
- 1.14 The policy of setting sector-neutral standards has also come under scrutiny in recent years from a number of academics and other writers. Concerns have also been raised within the public and not-for-profit sectors about the implications of the international standards on which Australian standards are now based having been developed solely for profit-oriented businesses.
- 1.15 These and other issues led the FRC to determine, in accordance with its role and powers, to review whether a sector-neutral approach to accounting standard-setting is able to meet the needs of users and the public interest more generally. While it is an over-simplification of the issues involved, some have described the review as considering whether, in relation to accounting standards, “one size fits all”.

⁹ One of five mutually exclusive sectors in the International Monetary Fund’s Government Finance Statistics Manual 2001: general government, non-financial corporations, financial corporations, non-profit institutions serving households and households.

¹⁰ ED142 *Financial Reporting of General Government Sectors by Governments*.

Part 2 – Approach to the Review

Statement of requirements

- 2.1 On initiating the review, the FRC set out a Statement of Requirements. This can be found at Appendix 1.

Phases of the review

- 2.2 Following my appointment to conduct the review for the FRC, an overall plan responsive to the Statement of Requirements was developed. This plan, involving five phases, was endorsed by the FRC, which established a Steering Committee to guide the review.¹¹

2.3 *Phase 1 – Preliminary planning and scoping*

This phase included an issues based literature review and dialogue with the FRC Steering Committee to confirm the scope of the review, reach agreement on definitional aspects, confirm the preliminary research issues and agree on an overall timetable for the review.

2.4 *Phase 2 – Stakeholder liaison and research issues*

Phase 2 involved liaison with the AASB to confirm its current approach to developing standards for different sectors and to be informed about any planned future initiatives relevant to the review. This phase also involved liaison with a selected group of stakeholders and user groups through face-to-face meetings or written communication as well as the gathering of views of other stakeholders through additional research. The results of this work are reported in Part 6. At the completion of this phase the preliminary issues to be considered in the review were confirmed in conjunction with the Steering Committee.

2.5 *Phase 3 – Detailed research and analysis*

This phase comprised two overlapping streams:

¹¹The members of the Steering Committee were Don Challen, Charles Macek, Phillip Prior and Catherine Walter AM

- Stream A: Review and Analysis of Standard-setting Approaches and Structures in Selected Countries and at the International Level

This stream involved research and a survey of the two international standard-setting bodies and those in four selected countries, as well as inquiries in relation to certain specific matters. The results of this work are reported in Parts 4 and 5.

- Stream B: Review of existing Australian Accounting Standards and Conceptual Framework documents

This stream involved reviewing the Australian Accounting Standards and Conceptual Framework documents at 1 January 2006 from a sector application perspective. The results of this work are reported in Part 7.

2.6 *Phase 4 – Develop findings and evaluate options*

This phase involved bringing together the various streams of the review to identify issues and options for consideration by the FRC.

2.7 *Phase 5 – Final report*

This phase represented the preparation of this report for consideration by the FRC and its stakeholders.

Matters not covered by the review

2.8 The following matters were not subject to review:

- The adoption of standards based on International Financial Reporting Standards for profit-oriented entities;
- Developments in the form in which financial information may be made available to users, such as XBRL or similar;
- The appropriateness of accrual accounting for all sectors; and
- Issues related to standard-setting for different size entities.

2.9 While the adoption of standards based on International Financial Reporting Standards for profit-oriented entities has significant implications for a sector-neutral approach to standard-setting, the adoption of these standards themselves for profit-oriented entities represents a firm policy position of the Australian government and FRC and has not been subject to reconsideration.

- 2.10 There is little doubt that developments in the form in which financial information is made available to users will continue to occur over coming years. While it is possible that these developments will have an impact on the manner in which accounting standards are set, the implications for a sector-neutral accounting standard-setting approach are less clear and have therefore not been covered by the review.
- 2.11 Preliminary analysis as part of this review identified a number of issues related to the application of accrual accounting in the public sector and the not-for-profit sector. However there was minimal evidence of concern about the adoption of the accrual basis of accounting per se. Furthermore the fact that the two international accounting standard-setting bodies and the International Monetary Fund in its Government Finance Statistics all now use and advocate accrual accounting suggested that it would not be worthwhile to re-examine this issue.
- 2.12 Consideration was given to exploring issues related to setting standards for different size entities as part of this review.¹² However it was decided to exclude this from the scope of the review because the IASB currently has a project underway on accounting standards for small and medium-sized entities and the Trans-Tasman Accounting Standards Advisory Group has also been considering issues related to size as part of its work on differences between the financial reporting frameworks in Australia and New Zealand.

Definitional and similar matters

- 2.13 For the purposes of the review a number of definitional and similar matters were agreed. They are described below.

Sectors...

- 2.14 For the purposes of the review, three broad sectors have been considered, namely:

- Profit-oriented entities;
- Public sector not-for-profit entities; and
- Other not-for-profit entities.

- 2.15 In the context of the current Australian Accounting Standards, both public sector not-for-profit entities and other not-for-profit entities are referred to as “not-for-profit entities”. A not-for-profit entity is defined in Australian Accounting Standards as “an

¹² The Institute of Chartered Accountants in Australia have published a Business Practice Guide which provides a non-authoritative form of simplified reporting for small and medium-sized entities. Refer to <http://www.icaa.org.au/tech/index.cfm?menu=312&id=A106597203>. (Financial Reporting)

entity whose principal objective is not the generation of profit".¹³ A not-for-profit entity can be a single entity or a group of entities comprising the parent entity and each of the entities that it controls.

- 2.16 Profit-oriented entities in the public sector (referred to in this report as "government business enterprises") are an important subset of the profit-oriented entities sector.

Sector-neutral approach...

- 2.17 In its pure form, a sector-neutral approach to accounting standard-setting is one in which standards are developed with regard to, and which establish identical requirements and guidance for like transactions and events for all entities to which the standards apply. Such standards would be based on a single conceptual framework. As far as I am aware, such an approach to accounting standard-setting is not followed in any jurisdiction.

- 2.18 For the purposes of this review, a "sector-neutral" approach has been taken to mean the approach currently adopted by the AASB. That approach is to base Australian standards, interpretations and conceptual documents on those of the IASB but make such modifications as the AASB considers necessary so that (with a small number of exceptions) each standard and other document may apply to all entities. The current approach is explained more fully in Part 3 of this report.

Australian Accounting Standards...

- 2.19 The Australian Accounting Standards considered as part of this review are:
- AASB Standards 1 to 7 which are the equivalents of the most recently issued IFRS standards;
 - AASB standards 101 to 141 which are the equivalents of the standards issued previously as international accounting standards ("IAS");
 - AASB standards without international equivalents (comprising AASB 1004, 1023, 1031, 1038, 1039 and 1048); and
 - AAS standards which cover specific public sector entities and financial reporting by superannuation plans (AAS 25, 27, 29 and 31).

The Conceptual Framework documents considered as part of this review are:

¹³ See for example paragraph AUS6.1 of AASB 102 *Inventories*.

- The AASB *Framework for the Preparation and Presentation of Financial Statements* (“AASB Framework”);
- Statements of Accounting Concepts which have not been withdrawn (SAC 1 and SAC 2).

Selected countries...

2.20 For the purposes of the review, it was agreed to consider international standard-setting arrangements and developments in relation to the International Accounting Standards Board (“IASB”) and the International Federation of Accountants (“IFAC”), and in particular it’s International Public Sector Accounting Standards Board (“IPSASB”).

2.21 Following an analysis of countries which have well developed standard-setting arrangements for all the sectors being examined in this review, it was agreed that New Zealand, Canada, the United States of America and the United Kingdom would be the countries considered. There are structural and other differences in the approaches taken in each of these countries and accordingly they represented an opportunity to compare approaches with the existing Australian sector-neutral approach.

Key Stakeholders...

2.22 The steering committee agreed the following as the stakeholders to be approached to provide views on the current arrangements for standard-setting for the three sectors being examined:

- The professional accounting bodies:
 - CPA Australia;
 - The Institute of Chartered Accountants in Australia (“ICAA”); and
 - The National Institute of Accountants (“NIA”);
- The Heads of Treasuries Accounting and Reporting Advisory Committee (“HoTARAC”);
- The Australian Bureau of Statistics;
- The Australian Institute of Company Directors;
- The Australasian Council of Auditors-General (“ACAG”);

- The Joint Committee of Public Accounts and Audit of the Commonwealth Parliament;
- Selected commentators, including economic commentators; and
- A group of stakeholders representing the not-for-profit sector.¹⁴

Structure of this report

- 2.23 The core elements of the review are discussed in Parts 3 to 7 of the report. In Part 8 the issues are identified and options evaluated with reference back to the earlier parts where relevant.
- 2.24 *Part 3* describes the current approach adopted by the AASB to accounting standard-setting for the three sectors being considered in this review.
- 2.25 *Part 4* examines the international standard-setting scene in 2006 and the implications this has for the setting of standards for the three sectors in Australia.
- 2.26 *Part 5* examines the approach to accounting standard-setting for the three sectors in the selected countries (New Zealand, Canada, the United States of America and the United Kingdom).
- 2.27 *Part 6* summarises the views of those stakeholders consulted during the course of the review and some other stakeholder views identified from other documented sources.
- 2.28 *Part 7* reports on the review of existing Australian Accounting Standards and Conceptual Framework documents from a sector application perspective.
- 2.29 *Part 8* considers the issues in relation to standard-setting for different sectors in Australia in 2006 and identifies and discusses options which could be considered for the future.

¹⁴ Each of the three professional accounting bodies also have members in this sector and their views in relation to the implications of accounting standards for the sector have been taken account of.

Part 3 - The Australian Accounting Standards Board's current approach

Description of Approach

- 3.1 The AASB's approach to setting standards for different sectors has built on the approaches of predecessor standard-setting boards in Australia and has continued to evolve even during the short period of this review.
- 3.2 Soon after the establishment of the AASB as a single standard-setting board responsible for all sectors in 2000, it decided to issue one set of standards for all entities as an overriding strategy. Prior to that, there had been two sets of standards, one issued by the former Australian Accounting Standards Board and the other by the Public Sector Accounting Standards Board of the accounting profession. However for more than a decade, those boards had worked together on conceptual documents and proposed standards and the differences between the two sets of standards were not extensive.
- 3.3 After receiving the July 2002 strategic direction to adopt IFRS for application to reporting periods beginning on or after 1 January 2005, the AASB decided to continue to issue one series of sector-neutral standards, that is, standards applicable to both for profit and not-for-profit entities, including public sector entities.
- 3.4 Except for standards that are specific to not-for-profit entities or of a purely domestic nature, the AASB uses the standards of the IASB as the "foundation" standards to which it adds material detailing the scope and applicability of the standard in the Australian environment. Additions are made, where necessary, broadening the content to cover those sectors not addressed by the IASB (that is not-for-profit entities) as well as domestic, regulatory or other issues.
- 3.5 In developing the single set of standards, the AASB also has regard to the standards of the International Public Sector Accounting Standards Board ("IPSASB") of the IFAC in respect of issues affecting not-for-profit entities. The IPSASB generally uses the standards of the IASB as a basis for its standards and, accordingly, adopting IASB standards simultaneously helps convergence with existing and future International Public Sector Accounting Standards ("IPSAS").
- 3.6 To date the AASB has also retained a group of standards which are applicable only to the public sector. These standards overlay the other standards for the public sector entities to which each applies:

- AAS 27 *Financial Reporting by Local Governments*;
 - AAS 29 *Financial Reporting by Government Departments*; and
 - AAS 31 *Financial Reporting by Governments*.
- 3.7 Furthermore, in implementing the FRC strategic direction to harmonise the requirements applicable to general purpose financial reports of public sector entities and those applicable to Government Finance Statistics, the AASB has issued an exposure draft (ED142 *Financial Reporting of General Government Sectors by Governments*). If and when finally approved as a standard, this standard would also be specifically applicable to the public sector environment.
- 3.8 The approach of the AASB and its Urgent Issues Group (UIG)¹⁵ has also been to issue UIG Interpretations¹⁶ to apply wherever possible to all entities. There are some however that are limited in their application. For example, UIG 1038 *Contributions made by Owners to Wholly-Owned Public Sector Entities*.

Recent Developments

- 3.9 Just prior to this review being commenced, the AASB decided that the standards dealing with financial reporting by local governments, government departments and governments (AAS 27, 29 and 31) should be withdrawn, with any issues not adequately addressed in other Australian Accounting Standards being considered and retained where still relevant as part of the withdrawal process. This decision was communicated in a Strategy Paper *Australian Accounting Standards and Public Sector Entities* which has been updated following consultation and further board consideration.¹⁷
- 3.10 The AASB has indicated it will retain material currently contained in the three standards where needed. It will generally locate requirements which it considers remain necessary in topic-based standards, rather than industry-based standards as at present. Those topic-based standards will be applicable to all entities for which the topic is pertinent. Where an existing topic-based standard exists, that will be the vehicle to prescribe the additional requirements for not-for-profit public sector entities. Where a topic is substantive but not addressed, or where it is inappropriate for it to be addressed in an existing Australian Accounting Standard, a stand-alone single topic-specific standard will be created. Finally, where disclosure topics are not individually substantive but warrant the authority of a Standard and are not addressed, or it is not

¹⁵ The AASB recently decided that the UIG would be disbanded and its outstanding workload taken up by the AASB. The last meeting of the UIG was held in early June 2006.

¹⁶ UIG Interpretations are given authority under AASB 1048 *Interpretation and Application of Standards*.

¹⁷ The latest version of this strategy paper is available on the AASB website and is dated 28 February 2006.

appropriate for them to be addressed in existing Australian Accounting Standards, a stand-alone multi-topic-based standard will be developed.

- 3.11 The AASB has over recent months been reviewing the provisions of the three standards and is expected to publish an exposure draft to outline its recommendations later this year.
- 3.12 At its February 2006 meeting, the AASB reviewed its strategies and agreed sector-neutrality should remain one of the board's strategies but should be re-expressed in terms of like transactions being treated in the same manner by all entities. This approach would be described as "transaction-neutrality". The board also agreed that sector-neutrality should be better explained, in particular, its use as a guiding principle rather than as a constraint. The board agreed that its sector-neutrality strategy would be revised.¹⁸
- 3.13 In a related decision, the AASB agreed there was a need to consider the AASB *Framework for the Preparation and Presentation of Financial Statements* in light of the needs of not-for-profit entities and a broad range of constituents. It was noted that the timing of any review would be affected by work currently being done at the IASB and the IPSASB on framework issues.
- 3.14 While the term "sector-neutral" is widely used in Australia, it is a misnomer. The term "transaction-neutrality" is more accurate and the re-expression of the AASB's strategy is sensible. However due to widespread use of the term "sector-neutral" and because this review has always been described as a "review of sector-neutral accounting standard-setting", the term has been retained in this report. As stated in paragraph 2.18 it means the approach currently adopted by the AASB and as described in this Part.

¹⁸ At the time of finalising this report, the strategy has not yet been revised.

Part 4 – The International Standard-Setting Scene

- 4.1 The role of national accounting standard-setters such as the AASB is increasingly being influenced by international standard-setting bodies. In this part the international accounting standard-setting environment is considered and, in particular, the IASB and IPSASB. The role and likely future direction of the IASB and IPSASB and the differences in their assessments of the needs of users are also explored below.
- 4.2 One of the functions of the AASB is “to participate in and contribute to the development of a single set of accounting standards for world-wide use”.¹⁹ Furthermore, the strategic direction given to the AASB by the FRC to adopt IFRS for application to reporting periods beginning on or after 1 January 2005 has made an already close relationship with the IASB of crucial importance to the AASB.
- 4.3 However the AASB’s responsibilities to set standards for not-for-profit entities, including those in the public sector, means it will also have regard to the work of IPSASB in respect of entities for which that body sets standards. How much regard is a matter of conflicting opinions. In contrast with the profit-oriented entities environment there is limited current pressure for countries like Australia to align their public sector accounting with the standards and other material of IPSASB.²⁰ Some are also concerned about the resources available to IPSASB and therefore its ability to maintain its role. However IPSASB is the only international body currently addressing issues like accounting for non-exchange revenues, accounting for heritage assets, accounting for social policy obligations and similar matters – all of which are significant issues in the public sector context.
- 4.4 While not considered in this part of the report, it is acknowledged that the International Monetary Fund in some respects also acts as a standard-setter in issuing the Government Finance Statistics Manual guiding the preparation of financial information by governments on a GFS basis.

The IASB

- 4.5 The IASB is the standard-setting body of the International Accounting Standards Committee Foundation (“IASC Foundation”). The IASC Foundation is a not-for-profit corporation, which was incorporated in the state of Delaware, USA on 6 February 2001.

¹⁹ *Australian Securities and Investments Commission Act 2001*, section 227(1) (d).

²⁰ IFAC Statement of Member Obligations 5 “International Public Sector Accounting Standards and other PSC Guidance” requires IFAC member bodies such as CPA Australia and the ICAA to use their best endeavours to ensure that IPSAS are implemented in their jurisdiction.

4.6 The objectives of the IASC Foundation are:

- a) to develop, in the public interest, a single set of high quality, understandable and enforceable global accounting standards that require high quality, transparent and comparable information in financial statements and other financial reporting to help participants in the world's capital markets and other users make economic decisions;
- b) to promote the use and rigorous application of those standards;
- c) in fulfilling the objectives associated with a) and b), to take account of, as appropriate, the special needs of small and medium sized entities and emerging economies; and
- d) to bring about convergence of national accounting standards and International Accounting Standards and International Financial Reporting Standards to high quality solutions.²¹

4.7 While the IASB develops International Financial Reporting Standards²² neither the IASB nor the IASC Foundation has the authority to impose IFRS on any entity. The decision to require the financial statements of particular entities to be presented in compliance with IFRS is a matter for national or regional jurisdictions.

4.8 IFRS are developed for profit-oriented entities. The *Preface to International Financial Reporting Standards* states in paragraph 9:

...IFRS are designed to apply to the general purpose financial statements and other financial reporting of all profit-oriented entities. Profit-oriented entities include those engaged in commercial, industrial, financial and similar activities, whether organised in corporate or in other forms.

4.9 IFRS are accordingly not developed for not-for-profit entities. As also stated in paragraph 9 of the *Preface to International Financial Reporting Standards*:

...although IFRS are not designed to apply to not-for-profit activities in the private sector, public sector or government, entities with such activities may find them appropriate. The Public Sector Committee²³ has issued a Guideline²⁴ stating that IFRS

²¹ IASC Foundation Constitution, section 2, July 2005.

²² The IASB defines International Financial Reporting Standards as comprising:

- a) International Financial Reporting Standards;
- b) International Accounting Standards; and
- c) Interpretations issued by the International Financial Reporting Interpretations Committee ("IFRIC") or the former Standing Interpretations Committee.

²³ Renamed the International Public Sector Accounting Standards Board in 2004.

are applicable to government business entities. The PSC prepares accounting standards for governments and other public sector entities, based on IFRS.

4.10 It should be noted that the IASB is not precluded by the IASCF Constitution from developing standards for not-for-profit entities including those in the public sector. During the review of the IASC Foundation constitution in 2004/05, the issue was raised by various commentators including the FRC²⁵.

4.11 However the Trustees of the IASC Foundation concluded that it would not be appropriate to specifically add accounting standards for not-for-profit and public sector entities to its objectives.²⁶ In explaining this decision, the Trustees stated that they:

*Considered whether the organisation's objectives should include developing accounting standards for not-for-profit and public sector entities. While the Constitution would not prohibit the preparation of standards for not-for-profit and public sector entities, the Trustees believe that, because of other priorities and resource constraints, focusing on the public sector and not-for-profit entities is impractical at present. The Trustees plan to revisit the question of not-for-profit and public sector accounting in a few years' time.*²⁷

4.12 The IASB has confirmed in response to an information request for the purposes of this review that its current strategy is focused on convergence work, primarily with the Financial Accounting Standards Board ("FASB") in the United States. While the IASB's work programme includes a number of other projects that are not part of the convergence programme, resource constraints and the priority accorded to convergence work means that any consideration of sectors other than profit-oriented entities is unlikely in the next five years.

4.13 I discussed these matters directly with the Chairman of the IASB, Sir David Tweedie, and the Director of Technical Activities, Elizabeth Hickey. Sir David advised that while the IASB does not have a policy on sector-neutrality, he personally is very much in favour of a sector-neutral approach to accounting standard-setting internationally in the medium to long term. However he reiterated that resource constraints meant that any consideration of entities other than profit-oriented entities would not occur for a minimum of five years.

²⁴ The guideline has been withdrawn by IPSASB. However the Preface to International Public Sector Accounting Standards now explains that government business enterprises apply IFRS (paragraph 12).

²⁵ Letters from the FRC Chairman, Charles Macek, to the IASC Foundation of 11 February 2004 and 2 July 2004.

²⁶ It is arguable that as the debt securities of governments, other public sector entities and other not-for-profit entities are issued on national and international capital markets then the development of accounting standards for these entities is already an objective of the IASB (See paragraph 4.6(a) above).

²⁷ Paragraph C8 of section C of the document entitled "*Changes in the IASC Foundation Constitution*".

The IPSASB

- 4.14 IFAC is the world-wide organisation for the accountancy profession. Its mission is to serve the public interest, strengthen the global accountancy profession and contribute to the development of strong international economies by establishing and promoting adherence to high quality professional standards, furthering the international convergence of such standards, and speaking out on public interest issues where the profession's expertise has most relevance.
- 4.15 The IPSASB is a board of IFAC which develops IPSAS. These standards set out requirements for financial reporting by governments and other not-for-profit public sector entities. These standards apply to general purpose financial statements prepared on the accrual basis of accounting. There is also a single comprehensive standard that applies to the cash basis of accounting.
- 4.16 As noted in paragraph 4.9 above, IPSAS do not apply to government business enterprises. Government business enterprises apply IFRS issued by the IASB.
- 4.17 The IPSASB acknowledges the right of governments and national standard-setters to establish accounting standards and guidelines for financial reporting in their jurisdictions. However IPSASB believes that adoption of IPSAS will lead to a significant improvement in the quality of general purpose financial reporting by public sector entities in many jurisdictions. IPSAS are also likely to be of considerable use to jurisdictions that have not yet developed accounting standards for governments and public sector entities. The IPSASB strongly encourages the adoption of IPSAS and the harmonisation of national requirements with IPSAS (refer to paragraphs 25 to 28 of the *Preface to International Public Sector Accounting Standards*).
- 4.18 The IPSASB has adopted an approach whereby the requirements of its standards which deal with topics that are dealt with by IFRS differ from their IFRS counterparts only where there is a public sector reason for a difference. This approach has been followed since IPSAS were first developed in 1997. The IPSASB is continuing an ongoing programme of convergence with IFRS. The IPSASB is currently also addressing a number of issues that are public sector specific or of particular significance to not-for-profit public sector entities. These issues include accounting for social policy obligations, accounting for heritage assets, presentation of budget information in Financial Statements and accounting for non-exchange revenues (including taxes and transfers). In relation to each of these topics, it is likely that in due course IPSASB will issue standards which do not have an IASB counterpart.
- 4.19 It should be noted that the Board of IFAC, in a letter to the IASC Foundation of 11 February 2004, was another of the parties who encouraged the IASB to set

international financial reporting standards that could be applied on a global basis to all types of enterprise.²⁸

- 4.20 In response to a question about whether there are any current developments which would lead to changes in the approach at an international level to establishing reporting requirements for different sectors, IPSASB has drawn attention to the joint project between the IASB and the FASB to revise and converge their respective conceptual frameworks for the preparation and presentation of financial statements. The IPSASB has raised some concerns with the current direction of the revisions and their implications for the public sector. Specifically it has noted that its IFRS convergence programme may be adversely affected, and that differences between public and private sector standards may become more pronounced if the IASB Framework is amended to reflect the proposed revisions and the IFRS are subsequently amended to ensure consistency with the revised framework.

Government Finance Statistics

- 4.21 The IPSASB has, in recent years, worked actively with the International Taskforce on the Harmonisation of Public Sector Accounting (“TFHPSA”) to identify differences between IPSAS and bases of financial reporting used for statistical purposes and to propose amendments to the next revision of the System of National Accounts (“SNA”) due for issue in 2008.
- 4.22 The IPSASB has issued ED 28 *Disclosure of Financial Information about the General Government Sector*²⁹ as a bridge between general purpose financial statements and statistical basis financial statements. This exposure draft followed on from the IPSASB Research Report *International Public Sector Accounting Standards (IPSASs) and Statistical Bases of Financial Reporting: An Analysis of Differences and Recommendations for Convergence*.
- 4.23 The IPSASB Research Report explained that the two different bases of financial reporting have different objectives, are focused on different reporting entities and treat some transactions and events differently. However it also notes that the two bases of financial reporting deal with similar transactions and events and have many similarities in the treatment of those transactions and events and, in some cases, have a similar type of report structure. The IPSASB has indicated that in some jurisdictions the disclosure of information about the General Government Sector can support and

²⁸ See paragraph 4.10.

²⁹ For statistical purposes, the GGS comprises government controlled entities primarily engaged in non-market activities. The GGS is sometimes described as comprising those entities that fulfil the core functions of government as their primary activity.

enhance the decision-making of, and accountability to, users of general purpose financial statements³⁰

- 4.24 IFAC has advised that whilst specific arrangements have not yet been finalised, it is anticipated that liaison between the accounting and statistical communities through the IPSASB and the successor to the TFHPSA will be maintained, with the objective of ensuring that unintended differences between accounting and statistical bases of financial reporting do not arise. They consider this is in the interests of users and preparers of public sector financial reports.

Users and their information needs – IASB and IPSASB

- 4.25 Paragraph 9 of the IASB's *Framework for the Preparation and Presentation of Financial Statements* ("IASB Framework") states that the users of financial reports include present and potential investors, employees, lenders, suppliers and other trade creditors, customers, governments and their agencies and the public. The different information needs of these users are discussed.
- 4.26 The IASB Framework explains that while all the information needs of these users cannot be met by financial reports there are needs which are common to all users. As investors are providers of risk capital to the entity, the provision of financial reports that meet their needs will also meet most of the needs of other users that financial reports can satisfy.
- 4.27 Users of general purpose financial reports are identified in paragraph 14 of the *Preface to International Public Sector Accounting Standards*. This gives examples of such users as citizens, voters, their representatives and other members of the public.
- 4.28 *IPSAS 1 Presentation of Financial Statements* also identifies users and elaborates on the broad categories identified in the *Preface*. IPSAS 1 also discusses the needs of those users.³¹
- 4.29 The need for users to receive information about the financial position, performance and cash flows of an entity is common between the IASB and IPSASB. However IPSASB places a greater emphasis on the demonstration of accountability by the entity as well as on the following:
- Provision of aggregate information useful in evaluating an entity's performance in terms of service costs, efficiency and accomplishments;

³⁰ ED 28, paragraph 9.

³¹ Refer to paragraphs 13 to 24 of IPSAS 1.

- Indicating whether resources were obtained and used in accordance with the legally adopted budget; and
- Indicating whether resources were obtained and used in accordance with legal and contractual requirements, including financial limits established by appropriate legislative authorities.

4.30 IPSAS 1 also encourages inclusion in financial statements of a comparison with the budgeted amounts for the reporting period, where the financial statements and the budget are on the same basis of accounting. This has been taken further in the recent ED 27: *Presentation of Budget Information in Financial Statements*.

Implications of the international standard-setting scene for Australia

4.31 Consistent with the first FRC strategic direction, the foundation standards on which Australian accounting standards are being based are IFRS. Those standards are developed with regard only to profit-oriented entities.

4.32 As discussed in the preceding section, the IPSASB considers that there are a different set of users of public sector financial reports and that the information needs of those users differ in some important respects from the users identified by the IASB. These users and their different information needs are not considered by the IASB and this suggests that the needs of some other users need to be considered by the AASB in seeking to adapt IFRS to apply to public sector entities.

4.33 For some years there has been, in the minds of some, an expectation that there would be a trend towards sector-neutral standards internationally under IASB leadership.³² It is clear from the comments of the IASB Chairman that this will not occur in the next five years.

4.34 A decision to move in this direction would need to be accompanied by significant changes in the membership and staffing of the IASB and in its processes as well as perhaps also in the Trustees of the IASC Foundation (a point made in the FRC letters which commented on the IASC Foundation Constitution Review – see paragraph 4.10). It seems highly unlikely that the extent of change necessary to enable the IASB to develop standards for not-for-profit entities, whether or not including public sector entities, could occur in anything less than a decade and, in all probability, far longer.

³² As explained in paragraph 4.18, IPSAS generally differ from any equivalent IFRS only where there is a public sector reason for the difference.

- 4.35 I note also the reservations expressed by IPSASB in relation to the apparent direction of the conceptual framework project being pursued by the IASB and FASB (see paragraph 4.20). It is anticipated that the first due process document in that project will be issued at the end of June 2006 and will comprise Preliminary Views on a new Objective for General Purpose Financial Reporting as well as new Qualitative Characteristics of such financial reporting.
- 4.36 A number of national standard-setters are monitoring the work of the IASB and FASB³³ and are noting that, from the perspective of the IASB, the new conceptual framework material is more specifically targeted towards profit-oriented entities than the existing Framework. This will create significant challenges for those standard-setters (such as the AASB) developing standards and other documents based on IFRS for a broader range of entities.
- 4.37 The IPSASB has itself recently decided to initiate a conceptual framework project, something it has considered on a number of occasions but previously decided against pursuing. It seems highly likely that any IPSASB framework will differ in a number of important respects from that emerging from the IASB/FASB project. This will raise a significant strategic issue for the AASB and other standard-setters who have a broader mandate than profit-oriented entities only.
- 4.38 Another implication for national standard-setters with broad mandates from the international standard-setting environment arises from the likelihood of increasing differences between the standards of the two international bodies. A topical example will illustrate this. Following a lengthy development process, IPSASB has recently issued an exposure draft on accounting for non-exchange transactions. This is a crucial topic for both public sector and other not-for-profit entities because revenue of these entities is primarily not earned in exchange transactions. IASB has a standard dealing with Revenue which is written in an exchange transaction context and IPSASB has an equivalent of the IASB standard³⁴ expressly limited to exchange transactions. A review of IPSASB's exposure draft has highlighted the difficulty in demarcation between the different types of revenue transaction. It is not uncommon for transactions to include both exchange and non-exchange components and ensuring the appropriate accounting treatments apply is not easy. The IASB also has a standard on accounting for government grants³⁵ which is outdated and widely viewed as needing urgent revision. However the IASB has recently deferred work on this standard. It seems likely that a significant difference will emerge between the provisions applying to profit-oriented and public sector not-for-profit entities internationally. While Australia already

³³ The author is assisting those standard-setters through the UK Accounting Standards Board.

³⁴ IAS 18 *Revenue* and IPSAS 9 *Revenue from Exchange Transactions* respectively.

³⁵ IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*.

has a sectoral difference on this topic, international differences seem likely to create new challenges for the AASB.

- 4.39 Another issue for national standard-setters with broad mandates is emerging from the work of the International Financial Reporting Interpretations Committee (“IFRIC”). That committee has been considering issues related to service concessions (aspects of public private partnership arrangements). However it is addressing those issues only from the perspective of the private sector partner. This creates a risk that the treatment by public sector participants in these arrangements may not be consistent with those prescribed for the profit-oriented participants. A further concern is that the accounting treatment required by IFRIC may not be the most appropriate treatment if the accounting on the “other side” of the transaction has not been fully considered. Standard-setters with responsibility for all participants in these arrangements may not be able to ignore the “other side” of the arrangements.
- 4.40 The developments described above are contributing to make the task of a national standard-setter with responsibility to set standards for all entities in its jurisdiction increasingly difficult.

Part 5 – Standard-setting Approaches and Structures in Selected Countries

- 5.1 In this part the way in which accounting standards are set for different sectors in four countries is examined and where standard-setting may be heading in those countries. The information reported here has been based on material provided by representatives of the relevant bodies in the countries concerned. None of the views reported are official positions of the standard-setting bodies – official positions are only determined after extensive due process and deliberations.

New Zealand

- 5.2 New Zealand is a close neighbour of Australia and there have traditionally been close ties between the two countries. The Closer Economic Relations (CER) Framework has been in place between the two countries since 1983. In the context of this Framework, the Australian Treasurer and the New Zealand Minister of Finance announced on 30 January 2004 the formation of the Trans-Tasman Accounting Standards Advisory Group.
- 5.3 The overriding role of the Trans-Tasman Accounting Standards Advisory Group is to advise the respective governments and accounting standard-setters on ways to reduce business costs and improve efficiency through identifying inconsistencies in the accounting standard-setting frameworks and assisting the move to a single approach to accounting standard-setting to apply in both jurisdictions.³⁶

Standard-setting bodies

- 5.4 New Zealand has two accounting standards bodies – the Accounting Standards Review Board (“ASRB”) and the Financial Reporting Standards Board (“FRSB”).
- 5.5 The ASRB was established and is empowered under the *Financial Reporting Act* 1993 (“FRA”). The primary role of the ASRB is to review and, if it thinks fit, approve financial reporting standards which are submitted to it, for application to the financial statements required to be prepared by reporting entities³⁷, groups, local authorities, council controlled organisations, state-sector bodies and other entities in accordance with the FRA, the *Local Government Act 2002*, the *Public Finance Act 1989* or any

³⁶ Information about this Advisory Group can be found at www.frc.gov.au/trans_tasman

³⁷ The FRA defines “reporting entity” as – a) an issuer; or b) a company, other than an exempt company; or c) a person that is required by any Act, other than this Act, to comply with this Act as if it were a reporting entity.

other enactment that requires the person to comply with the FRA as if that person were a reporting entity.

- 5.6 The FRSB is a national committee of the New Zealand Institute of Chartered Accountants (“NZ Institute”). The Executive Board of the NZ Institute approves the Constitution and appoints the members of the FRSB.
- 5.7 The FRSB develops financial reporting requirements for reporting entities in the profit-oriented sector, the public sector and the other not-for-profit sector. The FRSB develops standards, including undertaking a due process, and submits proposed standards (and other pronouncements) to the ASRB for approval.
- 5.8 Section 25 of the FRA provides that the NZ Institute (in practice the FRSB) or any other organisation or person may, from time to time, submit financial reporting standards, or amendments to financial reporting standards, to the ASRB for approval. To date, all standards approved by the ASRB have been submitted to it by the FRSB.

Reporting requirements for different sectors

- 5.9 Most profit-oriented entities in New Zealand operate as companies. Companies are subject to the requirements of the FRA which requires them to prepare financial statements within specified time periods.
- 5.10 Except for exempt companies, all companies and other issuers of securities under the *Securities Act 1978* must comply with *generally accepted accounting practice* in preparing their financial statements. Compliance with generally accepted accounting practice (“NZ GAAP”) requires that entities:
- Comply with financial reporting standards approved by the ASRB; and
 - Where there is no applicable financial reporting standard or rule of law, follow accounting policies that are appropriate to the circumstances of the reporting entity and have authoritative support within the accounting profession in New Zealand.
- 5.11 Exempt companies are a category of small stand-alone company which have less onerous reporting obligations. As size is not a focus of this review, exempt company requirements are not discussed further.
- 5.12 Profit-oriented entities in the public sector are almost all either state-owned enterprises or council controlled trading organisations.³⁸ These entities are required

³⁸ Both categories of entity are Government Business Enterprises as this term is used internationally.

by the *State-Owned Enterprises Act 1986* and the *Local Government Act 2002* to comply with NZ GAAP (as defined above).

- 5.13 Public sector not-for-profit entities include the Government of New Zealand, government departments, crown entities, local authorities and council controlled organisations which do not trade. All of these entities are required by the *Public Finance Act 1989* or *Local Government Act 2002* to comply with NZ GAAP.
- 5.14 There are other types of organisation with particular characteristics whose own Acts require them to comply with the FRA as if they were reporting entities under that Act.
- 5.15 The statutory reporting responsibilities of not-for-profit entities in the private sector are less clear. A Charities Commission was recently established under the *Charities Act 2005* and while that body has indicated that it will require financial information to be provided to it and made available to the public, it has not as yet specified the form of that reporting.
- 5.16 Not-for-profit entities which are not charities may be established under a range of other Acts including the *Incorporated Societies Act 1908* and the *Industrial and Provident Societies Act 1908*. These statutes include specific reporting requirements, without any obligation to comply with NZ GAAP.
- 5.17 It is appropriate also to note that where there are no specific legislative requirements relating to financial reporting of not-for-profit entities, the NZ Institute requires its members who are involved in, or have responsibility for the preparation or presentation of general purpose financial reports, to take all reasonable steps within their power to ensure that NZ GAAP is complied with.³⁹

How are standards set for different sectors?

- 5.18 Since 1992, New Zealand has followed a policy of issuing a single set of standards which have been applicable to all entities.
- 5.19 As part of the decision to adopt IFRS in New Zealand, the ASRB decided that there should continue to be one set of standards for application by all entities. However it was recognised that as IFRS are developed for application only by profit-oriented entities, it would be necessary to introduce some additional or modified requirements to enable broader application of the standards.
- 5.20 The ASRB set out in its Release 8 (paragraph 27) the guidelines to be observed in adapting an IFRS for issue as a New Zealand IFRS. These guidelines are:

³⁹ Paragraph 103 of the NZ Institute's *Code of Ethics*.

- The disclosure requirements of the IFRS cannot be reduced for profit-oriented entities;
- Additional disclosure requirements can be added for all entities;
- Recognition and measurement requirements in an IFRS cannot be amended for profit-oriented entities;
- Recognition and measurement requirements can be amended for public benefit entities, with a rebuttable presumption that amendments are based on existing IPSAS or existing FRS⁴⁰ as applicable;
- Guidance materials may be added based on the same principles as applying to the addition of recognition and measurement requirements as outlined above; and
- Where an IFRS contains alternative permissible treatments, the ASRB may determine that only one option can be applied to be able to comply with NZ GAAP.

5.21 Where New Zealand equivalents to IFRS contain additional requirements for the purpose of meeting NZ GAAP, these are clearly identifiable within the text and distinguishable from the IFRS on which the New Zealand equivalent has been based. In practical terms this has been done, in a similar way to that adopted in Australia, by inclusion of “NZ” paragraphs in shaded boxes.

5.22 As part of its implementation of the ASRB’s guidelines, the FRSB has introduced the term “public benefit entities” (“PBEs”). These are entities whose primary objective is to provide goods or services for a community or a social benefit and where any equity has been provided with a view to supporting that primary objective rather than for the financial return to equity shareholders. The FRSB has recently issued guidance to assist in the determination of which entities are in fact PBEs. In general terms, PBEs are the equivalent of “not-for-profit entities” in Australian Accounting Standards.⁴¹

5.23 The development of financial reporting requirements for PBEs is still evolving. However the most common approach is to include additional requirements, alternative requirements or exemptions from requirements in a shaded box within a

⁴⁰ That is the financial reporting standards on issue immediately prior to the adoption of IFRS in New Zealand.

⁴¹ This view has also been expressed by the AASB and FRSB following a joint meeting on 3-4 May 2006. Refer to AASB Action Alert Number 94 – May 2006.

particular standard. The text specifies whether the requirements apply to PBEs, all entities or all entities qualifying for differential reporting.⁴²

5.24 Other approaches that the FRSB has advised it is likely to consider in establishing requirements for different sectors include:

- Development of standards applicable only to a particular sector. For example, this is a possibility that may be considered in the context of developing financial reporting requirements applicable to PBEs for accounting for revenue from non-exchange transactions; and
- Development of guidance applicable only to a particular sector. Such guidance may be in the form of application guidance attached to a particular standard or it may be a separate pronouncement, for example guidance on financial reporting by other not-for-profit entities.⁴³

Reasons for different requirements

5.25 The approach of the FRSB is to focus on the nature of the transactions or events and users' information needs in respect of those transactions and events. There are frequently no differences in the requirements between the sectors.

5.26 However, in some cases, New Zealand equivalents to IFRS do include different requirements for different sectors. The general reason for these differences arises from the fact that IFRS are developed solely from a profit-oriented perspective. IFRS therefore do not necessarily:

- Consider transactions in other sectors; or
- Consider transactions from the point of view of other sectors.

5.27 In 2005, the FRSB established a PBE Working Group⁴⁴ to assist in consideration of financial reporting issues affecting PBEs. The following criteria have been established by the FRSB to guide the work of the PBE Working Group and, in particular, to assist in identifying circumstances where additional guidance or reporting requirements may be necessary or where different reporting requirements may be appropriate for PBEs:

⁴² Differential reporting is a regime which gives reporting concessions to those entities which qualify but are still required to comply with NZ GAAP.

⁴³ The NZ Institute issued a research bulletin R-120 on Financial Reporting by Voluntary Sector Entities in 1999. This bulletin is being revised and updated at present.

⁴⁴ The author has observer status at meetings of this Working Group.

- Where following an international accounting standard will represent an inappropriate loss of accountability to stakeholders;
- Where the IASB has not dealt with a particular issue or has only addressed an issue in a perfunctory manner and the issue is particularly relevant to PBEs. (For example, inventory that an entity intends to distribute at no charge, donated assets, impairment of non-cash generating assets, social policy obligations);
- Where compliance with a particular standard would be inappropriate in New Zealand because of other regulatory requirements. (For example, service performance reporting requirements negating the need for segment reporting, financial year definitions in statute overriding the IFRS conventions regarding subsidiaries harmonisation of reporting dates with parents); and
- Where, subject to a rebuttable presumption that overall costs for complying with standards will not differ between profit-oriented entities and PBEs, the costs of complying with a particular treatment exceed the benefits to stakeholders of doing so. (For example, related party transactions conducted at arms length between government entities, individual asset revaluations, and the requirement to disclose the historical cost of revalued assets).

5.28 While neither the ASRB nor FRSB has published a strategy or policy on sector-neutrality, the general approach of both boards is that there will be a presumption of common requirements unless there are reasons that that is inappropriate (as evidenced in ASRB Release 8 and the New Zealand *Preface*).

Users and their information needs

5.29 The identification of users and discussion of their core information needs is found in the New Zealand equivalent to the IASB *Framework for the Preparation and Presentation of Financial Statements* ("NZ Framework"). The users identified are the same as those in the IASB Framework (and in fact the AASB Framework) namely investors, employees, lenders, suppliers and other trade creditors, customers, governments and their agencies and the public. However the NZ Framework (paragraph 9.1) also identifies additional users and outlines their information needs. The additional users are funders or financial supporters (for example, tax payers and donors) and elected or appointed representatives.

5.30 Funders or financial supporters provide a source of cash and/or resources that does not generate a direct return and is not provided in exchange for direct benefits. Funders and financial supporters are interested in the quality of the goods and

services produced and whether the goods and services were produced in accordance with relevant contracts or agreements. They are also interested in information about the continuance of an entity, such as its sustainability, flexibility and vulnerability.

- 5.31 Elected or appointed representatives such as members of parliament and local authority councillors represent their respective constituencies. These users use financial information to assess an entity's actual achievement against its formal objectives and targets and hold entities accountable for their performance. They are likely to use financial statements in conjunction with non-financial information.

Mechanisms to ensure different user needs are taken account of

- 5.32 The FRA requires the Minister to appoint ASRB members who have a background in at least one of business, accounting, finance, economics or law. In addition the *Crown Entities Act 2004* (the ASRB is a crown entity under New Zealand legislation) requires that an appointee must have appropriate knowledge, skills and experience for the position and the Minister must take into account the desirability of promoting diversity in the membership of the board. The *Crown Entities Act* criteria are not to be read as being limited by the FRA criteria.⁴⁵ As noted earlier, members of the FRSB are appointed by the Institute's Board. In making appointments to the FRSB, the Board places primary emphasis on the professional qualities of appointees. However the Board is also mindful that the quality of the FRSB functions may be served best by ensuring that those skills and qualities are drawn from as wide a range of users, preparers and auditors of financial reports and from different sectors as is reasonably practical. The Board has set a guide for determining the composition of the FRSB.

- 5.33 At the present time, the guide for determining the composition of the FRSB is that:

- a) Not more than half shall be members of the NZ Institute in public practice;
- b) Not less than two shall be employed in management or industry;
- c) Not less than two shall be employed in the public sector; and
- d) Not less than one shall be an academic.⁴⁶

- 5.34 The ASRB requires all persons or organisations submitting standards to it for approval⁴⁷ to consult with persons or organisations likely to be affected by the proposed standard, or representatives of such persons or organisations, and will, if it

⁴⁵ At the present time 1 of 7 members of the ASRB is from the public sector. Two other Board members have experience with commercial entities in the public sector.

⁴⁶ At the present time 2 of 12 members of the FRSB are from the public sector. Some FRSB members have involvement with the other not-for-profit sector.

⁴⁷ See paragraph 5.8.

thinks fit, consult with any such person or organisation itself. The ASRB considers that its role is primarily to ensure that the needs of different users have been considered during the process rather than that it itself will consider the needs of different users.

- 5.35 The FRSB uses other mechanisms to increase the likelihood that the needs of different users are taken account of appropriately. These mechanisms include:
- Working groups with relevant sector participation (for example the PBE Working Group established recently);
 - Observers from both the IASB and the IPSASB attending and participating at FRSB meetings; and
 - Consultation with relevant sector groups where necessary.
- 5.36 The PBE Working Group includes representatives from central government, local government, public sector auditors, not-for-profit entities, Big 4 accounting firms, independent advisors and academia.
- 5.37 The FRSB is also considering how its processes and interaction with constituents could be improved to ensure views of the various constituent groups are considered during the development of financial reporting standards in New Zealand.⁴⁸ Possible approaches could include:
- Actively targeting constituents likely to be affected by proposed new or revised standards;
 - Holding round-table discussions with constituents to solicit feedback on proposed new and revised standards;
 - Educating constituents on the likely impact of proposed new and revised standards, on the role of the ASRB and FRSB, and how to contribute to standard-setting; and
 - Building relationships with relevant industry and professional groups.

Current or future developments in standard-setting for different sectors

- 5.38 The New Zealand Government is currently reviewing the FRA. This review may affect which entities are required to prepare general purpose financial reports.

⁴⁸ I understand these possible approaches are a response to a concern about the very small number of responses being received through the formal exposure draft process.

Specifically, officials have been asked to report to the Minister of Finance on financial reporting by charities registered under the Charities Act 2005 by 30 November 2006.

- 5.39 The Charities Commission is considering what financial reporting requirements charities will be required to comply with for the purposes of registering as a charity in New Zealand over the next 18 months. No requirements have been specified at the time of this report. A Task Force commissioned by the NZ Institute has just released a Report which raises a number of issues relating to financial reporting by not-for-profit entities, including an Appendix detailing the issues the Task Force considers need to be addressed.⁴⁹
- 5.40 The ASRB and FRSB advise that the IASB/FASB Conceptual Framework project may have implications for New Zealand. Given the responsibilities of the ASRB and FRSB to develop financial reporting requirements for public sector entities and other not-for-profit entities as well as profit-oriented entities, the implications of the project will need careful consideration.

Strengths and weaknesses of the current approach

- 5.41 The ASRB and FRSB have advised a number of strengths and weaknesses of the current approach to establishing reporting requirements for different sectors in New Zealand.
- 5.42 The strengths of the current approach are considered to include:
- Maintenance of a single body of standards means that similar transactions are accounted for in a similar manner regardless of the sector in which they occur therefore providing more relevant, reliable and consistent information to users;
 - The approach is efficient in the sense that duplication is avoided by having only one standard-setting infrastructure;
 - More robust standards are developed because they are developed and tested against a wider range of transactions and events;
 - There is cross-sector fertilisation of ideas;
 - The profile of the importance of good financial reporting has been raised in all sectors;

⁴⁹ The Task Force Report can be found at:
http://www.nzica.com/StaticContent/News/News_Pages.cfm?NewsID=1698

- The approach avoids or minimises unnecessary differences in financial reporting requirements developing between the sectors⁵⁰;
- All entities have a “one stop shop” for financial reporting standards as do auditors who are more easily able to undertake audits across all sectors; and
- The similarities with the approach of the AASB contributes to Trans-Tasman harmonisation.

5.43 On the other hand, the weaknesses in the current system are considered to include:

- There are situations where because IFRS are developed only with profit-oriented entities in mind, IFRS requirements for certain sectors may not be appropriate. This means that additional or alternative guidance or requirements need to be developed;
- There is a perception that standards based on IFRS lack relevance for PBEs;
- There is a tendency towards minimal change in the standards because of the risks of offending the ability of profit-oriented sector entities from asserting compliance with IFRS. In some cases it could be argued that this may result in less than optimal reporting requirements for all reporting entities.

Government Finance Statistics in New Zealand

5.44 The ASRB and FRFB have advised that there is a limited relationship between general purpose financial reporting and the GFS system in New Zealand. It is generally accepted in New Zealand that the information provided under GAAP and the GFS system are prepared for different purposes.

5.45 In addition in New Zealand the Government prepares prospective financial statements (consistent with its budget) using the same accounting policies as are adopted in its general purpose financial report. This differs from other jurisdictions where governments sometimes adopt GFS as the basis for preparation of their budgets.

5.46 The ASRB and FRFB are monitoring the IPSASB and AASB projects in relation to GFS and the General Government Sector.

⁵⁰ As may be more likely to occur with different bodies and different sets of standards.

Canada

Standard-setting bodies

- 5.47 Canada has two accounting standard-setting boards – the Accounting Standards Board (“AcSB”) and the Public Sector Accounting Board (“PSAB”).
- 5.48 The AcSB is responsible to develop Canadian generally accepted accounting principles (“Canadian GAAP”) for profit-oriented enterprises and not-for-profit organisations in the private sector.
- 5.49 The PSAB is responsible for setting accounting standards for the public sector in Canada. The PSAB has decided that:
- government business enterprises should follow Canadian GAAP as established by the AcSB; and
 - government not-for-profit organisations that have an equivalent in the private sector should comply with not-for-profit standards as set by the AcSB but that their financial statements must be restated for consolidation in the government’s consolidated financial statements.⁵¹

Reporting requirements for different sectors

- 5.50 In excess of 120 separate federal and provincial laws (primarily corporation and securities legislation) mandate the use of Canadian GAAP for financial reporting by corporations and not-for-profit organisations. Moreover, they define Canadian GAAP as the standards issued by the AcSB and as included in the *Canadian Institute of Chartered Accountants’ Handbook*. The securities legislation in Ontario and the *Canadian Business Corporations Act* allow corporations that are SEC registrants to file and issue their statements in accordance with US GAAP.
- 5.51 The governments of British Columbia and territories of Nunavut and Yukon are required to follow GAAP set by the PSAB. Other governments are not so required but the extent of voluntary compliance is reported as outstanding. The Auditors-General of the provinces have agreed that they will require compliance with GAAP set by PSAB before issuing a “clean” audit opinion. The provincial governments of Ontario, Manitoba (a rural Act only), Saskatchewan, Alberta and British Columbia require municipalities in their provinces to follow GAAP set by the PSAB. It is anticipated that the remaining provinces will follow this trend by 2007.

⁵¹ Note that under the PSAB standards, government business enterprises are combined into the consolidated financial statements of government using the modified equity method of accounting - hence no accounting adjustments are necessary in their case.

5.52 There is some confusion in respect of the reporting requirements for First Nations, the Canadian aboriginal people. A government department prescribes financial reporting requirements for grants and contributions made to them. However there is some uncertainty as to the standards that First Nations should follow. A PSAB commissioned study is expected to resolve this in the next year or so.

How are standards set for different sectors?

5.53 As noted above, Canadian GAAP for profit-oriented enterprises and not-for-profit organisations in the private sector is set by the AcSB. While the base standards are developed for profit-oriented entities, modifications or additions are made for not-for-profit organisations where this is considered appropriate. There are a number of standards that deal with unique characteristics of not-for-profit organisations.

5.54 The PSAB develops and publishes a separate set of standards for public sector entities.

5.55 It should be noted that both Canadian boards are supported by staff of the Canadian Institute of Chartered Accountants with all staff reporting to the Vice-President, Standards. Accordingly there is a degree of coordination amongst the staff, although the boards themselves have to date operated substantially independently.

Reasons for different requirements

5.56 The underlying reason for differences in the requirements for different sectors is the view that there are a number of differences between governments, profit-oriented enterprises and other not-for-profits and that one set of standards does not necessarily fit all sectors.

5.57 The PSAB has set out the unique characteristics of government in Appendix A to Section PS 1100 *financial statement objectives – federal, provincial and territorial governments*. Some of these characteristics are that:

- Government's goal is to provide services and redistribute resources, not make a profit;
- Most government tangible capital assets are different in nature than those held by business;
- Government capital spending may not focus on maximising financial return because government objectives are broader;
- The principal source of revenue for governments is taxation;

- Governments operate in a non-competitive environment;
- A government's budget portrays public policy, establishes estimates of revenue, expenditure and financing requirements and is an important part of the government accountability cycle; and
- Governments are held to a higher standard of accountability than a business or a not-for-profit organisation.

5.58 While neither of the Canadian boards has set out a strategy or policy on sector-neutrality, their policy is implicit in the structural arrangements which are in place.

Users and their information needs

5.59 The AcSB have identified the users of financial reports of profit-oriented enterprises as present and potential debt and equity investors and their advisors, creditors and others who do not have internal access to entity information. Because it is not practical to expect financial statements to satisfy the many and varied information needs of all external users of information about an entity, the AcSB's objective of financial statements focuses primarily on the information needs of investors and creditors.

5.60 In the case of not-for-profit organisations, the AcSB has identified members, contributors, creditors and others who do not have internal access to entity information as the users. The primary focus is on members, contributors and creditors.

5.61 Investors and creditors of profit-oriented enterprises are interested, for the purpose of making resource allocation decisions, in predicting the ability of the entity to earn income and generate cash flows in the future to meet its obligations and to generate a return on investments.

5.62 Members, contributors and creditors of not-for-profit organisations are interested, for the purpose of making resource allocation decisions, in the entity's cost of service and how that cost was funded and in predicting the ability of the entity to meet its obligations and achieve its service delivery objectives.

5.63 Investors, members and contributors also require information about how the management of an entity has discharged its stewardship responsibility to those who have provided resources to the entity. This information is especially important in the

not-for-profit sector where resources are often contributed for specific purposes and management is accountable for the appropriate utilisation of such resources.⁵²

- 5.64 The PSAB has identified the users of government financial statements as the public, legislators, investors and analysts.
- 5.65 Legislatures and governments are accountable to the public, who provide the revenues and resources necessary for government operations, who receive government services and who are the beneficial owners of the public money and property for which legislatures and governments are responsible.
- 5.66 As elected representatives of the public, legislatures are primary users of government financial statements. Legislatures grant authority to the government to administer public resources and financial affairs and hold the government accountable for its financial administration.
- 5.67 Investors in government securities and enterprises provide financial resources and government has an interest in providing information to them which is useful to them in evaluating its ability to finance its activities and to meet its liabilities and contractual obligations. Economic and financial analysts serve legislatures and investors and other interested parties using financial statements and other information to analyse and evaluate financial issues.⁵³

Mechanisms to ensure different user needs are taken account of

- 5.68 The needs of different users are primarily addressed by having separate boards with members who are familiar with both the needs and requirements in the particular sectors.
- 5.69 In the case of the not-for-profit entities subject to the standards of the AcSB, a Not-for-profit Organisations Advisory Committee has been established which normally meets 3 to 4 times a year. A designated staff member has responsibility for the work of the committee. The mission of this committee is to serve the interests of the public and the profession by providing input to the standard-setting process concerning financial reporting by not-for-profit organisations. Specifically its responsibilities are:
- To advise the AcSB and its staff on actual or potential problems relating to financial reporting by not-for-profit organisations and recommend new projects when warranted;

⁵² Section 1000 *financial statement concepts*

⁵³ Section PS 1000 *financial statement concepts – federal, provincial and territorial governments.*

- To review project proposals to identify whether a new project is likely to pose particular problems for not-for-profit organisations and to suggest ways of dealing with any issues;
- To provide advice to the AcSB during the development of discussion papers, statements of principle and exposure drafts from a not-for-profit perspective;
- To assist in the development of guidance for not-for-profit organisations in implementing accounting standards;
- To act as an expert resource for the AcSB and its staff in dealing with specific accounting issues having implications for not-for-profit organisation; and
- To assist the AcSB in keeping the users, preparers and auditors/reviewers of the financial information about not-for-profit organisations informed about the Board's activities and, in particular, making known proposed final standards potentially having a significant effect on not-for-profit organisations and the rationale for the requirements of those standards.

Current or future developments in standard-setting for different sectors

5.70 While there are no changes proposed to the current Canadian structure and no other changes being contemplated specifically related to the different sectors, a recent significant decision of the AcSB may have downstream consequences.

5.71 The AcSB adopted a new strategic plan on 4 January 2006: *Accounting Standards in Canada: New Directions*. The AcSB will pursue separate strategies for each of three major categories of reporting entities - publicly accountable enterprises, non-publicly accountable enterprises and not-for-profit organisations. The AcSB considers that "one size does not necessarily fit all".⁵⁴ It considers each category of entity deserves a strategy that specifically addresses the particular needs of the users of financial statements of entities in that category, even though the outcomes of some of the strategies may be the same or similar for all categories.

5.72 In relation to publicly accountable enterprises, the strategy is to converge Canadian GAAP with IFRS over a transitional period of approximately five years. Publicly accountable enterprises are public companies plus some other classes of enterprise that have relatively large or diverse classes of financial statement user.⁵⁵

⁵⁴ Paragraph 12 of Strategic Plan.

⁵⁵ The AcSB has indicated that it will review its current definition of "publicly accountable enterprises" (found in Section 300 *Differential Reporting*) in carrying out its strategy.

- 5.73 In relation to non-publicly accountable enterprises, the AcSB will undertake a comprehensive examination of the needs of the users of these enterprises' financial statements, and then determine and implement the most appropriate financial reporting model to meet those needs. Non-publicly accountable enterprises are all profit-oriented entities that are not publicly accountable⁵⁶.
- 5.74 Not-for-profit organisations will continue to apply those elements of Canadian GAAP for profit-oriented enterprises that are applicable also to their circumstances. The AcSB will consult with the not-for-profit sector to determine whether all not-for profit organisations should base their accounting on the standards for publicly accountable enterprises, or whether the approach applied to non-publicly accountable enterprises should also be applied to some not-for-profit organisations.
- 5.75 The AcSB has said in its published strategic plan that:
- “Trying to be “all things to all people” in a single set of accounting standards might result in serving no-one adequately. Accordingly the AcSB will consider the need for separate bases of financial reporting for the major categories of reporting entities. The categories reflect the characteristics of the users and the uses of financial statements in each sector. The AcSB believes that by focusing on the particular needs of the sector for which each basis of financial reporting is designed, the result will be financial information that is more useful and cost-effective to that sector.”⁵⁷*
- 5.76 The AcSB also reports that one of the principal concerns of respondents to its proposals when published in 2005 was that essentially the same transaction, event or circumstance might be treated differently in the financial statements of different entities.⁵⁸ The AcSB notes that the comparability of financial information is significant only when the information is relevant to financial statement users. Consistent reporting by all entities of irrelevant information is of no benefit to the users of financial statements and therefore does not enhance financial reporting. The issue is determining which pieces of information are useful to the users of all entities' financial statements, and which are useful only to the users of some entities' financial statements. Differing cost/benefit tradeoffs for different types of entities also enter into consideration of which requirements ought to apply to which entities.⁵⁹
- 5.77 The AcSB has also noted that some significant types of not-for-profit organisations fall within the public sector, and that the PSAB has currently directed them to apply the

⁵⁶ Canada already has in place a form of differential reporting for non-publicly accountable enterprises. The Differential Reporting Advisory Committee advises the AcSB on matters related to accounting standards and these entities.

⁵⁷ Paragraph 13 of Strategic Plan.

⁵⁸ Paragraph 15 of Strategic Plan.

⁵⁹ Paragraph 16 of Strategic Plan.

AcSB standards.⁶⁰ The AcSB has stated that it will take some steps to improve the consistency of its own standards applicable to not-for-profit organisations with the standards set by the PSAB, as well as coordinating activities with the PSAB on issues affecting public sector not-for-profit organisations.⁶¹

5.78 The AcSB believes that when the transactions, events or circumstances to be accounted for by not-for-profit organisations are essentially the same as transactions, events or circumstances to be accounted for by profit-oriented enterprises, the same standards should apply to all reporting entities. However it may be necessary for the AcSB to provide application guidance that is specific to not-for-profit organisations to ensure appropriate application of standards to them. When the transactions, events or circumstances to be accounted for by not-for-profit organisations are unique to that sector, the AcSB may need to provide standards specifically for that sector. The number of such unique transactions, events and circumstances is expected to be limited.⁶²

5.79 When the AcSB incorporates IFRS into Canadian GAAP, it will add any necessary application guidance for the specific circumstances of not-for-profit organisations as well as addressing the unique transactions, events and circumstances of not-for-profit organisations. In supplementing IFRS in this way, the AcSB has indicated it will look to corresponding standards developed in other countries that have adopted IFRS and applied similar standard-setting approaches to not-for-profit organisations.⁶³

5.80 In discussions with the Chairman of the AcSB and the Vice President, Standards of the CICA in March 2006, both acknowledged that the not-for-profit sector had not been given a high priority in Canada over many years. Both consider greater attention is needed to not-for-profit organisation's issues.

5.81 It was also noted that there had been discussion in Canada about whether not-for-profit requirements would be better addressed if considered together with those for public sector entities by the PSAB. However there is no active proposal to make any change along these lines.

5.82 Finally the PSAB plans to reconsider its current position that government business enterprises and government not-for-profit organisations that have an equivalent in the private sector should follow standards set by the AcSB.⁶⁴

⁶⁰ See paragraph 50.

⁶¹ Paragraph 84 of Strategic Plan.

⁶² Paragraph 85 of Strategic Plan.

⁶³ Paragraph 86 of Strategic Plan.

⁶⁴ See paragraph 5.49.

Strengths and weaknesses of the current approach

- 5.83 The major strength of the current structure is considered to be that the standards are set by those who have knowledge of the issues relevant to the different types of entity and are affected by them. In the Canadian environment that is considered of paramount importance, because the standard-setting boards derive a degree of acceptance from it that would not exist otherwise.
- 5.84 The main weakness is considered to be the tendency of the boards to “go their different ways” sometimes for unsupportable reasons. However it is considered easier to mitigate that weakness than to compensate for the lack of acceptance by the wider financial reporting community.
- 5.85 The existence of two separate boards is acknowledged to arise primarily from historical events and stimuli. Specifically, in 1980, the AcSB's reluctance to include governments within the scope of the CICA Handbook requirements led to the creation of a separate board to concentrate on governments.

Government Finance Statistics in Canada

- 5.86 The PSAB has considered the relationship between GAAP and GFS and concluded that the national accounts are so fundamentally different, particularly in relation to their objectives, as to make it pointless to attempt to harmonise the two.
- 5.87 The GFS/GAAP harmonisation debate, to the extent there has been any, has taken place at the federal level in Canada. A federal department is responsible for developing the national accounts. Provincial governments do not generally get involved in the preparation of GFS other than completing statistical returns for Statistics Canada.

United States of America

Standard-setting Bodies

- 5.88 There are three standard-setting bodies in the United States of America (USA) – the Financial Accounting Standards Board (“FASB”), the Governmental Accounting Standards Board (“GASB”) and the Federal Accounting Standards Advisory Board (“FASAB”).
- 5.89 The FASB promulgates generally accepted accounting principles (“US GAAP”) for all nongovernmental entities in the USA, including nongovernmental not-for-profit organisations. The GASB promulgates GAAP for all state and local government

entities in the USA, including Native American Tribes and governmental not-for-profit organisations. The FASAB promulgates GAAP for the federal government.

Reporting Requirements for Different Sectors

- 5.90 The Securities and Exchange Commission ("SEC") has statutory authority to establish financial accounting and reporting standards for publicly-held companies. However, since 1973 when the FASB was established the SEC has designated the FASB as the private sector organisation responsible for establishing standards for financial accounting and reporting. Those standards govern the preparation of financial reports of all publicly-held companies. Non-public companies and not-for-profit organisations are not statutorily required to prepare financial statements in accordance with US GAAP. However should those entities choose to prepare GAAP financial statements, the existing auditing standards define the sources of established accounting principles that are generally accepted in the USA as the accounting standards issued by the FASB and its predecessors or designees.
- 5.91 Many state and local governments are required by state statutes to prepare financial statements in conformity with GASB standards. Should those governments that are not statutorily required to apply GASB standards choose to prepare GAAP financial statements, the existing auditing standards define the sources of established accounting principles that are generally accepted in the USA as the accounting standards issued by the GASB and its predecessors or designees.
- 5.92 Agencies in the executive branch of the federal government are required to follow FASAB standards. The requirement to follow FASAB standards comes from a number of sources. The Director of the Office of Management and Budget, a FASAB sponsor, has directed executive agencies to follow FASAB standards in OMB Circular A-136. In addition, Section 3511(a) of the title 31, *United States Code*, states that executive agencies are required to follow accounting standards prescribed by the Comptroller General, another of FASAB's sponsors. Some other federal government organisations also voluntarily follow FASAB standards.
- 5.93 There are a number of other sources of reporting requirements established in the USA. For example there are various reporting requirements imposed on federal reporting entities by laws and regulations. These cover matters such as budget execution, strategic planning, performance etc. In relation to publicly-held companies, while the FASB is the designated standard-setting body, the SEC and its staff may, and occasionally do, issue guidance interpreting the application of FASB standards. That guidance only applies to publicly-held companies. Furthermore the FASB established an Emerging Issues Task Force in 1984 that provides guidance within the framework of existing authoritative literature. Both the FASB and GASB

clear limited guidance issued by the American Institute of Certified Public Accountants.

How are standards set for different sectors

- 5.94 Most accounting standards issued by the FASB apply to both business entities and non-governmental not-for-profit organisations. In some circumstances specific pronouncements explicitly exempt not-for-profit organisations from application or the subject matter precludes such applicability. Separate standards are issued, however, for transactions that predominantly fall within one sector (such as the accounting for contributions made) or when the reporting requirements differ significantly between sectors (for example, the FASB issued a separate standard for preparation of financial statements by non-governmental not-for-profit organisations).
- 5.95 Similarly a single set of standards establishes reporting requirements for all entities under the GASB jurisdiction. However GASB Statement #20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that use Proprietary Fund Accounting*, allows “business-type activities” (a broader group than government business enterprises) the option to apply new FASB standards that do not conflict with or contradict GASB standards. The goal of this standard is to enhance industry comparability, but not at the expense of overall state and local government public sector comparability. As GASB standards have expanded to cover a broader range of transactions and other events, the application of this provision has become more limited. A few entities have selected this alternative – primarily hospitals and electric utilities.
- 5.96 A single set of standards applies to all those entities under the jurisdiction of the FASAB.

Reasons for different requirements

- 5.97 The reason for different requirements across the three standard-setting bodies is the view that the different groups of entities are significantly different from one another. Specifically the GASB believes that all governmental entities are fundamentally different to for-profit entities in the private sector. Those differences result in different information needs of stakeholders, including information needed by those users to assess public accountability and make political, social and economic decisions.
- 5.98 In establishing different requirements for not-for-profit organisations compared with business entities, FASB considers there are three major characteristics that distinguish not-for-profit organisations and provide a basis for different accounting and reporting requirements. Those are:

- Receipts of significant amounts of resources from resource providers who do not expect to receive either a repayment or economic benefits proportionate to resources provided;
- Operating purposes that are primarily other than to provide goods or services at a profit or profit equivalent; and
- Absence of defined ownership interests that can be sold, transferred or redeemed, or that convey entitlement to a share of a residual distribution of resources in the event of liquidation of the organisation.

5.99 FASB considers these characteristics result in certain types of transactions that are infrequent in business enterprises, such as contributions and grants, and results in different stakeholder information needs. Because the distinguishing characteristics are relatively few in number and limited in their scope, FASB generally employs a “differences-based approach” in developing accounting standards that apply to non-governmental not-for-profit organisations. Under that approach the FASB deviates from the standards applicable to business entities only when substantive transactional or reporting considerations justify different accounting or reporting.

5.100 None of the standard-setting bodies in the USA have a policy or strategy on sector-neutrality. However their general views and approach to the issue are evident in their existence and the scope of their jurisdiction.

Users and their information needs

5.101 The FASB has issued two separate Concepts Statements setting forth the objectives of financial reporting by business enterprises and by non-business (not-for-profit) organisations. The users of general purpose financial statements of business enterprises include investors, creditors, suppliers, employees, regulators and others. However the framework identifies investors, creditors and their advisors as the primary beneficiaries of external financial reporting of business enterprises.

5.102 External users of financial reporting of non-business entities are considered to be the many people that base economic decisions on their relationships to and knowledge about non-business organisations. Primary among those external users are resource providers (such as members, contributors, grantors, lenders, suppliers, creditors, financial analysts and advisors), constituents that use and benefit from the services provided (such as members and other service beneficiaries), and governing and oversight bodies (such as regulatory authorities and legislators).

5.103 External users identified in the GASB Concept Statements are those to whom the government is primarily accountable, the citizenry, including intermediaries such as

the media and citizen groups; those who directly represent the citizens (legislative and oversight bodies); and those who lend or participate in the lending process (municipal bond community, including bond raters, bond insurers, buy and sell-side analysts). In addition, internal managers in government (who are not considered external users) also have many uses for general purpose external financial reports.

- 5.104 The FASAB Statement of Federal Financial Accounting Concepts (SFFAC) 1, *Objectives of Federal Financial Reporting*, identifies external and internal users, discusses their information needs, and establishes four reporting objectives. The users are citizens, Congress, top executives and programme managers. The needs of these users lead to four reporting objectives which are: budgeting integrity, operating performance, stewardship and systems and control.⁶⁵

Mechanisms to ensure different user needs are taken account of

- 5.105 The FASB members and most of its staff are drawn from the business sector. One of the seven FASB members is drawn from the investor community to provide an investor/creditor perspective. FASB also established a User Advisory Council, comprising volunteer representatives of the user community. That council meets with the Board semi-annually to provide the board with a user perspective on matters.
- 5.106 The structures supporting development of standards for non-governmental not-for-profit organisations are at this time less extensive and less formal. They consist primarily of staff with experience in the sector, liaison relationships with two key sector groups and the AICPA not-for-profit expert panel, as well as volunteer resource groups established on an as needed basis. One staff member is assigned to monitor all FASB projects from a not-for-profit perspective and lead liaison efforts with not-for-profit sector organisations. Over the next year, FASB expects to consider whether and how it might expand or strengthen those structures.
- 5.107 When the FASB initiates a project to develop standards that apply specifically to not-for-profit organisations, it establishes a volunteer resource group comprising preparers, auditors and users of financial statements of not-for-profit organisations to provide the Board and staff with ongoing advice. The FASB also consults with the AICPA's not-for-profit expert panel on issues relevant to the sector.
- 5.108 Although all state and local government entities are considered to be a single sector by the GASB, representatives from the "businesses-type activities" community serve on all relevant project taskforces and advisory committees. A GASB staff member with "business-type activities" experience is assigned to monitor GASB and FASB projects from a "business-type activities" perspective and to spearhead GASB liaison

⁶⁵ Additional information can be found in SFFAC 1 at www.fasab.gov/concepts.html

efforts with these organisations. For projects that have a major impact on the “business-type activities” environment, field test participants are actively recruited.

5.109 GASB also has a Governmental Accounting Standards Advisory Council (GASAC). More than a third of the members of the Council are from organisations of users.

5.110 As already noted, GASB views entities under its jurisdiction as a single sector. However GASB conducts extensive user need studies (in the form of focus groups, round-table discussions, and the use of surveys) for major projects.

5.111 FASAB views the Federal Government as a single sector.

Current or future developments in standard-setting for different sectors

5.112 There are no current developments which are expected to lead to changes in the approach to establishing reporting requirements for different sectors in the USA.

Strengths and weaknesses of the current approach

5.113 The Directors of the three standard-setting bodies have combined to suggest the strengths and weaknesses of the approach to establishing accounting standards for different sectors in the USA. They note that some give greater weight to the individual strengths and weaknesses than others.

5.114 The strengths of the current approach in the USA are considered to include:

- Unique environments and issues associated with the different sectors are addressed by Boards with specific expertise;
- Greater comparability is able to be achieved within an entire sector (for example, public sector, private sector);
- Similar measures are used by all entities within each consolidated reporting entity;
- The approach accommodates the different user needs of each sector and the different standard-setting priorities;
- Communications between standard-setters and their constituents is enhanced through sector specific discussion of issues (issues are not clouded by the need to draw analogies between transactions in different sectors);
- There is the ability to tailor the pace of change to the environment of the particular sector;

- There is the ability to use sector-specific standards to ensure accountability even if unique means are used to accomplish financial objectives; and
- At the federal level there has been the ability to integrate the accounting standard-setting for the Federal government with the overall reforms envisioned by the CFO Act and other financial management reform legislation.

5.115 The weaknesses of the current approach are considered to include:

- Industries (such as hospitals, utilities, colleges and universities) which have individual entities in different sectors are not comparable in all cases;
- There is a need to educate preparers and auditors regarding differences in standards;
- An appearance can be created that sector-specific standards are used to diminish accountability by excluding unique transactions/relationships; and
- Resource constraints associated with standard-setting.

Government Finance Statistics in the USA

5.116 FASAB has advised that it is not aware of any current considerations in relation to the relationship between general purpose financial reporting and the system of Government Finance Statistics. FASAB has consulted from time to time with the individuals responsible for GFS based reporting. However there is currently no formal relationship between the two systems nor any current proposals to harmonise them in any way.

GASB paper: Why governmental accounting and financial reporting is – and should be – different

5.117 In March 2006, during the course of this review, the GASB published a report entitled “Why Governmental Accounting and Financial Reporting is – and should be – different.”⁶⁶ The timing of the report and the contrast in views to those which have existed in Australia to date justify a brief summary of the report here⁶⁷.

5.118 The GASB report argues that governments are fundamentally different from for-profit business enterprises in several important ways. Governments have different purposes, processes of generating revenues, stakeholders, budgetary obligations and propensity for longevity. These differences require separate accounting and

⁶⁶ www.gasb.org/white_paper_full.pdf

⁶⁷ The summary here is based substantially on the Executive Summary on pages 1 to 4.

financial reporting standards in order to provide information to meet the needs of stakeholders to assess government accountability and to make political, social and economic decisions. GASB acknowledges that although state and local governments have had separate standards for over 100 years, occasionally the question is raised as to why governments cannot simply apply the standards established for business enterprises.⁶⁸

5.119 The GASB report addresses three core questions which are discussed briefly in the following paragraphs. The questions are:

- Why are separate accounting and financial reporting standards essential for governments?
- How do existing accounting and financial reporting standards reflect the different needs of stakeholders?
- Why is there an ongoing need to set additional governmental accounting standards?

5.120 The report argues primarily that separate accounting and financial reporting standards are essential because the needs of users of financial reports of governments and business enterprises differ. Due to their unique operating environment, governments have a responsibility to be accountable for the use of resources that is significantly different from business enterprises. Because government's primary sources of revenue, typically taxes, bear little direct relationship to the services received by individual taxpayers, taxpayers collectively focus on assessing the value received from the resources they provide to government. Governmental accounting and financial reporting standards aim to address this need for public accountability information by helping stakeholders assess how public resources are acquired and used, whether current resources were sufficient to meet current service costs or whether some costs were shifted to future taxpayers, and whether the government's ability to provide services improved or deteriorated from the previous year.

5.121 The longevity of government and its role to maintain and enhance the wellbeing of citizens through the provision of public services also results in information demands that differ from those of business enterprises. The GASB report explains that governments do not operate in a competitive marketplace, face virtually no threat of liquidation, and do not have equity owners. GASB argues that as a consequence information about fair values of capital assets is of limited value and measures of net

⁶⁸ Business enterprises are private sector entities organised for the purpose of earning profit and complying with the pronouncements of the FASB.

income and earnings per share have no meaning to users of governmental financial reports. Instead users need information to assess the government's stewardship of public resources, including information to evaluate the manner and extent to which resources are devoted to specific services and the costs of providing those services.

- 5.122 Users also need information to determine compliance with legally authorised spending authorities. Creditors of both businesses and governments are interested in information on the ability to repay debt. However government creditors focus more on information regarding the government's ongoing ability to raise taxes and the costs of activities that could compete for those resources, rather than on information about how earnings are generated.
- 5.123 The GASB report goes on to explain how existing accounting and financial reporting standards seek to reflect the different needs of stakeholders. It notes there are differences in components of the conceptual framework and in individual accounting standards. Specifically the GASB's conceptual framework places priority on addressing the informational needs of citizens and elected representatives, two constituencies not identified as users of business enterprise financial statements by the FASB. GASB's objectives consider public accountability to be the cornerstone on which all other financial reporting objectives should be built.
- 5.124 The report identifies some of the most significant differences in governmental and business financial reporting as:
- The measurement and recognition of certain types of revenues (for example, taxes and grants);
 - The view that capital assets provide services to citizens rather than contribute to future cash flows;
 - The use of fund accounting and budgetary reporting to meet public accountability needs;
 - The use of accountability principles rather than equity control to define the financial reporting entity; and
 - The treatment of pensions and other post employment benefits to allocate costs of services equitably to applicable periods.
- 5.125 Finally the GASB report considers why there is an ongoing need to set additional governmental accounting standards. Although GASB considers progress has been made, the need to develop and improve accounting standards for government still exists. For example, additional components of the conceptual framework are still

being addressed. In addition there are important types of transactions such as those associated with derivatives and intangible assets for which there are no existing standards or for which existing standards are not comprehensive. The GASB research agenda is also considering additional ways to communicate results of government activities. Finally over time governments and the governmental environment continue to change resulting in the ongoing need to update existing standards and to adopt new standards.

- 5.126 It is important to note that the scope of the GASB paper is limited to comparing governments to business enterprises. The paper does not consider nor express any views on issues related to not-for-profit organisations outside government and furthermore notes that governments in other countries may have different characteristics than governments in the USA and, accordingly, the paper does not address international differences⁶⁹.

United Kingdom

Standard-setting bodies

- 5.127 The United Kingdom (UK) has only one accounting standard-setting body comparable to the bodies discussed in relation to other countries in this report. That is the UK Accounting Standards Board (“ASB”). However, the Financial Reporting Advisory Board (“FRAB”) has an important role in relation to government accounting requirements and is accordingly discussed in this section.

Reporting Requirements for Different Sectors

- 5.128 The ASB is responsible for setting accounting standards for companies that have been incorporated under companies legislation (covering both profit-oriented and not-for-profit companies). The ASB has been established as a prescribed body for issuing accounting standards under regulations under the *Companies Act 1985*.
- 5.129 In central government, the government is responsible for setting accounting standards with the FRAB having a statutory role in terms of advising the Treasury on financial reporting principles and standards. In practice there are a number of bodies with responsibility for setting standards in the public sector, these being:
- HM Treasury for central government bodies in the UK (where powers are not devolved), including departments, agencies, non-departmental public bodies and trading funds;

⁶⁹ Refer to pages 4 and 5 of the GASB Report.

- Where powers are devolved, the Scottish Executive for central government bodies in Scotland and the Department of Finance and Personnel, Northern Ireland for these bodies in Northern Ireland;
- The NHS Executive setting standards for NHS trusts with Monitor, the independent regulator of NHS Foundation Trusts, responsible for NHS Foundation Trusts; and
- The CIPFA/Local Authorities (Scotland) Accounts Advisory Committee SORP Committee setting standards for local authorities (covering England, Wales, Scotland and Northern Ireland).

5.130 The role of the FRAB arises under the *Government Resources and Accounts Act* 2000 requiring HM Treasury to “consult a group of persons who appear to be appropriate to advise on financial reporting principles and standards”. The FRAB, originally set up in 1996, now fulfils this statutory role – a role it performed before the legislation was passed. The 2000 Act covers departments and executive agencies in England and Wales and whole of government accounts.

5.131 The *Government Resources and Accounts Act* (Northern Ireland) 2001 lays the same duty of consultation on the Department of Finance and Personnel, Northern Ireland and the FRAB has accepted the invitation to fulfil the role for Northern Ireland. There is no similar duty laid on Scottish ministers but they have agreed to consult the FRAB. Both the Department of Health and Monitor have also requested the FRAB to oversee their accounting guidance.

5.132 In relation to the not-for-profit sector, the accounting requirements for charities, registered social landlords and the higher and further education sectors differs according to the UK legislation, royal charter or other statutory instrument relevant to the establishment and constitution of the individual entity. Many of these entities are incorporated under companies legislation and are therefore required to prepare “true and fair” accounts and, in doing so, adopt relevant accounting standards. This in turn means UK GAAP, including the financial reporting standards issued by the ASB.

5.133 Sector-specific issues are addressed in Statements of Recommended Practice (“SORPs”) which are not issued by the ASB but by sector bodies recognised for this purpose by the ASB. These bodies are expected to meet criteria laid down by the ASB and to develop their SORP proposals in conformity with the ASB’s Code of Practice.

How are standards set for different sectors?

- 5.134 The standards issued by the ASB are intended for use by all sectors falling within its remit. Accordingly there is no reference in the standards to different sectors, other than that standards do not apply to small entities applying the separate Financial Reporting Standard for Smaller Entities (“FRSSE”).
- 5.135 The ASB does however recognise that accounting standards can helpfully be supplemented by industry or sector-specific guidance. Where this is the case, SORPs are issued. There are currently 12 bodies recognised by the ASB as SORP making bodies ranging from the British Bankers Association and the Association of British Insurers to Universities UK and the National Housing Federation. Each SORP must include a statement by the ASB confirming that the SORP does not appear to contain any fundamental points of principle that are unacceptable in the context of current accounting practice or to conflict with the accounting standards or the ASB’s plans for future standards.
- 5.136 Bearing in mind its relevance to the other not-for-profit sector, the Charities SORP deserves consideration. This SORP is based on extant UK GAAP and is compatible with the law. It provides the charity sector with an interpretation of accounting standards and principles and clarifies the accounting treatment for sector-specific transactions. The latest version of the SORP was issued in 2005.
- 5.137 The reporting guidance for the different entities in the UK government sector is based on the accounting standards issued by the ASB. In most cases, the standards apply as written although there is some interpretation for the public sector context.
- 5.138 Standards for the different types of public sector entity are published either as part of the Government Financial Reporting Manual⁷⁰, as accounting guidance provided by the Department of Health (for the National Health Service)⁷¹, Monitor (for NHS Foundation Trusts⁷²) or through the Local Authorities SORP.

Reasons for different requirements

- 5.139 As noted above, the standards issued by the ASB are intended for all sectors falling within its remit. However the SORPs reflect a view that an industry or sector may have special accounting or financial reporting issues that require clarification or interpretation within the principles of the standards. In other words it is acknowledged that accounting standards may not provide all the guidance needed to deal with the

⁷⁰ <http://financial-reporting.gov.uk>

⁷¹ <http://www.info.doh.uk/doh/finman.nsf>

⁷² <http://www.monitor-nhstf.gov.uk/publications.php?id=883>

particular issues in industries or sectors and that such guidance is both helpful and appropriate. The issuance of SORPs achieves this end.

- 5.140 In relation to the central government sector, in practice the Treasury and the devolved administrations use ASB standards as the basis for public sector reporting. The *Government Resources and Accounts Act 2000* (and the equivalent Northern Ireland legislation) requires the Treasury to have regard to any relevant guidance issued by the ASB or any other prescribed body or to the international accounting standards adopted by the European Union. The Act further requires the Treasury to “require resource accounts to conform to generally accepted accounting practice subject to such adaptations as are necessary in the context”.
- 5.141 Different requirements within the central government sector (that is, between different public sector entities) are small in number and primarily relate to the legal status of the entity. The Treasury and devolved administrations and the FRAB seek to ensure that any adaptations are kept to a minimum, are fully justified and make sense in the context of resource and other accounts.
- 5.142 Neither the ASB nor the FRAB have a formal policy on sector-neutrality. The expectation of the ASB is that accounting standards will be applicable across all sectors, albeit industry and sector-specific issues may need to be addressed. There is also an expectation that accounting standards will be relevant to public benefit entities (covering both the not-for-profit and public sector) although again, there will be supplementary guidance for the former through SORPs and for the latter through accounting requirements issued by the relevant authorities described above.

Users and their information needs

- 5.143 The ASB *Statement of Principles* considers the key users of profit-oriented entities financial statements are (present and potential) investors, with their core information needs being in respect of information that is useful in taking decisions about their investment in the entity. The *Statement of Principles* provides details on other users and their information needs but it is investors who are the defining class of user.
- 5.144 In its exposure draft of a *Statement of Principles: Interpretation for Public Benefit Entities* (“ED *Statement of Principles: Interpretation*”), the ASB has indicated that (present and potential) funders and financial supporters are the defining class of user for public benefit entities. These users are interested in information that helps them to assess how effectively management has fulfilled their stewardship role. They are also interested in information about the utilisation of the resources they supply to the entity that may be useful in taking decisions about resources they may choose, or be required, to supply in the future.

- 5.145 The *ED Statement of Principles: Interpretation* can be contrasted with the *Statement of Principles*, which concludes that all the purposes involved in the provision of financial information for profit-oriented entities involve economic decisions. While certain users of public benefit entities will have the ability to make these types of economic decision, other users, for example the public/taxpayer in relation to a government, will not have the same ability to make direct economic decisions. They will primarily be interested in assessing the stewardship exercised by the entity's management.⁷³
- 5.146 The primary user of central government accounts in the UK is considered to be Parliament, which is interested in performance against the amounts voted, uses the accounts to hold departments to account for their actions and is seen as a proxy for the citizen. Parliament falls within the defining class of user as put forward in the ASB's *ED Statement of Principles: Interpretation* discussed immediately above. Treasury is another key user which is interested in performance against the budgets agreed between the Treasury and departments.
- 5.147 The FRAB has not considered in any great detail the core information needs of users. However it advises that issues relating to user need are increasingly forming part of its agenda. In particular, there is interest in the relationship between Estimates, Accounts and Budgets, reflecting both the underlying accountability rationale for information and highlighting the importance of budgets in the government context.

Mechanisms to ensure different user needs are taken account of

- 5.148 The membership of the ASB, coming from a wide range of interests experienced in relation to profit-oriented entities, facilitates the views of users being represented well.
- 5.149 The ASB has three advisory committees which also assist. These are:
- The Committee on Accounting for Smaller Entities;
 - The Committee on Accounting for Public-benefit Entities; and
 - The Financial Sector and Other Special Industries Committee.
- 5.150 Of particular interest in the context of this report is the Committee on Accounting for Public-benefit Entities which advises the ASB on matters relating to public benefit and similar entities, including reviewing applications from relevant bodies seeking to develop SORPs and whether draft SORPs comply with accounting standards.

⁷³ Paragraphs 1.3 and 1.4 of the ED.

- 5.151 The FRAB comprises representatives from the different sectors for which it is responsible as well as independent members and users, thereby assisting to ensure different interests are considered.
- 5.152 The FRAB receives papers from officials (usually the Treasury Financial Reporting Policy team but occasionally from other departments if appropriate). The papers that are brought to the FRAB are subject to due process where the proposals impact on the reporting requirements of entities covered by the board's remit.

Current or future developments in standard-setting for different sectors

- 5.153 The main development which may have an impact on the profit-oriented sector relates to the application of IFRS. At present listed companies preparing group accounts are required to adopt IFRS. The ASB is considering whether full IFRS is also appropriate for those companies that are not currently required to apply IFRS but fall above the Companies Act threshold for being a smaller entity.⁷⁴ The ASB is currently undertaking research and seeking views of constituents on this matter.
- 5.154 For the public benefit entity sector the main development is the *ED Statement of Principles: Interpretation* which could influence the SORP making process and the development of central government accounting standards under the oversight of the FRAB.

Strengths and Weaknesses of the Current Approach

- 5.155 Some of the strengths of the current UK system are considered to be:
- The Statement of Principles which underpins preparation and presentation of financial reports provides a coherent framework of reference for use in the development and review of accounting standards;
 - There is a recognition that specialised industry and sector specific issues do arise: hence the need for SORP-making bodies that deliver supplemental guidance;
 - The Boards include a range of representatives, including users, and in the case of the ASB is supported by Advisory Committees which assist to ensure various interests are well considered; and
 - In the case of the government sector, the reporting requirements are based on established ASB accounting standards, but adapted or interpreted where necessary to reflect the needs of the public sector.

⁷⁴ Smaller entities apply the Financial Reporting Standard for Smaller Entities ("FRSSE").

5.156 Some of the weaknesses of the current system are considered to be:

- The current arrangements can be seen as complex and fragmented with different arrangements existing for standard-setting across both the profit-oriented (IFRS, UK GAAP and FRSSE) and the not-for-profit sectors (government requirements, statutory and funding body requirements, SORPs). This is a particular issue in relation to the not-for-profit sector as the UK moves towards convergence with IFRS;
- The need for improved research to support decisions, especially in terms of user needs. This is particularly relevant to decisions in relation to entities not currently required to adopt IFRS and, in particular, in relation to those entities under the oversight of the FRAB;
- The absence of a finalised conceptual framework for public benefit entities – the ASB acknowledges the need to push ahead in finalising the interpretation for public benefit entities; and
- In relation to the FRAB, some onlookers perceive a lack of independence because the board is appointed by the Treasury, after consultation with the Comptroller and Auditor General. This is however mitigated by the independence with which the Board operates, the publication of reports annually to Parliament which are not subject to any ministerial or official intervention⁷⁵ etc.

Government Finance Statistics in the UK

5.157 The Office for National Statistics (“ONS”) prepares “national accounts” for the UK which are prepared in accordance with the European national accounting standards used for economic statistics known as ESA (European System of Accounting) 95.⁷⁶

5.158 There is no direct relationship between UK GAAP and ONS National Accounts, although data collected across the sectors and reflected in the ONS will include information from financial statements that comply with different forms of UK GAAP. Both the ASB and FRAB have either established links or are monitoring developments in relation to the updating of the SNA framework due to be issued in 2008.

5.159 There are also issues in the central government sector that impact upon national accounts classifications (such as government support for network rail which has been

⁷⁵ FRAB reports are available at www.frab.gov.uk

⁷⁶ ESA is a system of accounting also based on SNA and very similar to the GFS.

reclassified to the private sector) and the Whole of Government Accounts project that is seeking to support the Chancellor's financial management of the public sector and therefore needs to ensure, as appropriate, consistency with the ONS framework for reporting statistical information on issues such as net debt, net borrowing and net cash requirement.

Part 6 – Views of some Australian stakeholders on the current approach

- 6.1 During the course of the review I met with a selection of stakeholders of accounting standard-setting to obtain their views on issues directly and indirectly related to sector-neutrality.
- 6.2 The FRC indicated the range of stakeholders who they wished me to approach. Not all parties chose to comment although the breadth of contributors and range of views suggests that this has not inhibited the value of this stream of the review. The limited nature of this stakeholder input is however acknowledged.
- 6.3 The liaison with stakeholders was preceded by a literature review to identify issues relating to sector-neutrality. This suggested that the greatest concerns would arise in the public sector closely followed by the not-for-profit sector.
- 6.4 My discussions confirmed that the greatest concerns about sector-neutrality lie in the public sector environment and this is reflected in the summary of views which follows. This was expected by the FRC in initiating the review.⁷⁷ No significant issues emerged from the profit-oriented sector. This is not surprising bearing in mind the consistency of support for the adoption of IFRS for this sector.
- 6.5 In relation to the other not-for-profit sector, I invited written comment from a small number of larger organisations and have also reviewed a range of recent material published in Australia by regulatory and professional bodies which comments on financial reporting in this sector. These sources have been referred to when discussing other not-for-profits in this Part.
- 6.6 In late January, CPA Australia decided to initiate a series of Think Tanks with their public sector members in Victoria, Queensland, New South Wales and the Australian Capital Territory. These Think Tanks were attended by well over 200 members reflecting a range of backgrounds and perspectives. Attendees came from federal, state and local government as well as government business enterprises (or their equivalents). The Australian Auditor-General and respective State Auditors-General were in attendance as well as standard-setters, academia and consultants to governments.

⁷⁷ When announcing this review, the FRC indicated that the project would assist the FRC in considering modifications to its strategic direction to the AASB, especially in relation to the public sector.

- 6.7 I was invited by CPA Australia to attend and observe these Think Tanks and was pleased to do so. The views expressed at the Think Tanks were summarised in a report of key themes which has been provided to me by CPA Australia. A number of concerns about standards-level matters were raised in the Think Tanks and are summarised in the CPA Australia report. These are matters which are the responsibility of the AASB and are only mentioned in this report as an indication of the sorts of issues of concern to stakeholders in this sector.
- 6.8 The summary of stakeholder views which follows is necessarily based on my assessment of the strength of support for different views expressed to me. It is my intention in this part to report these views and make such judgements as objectively as I can.
- 6.9 The views have been grouped together as follows:
- views relating to sector-neutral accounting standard-setting generally;
 - views relating primarily to profit-oriented entities;
 - views relating primarily to public sector not-for-profit entities;
 - views relating primarily to other not-for-profit entities;
 - views on structures, resources and processes; and
 - other issues.

Views relating to sector-neutral accounting standard-setting generally

- 6.10 In this section some high level themes from the stakeholder liaison are summarised to provide a general background for consideration of issues raised in relation to each of the sectors.
- 6.11 The different “business models” applying in the different sectors was highlighted by many and the importance of the accounting and reporting requirements responding to those differences. It was suggested that the differences are largely driven by different accountability frameworks.
- 6.12 Many contended that most transactions and events are the same in each of the different sectors. In the majority of cases, there is no reason for there to be different accounting treatments for the different sectors nor different reporting requirements.

There was general agreement that “transaction-neutrality” is in most circumstances appropriate.⁷⁸

6.13 Many expressed the view that Australian Accounting Standards were not, and could not be, genuinely sector-neutral. This is not only because changes are being made within them for not-for-profit entities but because the foundation standards are developed only for profit-oriented entities. In other words there is an inherent concentration or even bias towards profit-oriented entities. This view is particularly strong in the public sector as will be noted in subsequent comments. Some expressed the view that the two strategic directions given to the AASB are inherently inconsistent with sector-neutrality in the sense it is very difficult for the AASB to maintain a single set of requirements when IFRS and GFS differ.

6.14 Many stakeholders attached a high priority to having a conceptual framework that is appropriate for all sectors. Some felt that it was unfortunate that aspects of the earlier conceptual work in Australia had been lost and some who were up-to-date with the developments at the IASB⁷⁹ had concerns about the future. Others drew favourable attention to conceptual work relevant to not-for-profits being done by other standard-setters such as the UK Accounting Standards Board (see Part 5, paragraphs 5.144 to 5.146).

6.15 A number of stakeholders highlighted the benefits of having standards which are as similar as possible across all sectors. These included:

- enhanced comparability and understandability of financial information through having one base set of requirements in Australia;
- greater mobility for accounting professionals and skill transfer made easier between sectors;
- efficiency in standard-setting, because issues common across all sectors can be addressed at once; and
- better quality standards can emerge if the issues affecting all sectors are addressed.

6.16 On the other hand, others noted some of the challenges of developing a core set of common standards as:

- the difficulty for standard-setters to understand all the contexts in which the standards will apply;

⁷⁸ See paragraph 3.14.

⁷⁹ See paragraphs 4.35 to 4.37.

- standard-setting is more difficult and takes longer if the needs of different users and sectoral issues are all properly considered; and
- the concentration on financial aspects (such as the “bottom-line”) means that broader dimensions of performance which are particularly relevant in the not-for-profit sector are not given sufficient attention.

Views relating primarily to profit-oriented entities

- 6.17 While the adoption of IFRS for profit-oriented entities in Australia is not part of this review, I was aware of some calls for the adoption of “pure” IFRS as Australia’s reporting framework.⁸⁰ Biermann and Betkowski noted that the AASB had, in creating AIFRS, deleted some treatments permitted under IFRS, provided additional guidance and made the standards “sector-neutral”. The article noted that “one-way” convergence rather than “two-way” convergence had potential cost and perception implications for Australian corporates. The article wondered whether adopting “pure” IFRS would not be appropriate in the longer term and more easily implemented.
- 6.18 The National Institute of Accountants (“NIA”) also suggested in September 2005 that the move to IFRS was “half-baked” in that Australianisations had been adopted for profit-oriented entities.
- 6.19 I accordingly asked stakeholders with a particular interest in profit-oriented entities whether the inclusion of Australianisations to address not-for-profit issues was of concern in the for-profit environment. No such concerns were raised. I specifically confirmed with the NIA that their comments should not be interpreted as suggesting that a single set of standards was problematic for profit-oriented entities. Rather, within the context of the standards as they are, the NIA considers that profit-oriented entities should have requirements as close as possible to, or entirely consistent with, IFRS.
- 6.20 The Australian Institute of Company Directors (“AICD”) has not raised any concerns with me about the implications of a single set of standards for profit-oriented entities or any other related matters of concern. They have however drawn my attention to their initiative in developing a shareholder friendly report as an example of their concern that the needs of users may not have been fully addressed by the accounting standards as they currently are.
- 6.21 During the course of the review I heard no concerns that profit-oriented entities in the public sector should follow the requirements applying to profit-oriented entities in Australian Accounting Standards. On the contrary, a number argued that this was important for reasons of competitive neutrality so that where public sector organisations

⁸⁰ For example, Chris Biermann and Frank Betkowski, Company Director, July 2005, page 13.

are competing with private sector organisations the same reporting requirements apply. It was also noted that for meaningful benchmarking of performance, it is important that like entities follow the same standards.

Summary

- 6.22 In summary, there do not appear to be any issues of concern relating to profit-oriented entities arising from the current sector-neutral approach to accounting standard-setting.⁸¹

Views relating primarily to public sector not-for-profit entities

Don't overlook or under value what's been achieved...

- 6.23 A number of those with involvement or interest in the public sector highlighted how much had been achieved in the last 15 years in public sector reporting in Australia. Many, including a number of attendees at the CPA Australia Think Tanks, highlighted that the substantial progress across the Australian public sector should be acknowledged and should be the starting point for any discussion about the future.
- 6.24 Importantly, Standard & Poors also applauded the transparency within the Australian public sector and indicated that they were generally very appreciative of the quality of reporting available to them. They were very supportive of the move to accrual accounting and noted that a much richer picture is now given in relation to the performance and position of public sector entities.⁸² They expressed the view that they receive more and better quality information about governments and other public sector entities in Australia and New Zealand than their international colleagues do.
- 6.25 The Australian Bureau of Statistics ("ABS") also emphasised that developments in the quality of accounting information in the public sector in recent years have made their task of compiling government's contribution to their quarterly Gross Domestic Product and other series much easier. They particularly acknowledged the beneficial impact of AAS 31 *Financial Reporting by Governments* recognising a disaggregation of the public sector into the general government, public financial corporation and public non-financial corporation sub-sectors.

The public sector is different...

- 6.26 One of the strongest views which emerged through the liaison phase was that the differences in the public sector need to be acknowledged. Most who expressed this view highlighted government's key role in the provision of services as a key difference

⁸¹ Refer however to paragraph 6.99 regarding concerns about small and medium-sized entities.

⁸² As Standard & Poors noted, accrual information complements cash information.

and many also emphasised that governments distribute wealth rather than create wealth (as profit-oriented entities strive to do).

6.27 Some noted that the public has high expectations of government and those expectations lead to more onerous obligations in terms of reporting because of the pervasive role governments play in society.

6.28 Others highlighted a range of other differences including that:

- government is more transparent – noting parliamentary scrutiny, the role of Public Accounts and similar committees and, as one Auditor-General described it, “the fish bowl” in which much of the public sector operates;
- the notions of profit and equity are both of limited relevance in the public sector context;
- ex ante information (including budgets) is fundamental in the context of the accountability of public sector entities, but is of much lesser importance to profit-oriented entities;
- methods of funding, including the notion of appropriations, are very different to the way revenue is earned in profit-oriented entities;
- most of the public sector operates in a non-competitive environment;
- restructuring arrangements/machinery of government changes occur in quite different ways than in profit-oriented entities;
- most assets represent service capacity not future cash flows; and
- accountability is the key rationale for reporting, rather than decision making which is key for profit-oriented entities (some used the notion of “stewardship over resources” to describe this).

6.29 One person said that it was important not to confuse the need for public sector entities to operate in a business-like manner with them in fact being (profit-oriented) businesses.

But not that different...

6.30 While I heard and read a small number of views that the differences described in the previous section are so fundamental as to make any thought of common treatments between the different sectors inappropriate that was not the majority view. The majority view was that, while the differences are very important, there is still much that is

common between the sectors. An observation made to me was that “the public sector is different, but it is not that different from the private sector.” Views of this nature were expressed at meetings with the ACAG Technical Committee, HoTARAC and by others.

- 6.31 Various stakeholders highlighted the number of areas in which accounting for transactions and events should be identical across the sectors. In essence there was a strong view that stakeholders did not wish there to be accounting and reporting differences which are not justified on the basis of real differences.

The differences need to have a greater impact on the reporting...

- 6.32 There was a widespread view that current accounting standards do not sufficiently ensure reporting about the issues that matter most in the public sector and do not provide key information that users need.
- 6.33 Many of the concerns relate to presentational or “display” issues in financial reports. A number queried whether the current format of reports (at different levels of government including local government), was best meeting user needs in the public sector. ACAG members noted that some Councils are producing additional statements to report information that users have indicated they need. One example is a statement showing how resources have been used and applied. Some noted that bottom-line profit is not of itself meaningful in the public sector and felt that different presentations were possible and necessary. Others simply highlighted a concern about whether it is possible to meaningfully assess performance in the public sector under current Australian Accounting Standards.
- 6.34 These latter concerns perhaps link to comments made by others that there should be a greater focus on non-financial reporting within the overall suite of accounting standards. Others advocated more work on performance reporting generally – one advocating that there ought to be “a body of work on performance reporting”.⁸³ The New South Wales Audit Office has stated that the state’s “fundamental role is to provide services rather than make a profit. That does not mean the State and its agencies should not operate in a business-like manner, nor adopt relevant private sector management disciplines. It does mean that assessing the State’s performance calls for information about the nature, quality and quantity of services as well as its finances. Currently only the latter information is available in any comprehensive way.”⁸⁴
- 6.35 The importance of reporting against budgets was highlighted frequently and the IPSASB project noted. Bearing in mind the importance of budgets in the public sector

⁸³ “Performance Reporting” has in recent years come to be used to refer to the ongoing IASB project considering changes to reporting of financial performance. It is used here in its traditional usage to refer to reporting of wider dimensions of performance, including but not limited to financial.

⁸⁴ Awareness Issue 10, November 2005, The Audit Office of New South Wales.

context, stakeholders felt reporting of budgets and explanations for variances needed far greater attention from standard-setters.

- 6.36 Others drew attention to the importance of compliance information – in particular, but not exclusively, compliance with mandated authorities such as budgets and appropriations. Reporting of these matters was seen as essential to meeting user needs as part of the proper discharge of accountability.
- 6.37 Others drew attention to the issues around sustainability – in particular sustainability of service delivery and, in this context, some stakeholders emphasised the importance of greater attention to capital maintenance concepts in the public sector context.
- 6.38 Another issue highlighted was disaggregated information, stakeholders noting that the recent exposure draft on segments is not applicable to public sector entities. However many feel that disaggregated information is of particular importance in the public sector and that an effort should be made to establish a disaggregated information equivalent of segment reporting.
- 6.39 Another specific issue that was raised by a small number of commentators and raised by the Joint Committee on Public Accounts and Audit in a 2002 report⁸⁵ was about explanations of operating surpluses or deficits. On some occasions these surpluses have been related to the treatment of the capital use charge but in other circumstances arise for other reasons. Related concerns have arisen due to the treatment in Australia of non-reciprocal transactions. As one Auditor-General stated:

“Users have concerns when what they consider to be next year’s revenue is shown in this year’s accounts.”

- 6.40 In summary there are a number of aspects of current reporting under existing standards which public sector stakeholders consider need more attention in order that the needs of users are best met and the quality and integrity of public sector financial reporting is enhanced.

The importance of an appropriate conceptual framework...

- 6.41 Public sector stakeholders were particularly strongly of the view that an appropriate conceptual framework was needed if a sector-neutral approach to standard-setting was to be maintained. These concerns begin with the objective of financial reporting where the need for a greater emphasis on accountability and stewardship was frequently emphasised. Others were concerned that the reporting entity issues in the public sector needed to be resolved at a conceptual level – see also paragraph 6.45 below. Some

⁸⁵ Report 388 *Review of the Accrual Budget Documentation*, Joint Committee of Public Accounts and Audit, June 2002.

noted that a “pure” approach to sector-neutrality⁸⁶ was not in the interests of public sector users.

6.42 Because the current IASB/FASB conceptual framework project appears to be leading to a conceptual framework more closely aligned to profit-oriented entities than the existing framework, I asked some stakeholders how this could be responded to in Australia. None had considered possible solutions to the issue and no ideas were forthcoming. However the importance of having an acceptable underlying conceptual framework for each of the sectors was typically reiterated.

There are many accounting issues to be resolved...

6.43 Many of the stakeholder groups provided me with examples of public sector accounting issues that they felt had either not been addressed or had been inadequately or insufficiently addressed.

6.44 Some expressed the view that unresolved accounting issues in the public sector are subject to a “wait and see” approach.

6.45 Cataloguing issues which need, or may need, attention is not the purpose of this review. However some of the issues which were brought to my attention most frequently and which appear to be of some significance are:

- the clarity of definition of “not-for-profit entity” and, in particular, concerns about the impacts on reported performance where entities “transfer” from one sector to another. Real life examples were described to me of significant write-downs of assets because a government determined that particular entities were now profit-oriented;
- interpreting the notion of control in a public sector context, noting that in the frequent absence of ownership instruments this is a complex issue. Furthermore the issue which has been discussed recently about whether the General Government Sector is a reporting entity needs to be resolved. The issues are compounded by the federal and monarchical systems of government in the Australian Federation. The concept of control does not easily fit in these contexts and the issue has not been considered well as part of the move to accrual accounting in different countries in recent years. The issue of public sector bodies which have autonomy and independence is a further issue, which is currently being considered by the New Zealand FRSB ;

⁸⁶ See paragraph 2.17

- issues related to consolidation, in particular, the occurrence of “mixed groups” where some group entities are complying with standards for profit-oriented entities and others with standards for not-for-profit entities. This is creating challenges;
- a range of issues related to physical assets including concerns about consistency in guidance on and the practice of valuations, depreciation and a concern that depreciation charges can frequently bear no relationship to future capital needs.⁸⁷ In other words, the accounting and reporting is seen as inadequate to inform users about the sustainability of service delivery;
- the distinction between controlled and administered items;
- the need for guidance on related parties including disclosures about remuneration of directors, senior officers etc;
- revenue recognition, in particular revenue of a non-exchange nature;
- cultural and heritage assets, including concerns about recognition, measurement and depreciation as well as disclosure; and
- the absence of guidance (from the public sector perspective) on public private partnership arrangements.

Standard-setting is dominated by a profit-oriented mindset...

6.46 Various commentators, including some who have been involved in Australian standard-setting, felt that the use of IFRS as the “foundation” standards combined with the predominance of private sector people in the standard-setting process had led to a profit-oriented consciousness or mindset dominating the standard-setting process. Many acknowledged that the AASB has been constrained by the pressures of the move to IFRS. However they consider there is a view that any move away from IFRS is “a problem” and has the potential to compromise the benefits of compliance with IFRS for profit-oriented entities in Australia. Some attributed this thinking particularly to members from global firms. Accordingly there is “a fight” over every proposed additional paragraph and real issues for other sectors are not adequately addressed. Others expressed a similar concern when saying that they felt that public sector issues had been “glossed over” during the convergence process or that the public sector has been “shoe-horned” into the profit-oriented standards. Another view expressed was that the prevailing standard-setting mindset is that “if it is good enough for profit-oriented entities, it is good enough for the not-for-profits”.

⁸⁷ This is consistent with comments noted earlier about sustainability information.

Users and their needs...

- 6.47 Various stakeholders highlighted the importance of Parliaments as key users and noted that some users have difficulty understanding the information currently made available to them. Many felt that users need more attention in the standard-setting process and that their needs are not sufficiently well known or understood. One suggestion made was that the FRC fund the AASB to investigate user needs more fully.
- 6.48 Others noted that Public Accounts committees are often focused on political issues and include members who are not trained in fields which enable them to use information well. Nevertheless, as a key user, more work should be done on an ongoing basis to assess their needs.
- 6.49 Many at the CPA Australia Think Tanks expressed the view that the needs of users were not being well met and that it was those needs that should be driving future developments. Many felt that the needs were not being well met because the aspects of difference in the public sector, such as the greater focus on the discharge of accountability, had not been given enough consideration.
- 6.50 Other stakeholders expressed concern at the minimal input of users into the standard-setting process. Some suggested a "User Forum" (in contrast with the existing Consultative Group) which they felt might elucidate more input from key users if managed well.⁸⁸
- 6.51 Echoing the comments I have reported earlier about the perceived prevailing mindset of standard-setting, one respondent summed up the issues as follows: "The question needs to change from "Why shouldn't that apply to not-for-profit entities?" to "What are the needs of not-for-profit users?." Another felt that both questions need to be considered jointly.

The approach to standard-setting...

- 6.52 In the light of the many issues raised by public sector stakeholders, this section brings together views which are directly relevant to standard-setting approaches.
- 6.53 A substantial majority of those consulted were supportive of having a core set of standards that apply to entities in all sectors. No organisation has expressed a different view to me.

⁸⁸ In April 2006, the AASB announced the establishment of a User Focus Group of analysts to provide Input to the AASB and, through the AASB, to the IASB. I have been advised that the AASB intends to establish a Not-for-profit User Focus Group over coming months.

- 6.54 A significant majority of those consulted support a presumption of sector-neutrality, that is, that there should be accounting and reporting differences between the sectors only where those differences represent real underlying differences in accountability relationships, economic events or transactions or other matters. Each of the professional bodies is supportive of this approach.
- 6.55 It was also interesting to note the comments of the ABS on this issue. They noted that under the System of National Accounts (“SNA”) there is, in effect, sector-neutrality except that some issues that are specific to certain sectors need to be addressed in a different way for those sectors. Translating that approach across to accounting, they noted that common requirements would seem appropriate unless there are unique issues or unless the underlying rationale for an activity differs between the different types of entity.
- 6.56 The substantial majority of public sector stakeholders consider much more needs to be done to enhance reporting to better meet the needs of public sector users, and to address public sector issues that are unresolved.
- 6.57 Views were however mixed on how those public sector needs and issues should be addressed in the context of Australian Accounting Standards. Many seemed to be unconcerned with the manner in which the issues are addressed (some called this just “geography” and are only concerned that the matters are *in fact* addressed). Those holding this view are in favour of allowing the AASB to determine how the issues are addressed and are generally not concerned about most matters being addressed in topic-based standards (as currently proposed by the AASB).⁸⁹ The report on the CPA Australia Think Tanks expressed this view this way “the primary and urgent requirement is to address and resolve outstanding issues not *where* they are addressed”.
- 6.58 However others consulted are concerned that specific public sector standards should remain. That is, they want AAS 27, AAS 29 and AAS 31 to be revised and reissued as core public sector accounting standards. The ICAA has indicated it is yet to be convinced about the need to remove the public sector standards, noting that other industry standards still exist.
- 6.59 Those holding this view, which include the Australian Auditor-General⁹⁰, generally favour a matrix approach to standard-setting in Australia. There should continue to be a range of sector-neutral standards dealing with issues common across the sectors but there should also be specific standards for the public sector.

⁸⁹ See paragraphs 3.9 to 3.11.

⁹⁰ As presented at CPA Australia Think Tank in Canberra on Friday, 20 January 2006 and reported in Canberra Times on Saturday 21 January 2006.

- 6.60 It should be noted that all stakeholders accept the existing public sector standards need to be reviewed. The Joint Committee of Public Accounts and Audit in its report 388⁹¹, paragraph 6.7, noted that such a review was likely in the future and that it considered such a move would be timely. The adoption of IFRS has of course made the review essential.
- 6.61 Some of those who support retention of the public sector standards expressed the view that public sector issues have not received the same attention since the single board was established in 2000. They feel that removal of the specific public sector standards will further reduce attention to public sector issues.

Matters related to GFS

- 6.62 This review has taken place while ED 142 *Financial Reporting of General Government Sectors by Governments* has been under active consideration by the AASB. This exposure draft is the first step in the AASB's response to the strategic direction from the FRC.
- 6.63 Some public sector stakeholders and others with an interest in the sector expressed views on the issues. Those which are relevant to the subject of this review are summarised here.
- 6.64 Those associated with the Commonwealth and State Treasuries take the view that the General Government Sector is what users are most interested in. They attach a high priority to the development of harmonised reporting for the General Government Sector as between general purpose financial reporting and GFS. Some of this group advocate information about the General Government Sector as separate general purpose reports in addition to whole of government reports.
- 6.65 Others agree that there is important information value in the General Government Sector reports but draw attention to the crucial importance of whole of government accounts. Standard & Poors have expressed the view to me that they highly value the consolidated accounts in addition to those for the General Government Sector. They noted that movements between the General Government Sector and the rest of the reporting entity are frequently important and it is necessary to understand those movements to fully interpret the General Government Sector information⁹². They had no particular concern about whether or not they receive separate information on the other two key sectors of government which comprise part of the GFS reporting framework. Standard & Poors also noted that history suggests that governments who

⁹¹ Report 388 *Review of the Accrual Budget Documentation*; Joint Committee of Public Accounts and Audit, June 2002.

⁹² I note that the Victorian Public Accounts and Estimates Committee has also mentioned this concern in its submission on ED 142.

find themselves in difficulty frequently do not do so due to issues arising within the general government sector but rather to those entities outside of it.

- 6.66 Some stakeholders supported the publication of information on the General Government Sector on a basis as harmonised as possible, but felt that the debate about whether the General Government Sector is a reporting entity and related issues was unnecessary. Rather, they consider the information is of value to users and should be disclosed in addition to the whole of government accounts. One stakeholder described this as the “combined volumes” approach.
- 6.67 In relation to the harmonisation aspects of ED 142, relatively few made comments. The ABS raised two significant points. Firstly that the harmonisation should be with the ABS’s adaptation of GFS. This is because the ABS may be prepared to harmonise further than does the GFS, although the ABS will only do so where this can be justified for sound macroeconomic reasons. In addition, there may be some circumstances in which treatments may be suitable to Australia and using the ABS version of GFS is therefore more appropriate.⁹³
- 6.68 Another point made by the ABS was that harmonisation seems to have gone as far as is possible at this time. The ABS considers that the integrity of the statistical basis must be maintained (and accepts the same arguments apply to the accounting basis). A reconciliation between the two sets of information is a very positive move but the ABS doubts further alignment is possible at this time.
- 6.69 To date the AASB has only addressed the harmonisation strategic direction in relation to the General Government Sector. The next steps in this project are at this stage unclear. However some stakeholders expressed the view that they saw little merit in applying GFS at an individual agency level (albeit that information will need to be assembled at this level for the purposes of government level General Government Sector reporting).
- 6.70 Some are concerned that the GFS information and its different formats are not well understood. It was suggested to me that outside of Treasuries, the ABS and some economists, few are familiar with the format and the underpinning logic. Others however accepted that the GFS information is required to be disclosed by Australian governments and the issue of reconciling the different key indicators which are in the public domain is important.
- 6.71 Some felt that the provision of information about the General Government Sector was best viewed as a disaggregation matter. That is, it is akin to segment information for

⁹³ The AASB has recently indicated that it is the ABS version of GFS which will be built into the standard to be based on ED 142.

the core segment of government. This view could assist in resolving some of the difficult accounting issues such as whether partial consolidation is appropriate in the context of the General Government Sector. The ABS argued strongly that if partial consolidation was not followed, this would compromise the quality of the information provided.

- 6.72 Some viewed the whole GFS debate in the context of the different perspectives of accountants and economists. Standard & Poors noted this point but highlighted other aspects of the different perspective taken by economists and accountants. Economists consider that there is a significant amount of “noise” in some accounting information, particularly that related to unrealised value changes. In circumstances where assets or liabilities are revalued on a regular basis, they find different underlying inputs to the valuations between different states and they feel differences in these inputs are seldom justifiable. They acknowledge they are primarily interested in long-term trends and that short-term volatility compromises this focus. They note that significant budget to actual differences arise from these revaluations which, in their view, do not necessarily reflect anything useful about the underlying activity of the government.

Other comments...

- 6.73 Some raised a concern about public sector not-for-profits and other not-for-profits being treated together in existing standards.⁹⁴ They consider that there are differences between the two not-for-profit sectors and that those differences should be recognised where appropriate.
- 6.74 Another view expressed was that the AASB should, on a cost-benefit basis, exclude the public sector from requirements in IFRS that have minimal value in a public sector context. The example given was the voluminous financial instrument requirements.

Views relating primarily to other not-for-profit entities

- 6.75 The views expressed in this section come from a small number of not-for-profit organisations, the Australian Not-For-Profit Network, the three accounting bodies and from some recent reports on the sector which raise issues relevant to accounting standard-setting.

A complex regulatory regime...

- 6.76 The regulatory regime applying to other not-for-profit entities is complex and described by different parties as convoluted, inefficient, costly and not meeting the needs of small or large not-for-profits. The Smith Family has highlighted that this issue flows across

⁹⁴ I note that a current exception to this is AASB 124 *Related Party Disclosures*.

both accounting and taxation issues. The ICAA has raised concerns about particular types of entity which they do not consider are being considered. This includes trusts and other associations. The ICAA finds it spends a significant amount of time assisting members in this sector with this complex set of obligations. A study by the University of Melbourne Centre for Corporate and Securities Regulation surveyed over 1,700 not-for-profits leading to a report in 2004. This report highlighted the complexity of regulation issue as a key issue and advocated a single simplified regulatory regime in Australia. The issues relating to accounting standards need to be viewed in the context of this overall regulatory environment.

Users and their information needs

6.77 The Melbourne University report identified that these entities differ from profit-oriented entities in several ways, including:

- they rely heavily on volunteers;
- they enjoy exemption from income tax; and
- they have a wider group of stakeholders to consider, not only stakeholders interested in “the bottom-line”.

6.78 Eldercare Inc has emphasised that there are additional stakeholders of organisations in the other not-for-profit sector including various funders, sometimes the government. Some suggested the driver of the reporting requirements for other not-for-profit entities should be how they can best account to their stakeholders.

6.79 Some specific reporting recommendations have been proposed in this sector. In its 2003 report “*Review of Not-For-Profit Financial and Annual Reporting*”, the ICAA strongly recommended other not-for-profits develop both process and impact key performance indicators. They consider these are an important part of the reporting by these entities.

6.80 The Chair of the Australian Not-For-Profit Network, Kimberly Smith, expressed the view that the focus on “profit” in current standards is unhelpful and there needs to be a focus on wider dimensions of performance in this sector.

6.81 In its 2003 report, the ICAA advocated a form of segment reporting in this sector. They suggested that not-for-profits have three core business segments:

- generating funds;
- administering funds; and

- the expending of funds for the purposes for which the entity was established.

These different components of their activities should be separately reported in order to meet the needs of users.

Some support for a separate standard(s)...

- 6.82 There have been calls for separate standards for the not-for-profit sector. In June 1995 the then Industry Commission, in a report entitled *Charitable Organisations in Australia*, called for the Commonwealth Government to provide funds to the AASB and Public Sector Accounting Standards Board to develop, within two years, suitable accounting standards for community social welfare organisations. In its 2000 report on the not-for-profit sector, CPA Australia advocated standard-setters researching the needs of users of other not-for-profit financial statements prior to preparing an accounting standard on reporting by them (Chapter 4, page 19).
- 6.83 The 2003 ICAA report concluded that not-for-profits would benefit from the development of a financial reporting framework that meets their specific requirements. They had in mind here a framework that could combine an annual and financial report, be guided by the standard on concise financial reports and both reduce costs for entities and encourage a broader explanation of results, position and activities.
- 6.84 The Melbourne University report in 2004 drew on the 1995 Industry Commission recommendation referred to in paragraph 6.82 and put it forward once again - that the AASB should develop suitable accounting standards for not-for-profit organisations. They also advocated consideration be given to elements from which it would be appropriate to exempt small organisations. The Chairman of the Australian Not-For-Profit Network has advised that there is a ground swell of support within the sector for a separate standard for other not-for-profits in Australia.

Agreement that guidance is needed...

- 6.85 The professional bodies have indicated a range of difficulties with the adoption of AIFRS for this sector. This is partly because the standards have received minimal adaptation for the particular requirements of other not-for-profits. While there is a measure of support for a separate accounting standard for other not-for-profits (see above), there is general support from this sector for greater guidance. It has been suggested by one that while the standards should be able to accommodate the sector with modest changes, good quality implementation guidance would be of particular assistance.

- 6.86 The ICAA has indicated that while in general it supports a single set of standards for all entities, the needs of other not-for-profit users have largely been ignored. They consider guidance is needed to the sector in some form.
- 6.87 Some have noted favourably the existence of the Charities SORP in the United Kingdom as a model which could be followed in Australia.

Concerns about revenue recognition...

- 6.88 There are significant concerns in the other not-for-profit sector about the recognition of revenue. The Australian Not-For-Profit Network has advised of the “significant dissatisfaction” which exists in the sector regarding the recognition of revenue. They consider that consistent guidance is needed. Eldercare Inc has highlighted some of the difficulties in communicating with its users in the context of revenue recognition requirements. It receives government grants which are for either future capital or operational expenditure and in recent years has received grants on the last working day of the financial year. The treatment of these items as revenue in accordance with current Australian Accounting Standards has created a challenge in communicating with stakeholders. They indicated that the treatments also “give an incorrect perception of the actual accounts”.

Views on structures, resources and processes

- 6.89 Other than the calls by some for separate standards for the other not-for-profit sector, the general view of stakeholders is that a single set of core standards remains appropriate in Australia. There was also very little support for the establishment of two or more boards. ACAG representatives noted that there were two boards until 2000 and issues relating to having two boards were a factor in the establishment of the AASB as the single standard-setting board. Each of the professional bodies supports the retention of a single board.
- 6.90 However some stakeholders indicated that dissolution of the Public Sector Accounting Standards Board was based on an expectation that public sector issues would continue to receive appropriate attention. They are not convinced that this attention is in fact being given.
- 6.91 Public sector and not-for-profit stakeholders both raised concerns about the amount of standard-setting resource applied to the issues in their sectors. On more than one occasion public sector stakeholders expressed the view that a third of economic activity occurs in the public sector and yet they do not consider a third of standard-setting

resource is applied in the sector.⁹⁵ Many acknowledged the significant challenge that the AASB faced in addressing the IFRS strategic direction as well as the GFS strategic direction. One stakeholder indicated that it was hardly surprising that some issues would be delayed or even that some mistakes might be made at such a demanding time.

- 6.92 Some raised a concern that there is insufficient representation on the AASB from the public and other not-for-profit sectors. This was accompanied by a view from some that the AASB's collective understanding of the public sector is insufficient. Some queried whether the AASB has the expertise to deliver a sector-neutral set of standards across all three sectors.
- 6.93 Some concerns were also expressed about whether the public sector and other not-for-profit knowledge amongst the AASB staff is sufficient with some proposing that the balance of staff resource needs adjustment.
- 6.94 Perhaps in response to the issues raised in the two preceding paragraphs, some advocated the AASB either establish two sub-boards or, as an alternative, an expert panel or sub-committee to assist it in ensuring the issues in each sector are appropriately addressed. Some noted the existence of such panels or committees in other jurisdictions such as Canada, the United Kingdom and New Zealand.
- 6.95 Some stakeholders supported a greater emphasis on the work of the IPSASB. They felt this was necessary bearing in mind the increasing focus of IPSASB on public sector specific issues. Some consider IPSASB standards should be adopted unless there is a lack of support for a particular standard in Australia or the standard is not up-to-date with IFRS. Others referred to the strategic challenge and inherent conflict in having two international accounting standards bodies.
- 6.96 There was strong support for greater clarity of the AASB's intentions in relation to the public sector. Some referred to the need for a "strategic framework" for public sector/government reporting so that the broad future direction could be understood by stakeholders. A number suggested that the approach to dealing with sectors in the post – IFRS environment is being built up on an incremental basis without any strategic underpinning. In particular, some noted uncertainty in the priority they should give to exposure drafts of IPSASB without knowing whether the particular proposals fit into the AASB's plans for public sector reporting. Some referred to the "barrage of proposals" which are being faced with insufficient resources to respond and felt that having a

⁹⁵ I would observe that measuring how much resource is applied to each sector in a standard-setting environment which mostly considers all sectors together is very difficult. AASB staff have advised me that in recent times 30% of standard-setting time has been devoted to exclusively public sector topics. Much of this has related to the GFS project.

clearer idea of the future direction would be very helpful in determining their own priorities.

- 6.97 Some concerns were expressed about the influence of Treasuries on financial reporting within the public sector. This was less a criticism of Treasuries, who it was acknowledged are informed and have placed a significant investment in contributing to the process, but rather a concern about insufficient views from others. A “User Council” or other possible initiatives were suggested by some as a way of facilitating other public sector input.
- 6.98 The Consultative Group of the AASB is one means of input from stakeholders. Mixed views were received on the value of this group in the context of its ability to ensure issues across the sectors are addressed. Those views ranged from “reasonably happy” to “a waste of time”. There was a general recognition that the number of members of the group and the limited frequency of meetings meant it was difficult for the group to have much meaningful impact. At its April 2005 meeting, the consultative Group itself acknowledged this and encouraged the use of smaller, more focused groups to provide input on specific issues. As noted in paragraph 6.50 the AASB has decided to establish User Groups.

Other issues...

- 6.99 As noted in paragraphs 2.8 and 2.12, the issues relating to small and medium-sized entities (often referred to as differential reporting) are not part of the scope of this report. However a number of the stakeholders consulted raised concerns about the implications of accounting standards for these entities. Compliance costs were a concern to them and they want the matter to be addressed.

Part 7 – Existing Australian Accounting Standards and sector-neutrality

- 7.1 This part of the report reviews existing Australian Accounting Standards and Conceptual Framework documents from a sector application perspective. The standards and other documents reviewed are those in existence at 1 January 2006 although more recent developments have not been overlooked if they are relevant to an issue that arises in relation to the standards in place at that date.
- 7.2 The analysis of Australian Accounting Standards and Conceptual Framework documents is not intended to be a comprehensive technical analysis. The purpose of the review is to further inform the issue being considered in this report, namely, whether a sector-neutral approach to accounting standard-setting is, in 2006, is able to meet the needs of users. The analysis is therefore not exhaustive. The writer hopes that the overall themes are the focus of attention because there is always the capacity for disagreement on individual issues. Furthermore, the limitations of a “view of one” in the context of a standard-setting environment where consensus is the norm are acknowledged.
- 7.3 It is important to remember that the AASB had between July 2002 and mid-2004 to make the necessary equivalents to IFRS. The AASB conducted a due process during that period and there was an opportunity for stakeholders of all entities, including not-for-profit entities, to participate in this process. However the limited time available for commenting and the difficulty of identifying problems and issues without any opportunity for implementation, have contributed to the range of the issues identified here.
- 7.4 It is also important to acknowledge that any body of material such as the Australian Accounting Standards and Conceptual Framework documents will at any time have weaknesses and inconsistencies. I am aware of such weaknesses and inconsistencies in the body of standards of most jurisdictions with which I am familiar. The comments which follow need to be read with that understanding.
- 7.5 This report considers first the Conceptual Framework documents, followed by the Australian Accounting Standards.

Conceptual Framework documents – their appropriateness to all sectors

7.6 The analysis in this section is predicated on a view that the conceptual framework is the fundamental base on which accounting standard-setting is built.⁹⁶ The importance of the conceptual framework was emphasised by many stakeholders (see Part 6).

The documents themselves

7.7 The conceptual framework at 1 January 2006 comprises the following documents:

- AASB Framework: Framework for the Preparation and Presentation of Financial Statements (July 2004);
- SAC 1: Definition of the Reporting Entity (August 1990); and
- SAC 2: Objectives of General Purpose Financial Reporting (August 1990).

7.8 The AASB Framework is identical to the IASB Framework except for a small number of additions and deletions.

7.9 The most significant additions and deletions are as follows:

- Paragraph Aus1.6 clarifies that the term “financial statements” in the title of the AASB Framework means “financial report” in the Australian context;
- Paragraph 8 includes a statement that the term “reporting entity” is defined in SAC 1. SAC 1 effectively replaces the single sentence description of a reporting entity in the IASB Framework;
- Paragraph Aus14.1 refers to more detailed discussion of the objective of financial reporting in SAC 2;
- Paragraph Aus15.1 recognises, in respect of not-for-profit entities, that ownership groups and contributors of donations are usually more interested in the achievement of non-financial objectives than obtaining a financial return (this is in the context of paragraph 15 which relates economic decisions of users to information about cash equivalents and their timing and certainty);
- Paragraph Aus49.1, recognises, in respect of not-for-profit entities and assets, that assets provide the means for entities to achieve their objectives.

⁹⁶ Parts of the Conceptual Framework also have authority in accordance with the hierarchy established in AASB 108, paragraphs 10 and 11.

Furthermore it states that future economic benefits (as used frequently in the Framework) is synonymous with the notion of service potential; and

- Paragraphs Aus54.1 and 54.2 recognise, in respect of not-for-profit entities, that the provision of goods and services may not result in net cash inflows to entities (in contrast to various paragraphs of the Framework which, either directly or indirectly, relate future economic benefits to cash flows and cash equivalents). These paragraphs also explain that the fact that entities do not charge or do not charge fully does not preclude the entities from benefiting from the assets used. Assets such as monuments, museums and historical treasures provide needed or desired services, typically at little or no direct cost to the beneficiaries. These are assets because they enable the entities to meet their objectives of providing needed services.

- 7.10 As noted in the preceding paragraph, both SAC 1 and SAC 2 are referenced from the AASB Framework. SAC 1 defines and explains the concept of a reporting entity, a notion that has been used widely in Australia for 15 years. SAC 1 has been retained as part of the conceptual framework because the IASB Framework (and almost identical AASB Framework) does not provide useful guidance in respect of the reporting entity concept and, most importantly, because the concept is crucial in determining who must report in Australia. The single sentence description in the IASB Framework has been deleted in preparation of the AASB Framework and replaced by the definition from SAC 1. SAC 2 discusses the objective of general purpose reporting for entities in all sectors. It discusses the users of financial reports, their needs and the broad types of information that such reports should provide. It includes a definition of “general purpose financial report” which the AASB wished to retain.
- 7.11 I have been advised that SAC 1 and SAC 2 were primarily retained because of their importance in maintaining the status quo as regards the application of the standards. The AASB concluded there was insufficient time to modify the documents to be fully compatible with the AASB Framework. As a result a number of issues have emerged.

Analysis from a sectoral perspective

- 7.12 My analysis has highlighted some of the difficulties of adapting documents prepared only for profit-oriented entities to apply to all sectors. In the case of the Australian Conceptual Framework documents, this has been compounded by the decision to retain two existing Statements of Accounting Concepts and link them to the AASB Framework.

The application issue

- 7.13 Paragraph 8 of the AASB Framework states that it “applies to the financial reports of all commercial, industrial and business reporting entities, whether in the public or the private sectors. The term “reporting entity” is defined in SAC 1 *Definition of the Reporting Entity*. The wording of the first sentence is identical to the IASB Framework and, while covering both public and private sectors, only relates to profit-oriented entities. This limitation in scope of the AASB Framework was not intended, as evidenced by the inclusion of Aus paragraphs within the document which specifically cover not-for-profit matters. This apparent error highlights the difficulties with adaptation of a document prepared for only profit-oriented entities and seems to be consistent with a general desire to minimise changes from IASB wording.⁹⁷

A difficult relationship between the three documents

- 7.14 While the link between the AASB Framework and the two retained Australian SACs has been effectively established in the Framework itself there is nevertheless a difficult relationship between the three documents. For example, the objective of financial reports stated in paragraph 12 of the AASB Framework refers to information that is useful to users in making economic decisions. However the objective in SAC 2 (paragraph 43) is different, being to provide information to users for making and evaluating decisions about the allocation of scarce resources. Including evaluation of decisions within the objective is significant (thereby encompassing assessments of stewardship or the discharge of accountability). Reference to allocation of scarce resources rather than “economic decisions” assists in enabling the objective to be more acceptable across all sectors. The objective stated in paragraph 12 of the AASB Framework is, in my opinion, too narrow for public sector not-for-profits and other not-for-profit entities. The relationship between the two different objectives is unclear.
- 7.15 Another example of the difficult relationship between the three documents is found in the discussion of users and their information needs. Paragraphs 9-11 of the AASB Framework discuss users and their information needs. The wording is identical to that of the IASB. No linkage is made to SAC 2 from this section of the document. However SAC 2 also discusses users of general purpose financial reports and the purposes for which users require financial information as well as the types of information relevant to users. While there is common material, the classification of users is different, the users identified in SAC 2 are broader and more complete in a sector-neutral context than those in the AASB Framework and the material relating to users needs and types of

⁹⁷ I note that the New Zealand framework has amended the first sentence of paragraph 8 to state that the framework applies to “all reporting entities”.

information relevant to them covers public sector and other non-business entity contexts.⁹⁸

- 7.16 There are other examples of this difficult relationship between the documents. In my view this leaves readers with some uncertainty about what is the complete conceptual framework, how to address apparent differences between the AASB Framework and SAC 1 and 2, and what weight to give to material that is only found in SAC 1 and 2 without any reference or link from the AASB Framework.

Conflicting statements within the AASB Framework

- 7.17 Another difficulty of the approach of making only minor additions and deletions to the IASB Framework is the inconsistency between certain statements within the document itself. While the intentions of the AASB are I think clear, documents which have authority in the hierarchy need to be precise. Conflicting statements are a risk wherever substantive Aus paragraphs have been added to the documents, namely Aus15.1, Aus49.1, Aus54.1 and Aus54.2.
- 7.18 In paragraph 49 of the AASB Framework an asset is defined as “a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity”. Aus49.1 effectively adds to the definition of asset those resources which provide a means for entities to achieve their objectives. It also states that the notion of service potential is synonymous with future economic benefit. In my opinion, this highlights that the asset definition in paragraph 49 is inadequate for application to all sectors. My concern is that standard-setters and others will in all their work commence with the base definition in paragraph 49, notwithstanding the inadequacies of that definition. This does not seem a strong basis for a sector-neutral approach to appropriate accounting for assets. Whether the notion of “service potential” is in fact synonymous with “future economic benefits” may also be debatable⁹⁹, although I acknowledge that other standard-setters have used the same technique to attempt to overcome this problem.
- 7.19 The issue discussed in the previous paragraph is exacerbated by the linkage of future economic benefits to direct or indirect cash flows to the entity as the underlying logic throughout the discussion of financial position and assets in the Framework. Yet, as acknowledged in Aus54.1 and 54.2, this may not always apply in the case of not-for-profit entities. Paragraph 53 of the AASB Framework states: “The future economic benefit embodied in an asset is the potential to contribute, directly or indirectly, to the

⁹⁸ The New Zealand Framework includes an additional paragraph which, for all entities, identifies other users in a New Zealand context and discusses their information needs. (paragraph NZ9.1)

⁹⁹ If it were, presumably we could replace “future economic benefits” with “service potential”.

flow of cash and cash equivalents to the entity". This, and other statements, are not valid for many not-for-profit entities.

Sufficiency of recognition of other sectors in the AASB Framework

- 7.20 No Australian additions have been made to the section of the IASB Framework on Qualitative Characteristics of Financial Reports commencing at paragraph 24. The material is focused entirely on the qualitative characteristics of information for the purposes of economic decisions of users. As noted already this focus is not sufficiently broad to be an appropriate objective of financial reporting for not-for-profit entities. In my view, some modifications are necessary to this material to facilitate its application to all sectors.
- 7.21 A specific example is paragraph 30 which refers to materiality and limits materiality to information that could influence the economic decisions of users taken on the basis of the financial report. In a not-for-profit entity context, information is also material if it could influence the evaluations of the performance of the entity, including decisions about the allocation of scarce resources. However no addition has been made here to ensure appropriate application to all entities.
- 7.22 Another example is found in the section on equity from paragraph 65-68. While I have no difficulty with equity as it is defined (as a residual), the entire discussion here relates to equity in the context of profit-oriented entities. There is no discussion of the nature of equity within not-for-profit entities, whether in the public sector or not. As equity is a particularly difficult issue in conceptual terms in these sectors, it would seem important to provide some comment on these issues.
- 7.23 The section on recognition of expenses (paragraphs 94-98) includes discussion of the matching concept. That is, the notion that expenses are recognised on the basis of a direct association between the costs incurred and the earning of specific items of income. While this material has application to all entities, it is incomplete in relation to the not-for-profit context where for many entities the majority of their expenses are not incurred in order to earn income. In my opinion, some additional material would have been appropriate here to enable appropriate application across all sectors.
- 7.24 Another example is the discussion of the capital maintenance concept. This is covered in paragraphs 102 to 110 of the AASB Framework. In particular, paragraph 103 states that if the main concern of users is with the operating capability of the entity, the physical concept of capital should be used. This raises questions about the appropriate concept which should be applied for public sector entities where their objective is primarily related to the provision of services and their users are interested

in the ability to continue to deliver those services in the future (a notion of sustainability). This issue has not been explored.¹⁰⁰

- 7.25 I note also that the AASB Framework makes no reference to any non-financial or supplementary reporting, although in my view some non-financial reporting at a minimum is necessary to meet the needs of users of not-for-profit entities, in both the private and public sector. There is also no recognition of the importance of budget information and comparisons with budgets in the Conceptual Framework documents.

Reporting entity issues

- 7.26 While it is a matter that will require further research in the detailed context of the complex regulatory arrangements applying to other not-for-profit entities in Australia, I note that there are potential issues of conflict between the underlying notion of a reporting entity in the IASB Framework and the notion as defined and explained in SAC 1. This is a potential issue in the future, influenced also by a definition and explanation of “general purpose financial statements” in the recent IASB exposure draft of proposed amendments to IAS 1 *Presentation of Financial Statements*.

Terminology and Examples

- 7.27 The AASB Framework has many terms which are not entirely suitable for not-for-profit entities. Furthermore the examples and illustrations are limited to those which arise predominantly in the profit-oriented entities sector. This issue is discussed more fully in the analysis of Australian Accounting Standards which follows.

Summary

- 7.28 In summary, there are a number of issues in relation to the Conceptual Framework documents when viewed from a sector application perspective. In my opinion, the current documents do not provide a sufficient nor, in some respects, appropriate basis to underpin sector-neutral accounting standards for the future.¹⁰¹

¹⁰⁰ As noted in paragraph 6.37, the issue of the appropriate capital maintenance concept was raised by some stakeholders.

¹⁰¹ I have been advised that AASB staff have commenced examining matters related to the Conceptual Framework documents.

Australian Accounting Standards – their appropriateness to all sectors

Introduction

- 7.29 This section reports the findings of a review of the Australian Accounting Standards from a sector application perspective. The standards comprise a core of standards which apply to all entities¹⁰² as well as standards that apply only to some sectors.
- 7.30 By its nature an analysis of the Australian Accounting Standards from a sector application perspective highlights areas where the appropriateness of the standards for different sectors is questioned. However it is important to emphasise before raising any specific issues that the vast majority of the provisions in Australian Accounting Standards apply appropriately and properly to all entities in all sectors. There are a number of individual standards which have not had any sectoral adaptation and where I have found no issues. This seems to support the majority view from stakeholder feedback that there are many areas where issues are the same in each sector and providing common guidance is appropriate.
- 7.31 Furthermore, some modifications to IFRS have been made for the Australian context and the majority of these have been made to apply the standards more effectively to not-for-profits. Issues are raised in this report therefore only where provisions may not necessarily be appropriate to all entities and no or insufficient modification has been made by the AASB to date.
- 7.32 A complete review of the material on issue highlights how much there is and reminds one of the substantial amount of work undertaken by the AASB and its staff to achieve the so-called stable platform of standards for a 1 January 2005 commencement date. Some of the implicit criticisms below about areas that do not appear to have been addressed as fully as they ought need to be viewed and understood in the context of that volume of work.
- 7.33 Another general observation is the extent of similarity between the standards of Australia and New Zealand.¹⁰³ In many instances the same IFRS provisions have been modified and many have been modified in identical ways. In other areas the two Boards could still learn from one another. As will be apparent from Part 5 of this Report, the approaches being adopted in Australia and New Zealand are very similar.

¹⁰² Although some of those standards include particular provisions that apply only to not-for-profit entities.

¹⁰³ With which standards I am of course very familiar.

Analysis from a sectoral perspective

General influences throughout the standards

7.34 There are a number of pervasive influences throughout the text of the standards which are a consequence of their development for profit-oriented entities. Examples include:

- Terminology – Terms such as profit, loss, balance sheet, income statement, income etc are not entirely suitable in a not-for-profit context. However these terms permeate the standards.
- A focus on economic decisions – The driving objective of the IASB standards to help users make economic decisions influences the text in many of the standards. A broader objective, such as is appropriate for not-for-profit entities and which encompasses the discharge of accountability, is only found in some specific paragraphs where the AASB has chosen to emphasise this.
- Concentration on cash flows – The underlying notion of IASB standards is that economic benefits are represented by underlying cash flows. While the AASB has recognised this is not necessarily the case for not-for-profit entities, the notion is nevertheless found in various parts of the standards. By way of example, a sentence from the objective of AASB 107 – Cash Flow Statements states:

“The economic decisions that are taken by users require an evaluation of the ability of an entity to generate cash and cash equivalents and the timing and certainty of their generation.”

- A concentration on giving meaning to profit/loss – For profit-oriented entities profit or loss is an important indicator of financial performance. Accordingly IASB standards strive to provide guidance to ensure that the reporting of profit/loss has meaning. There are of course other factors which need to be taken into account in interpreting the profit/loss and this is acknowledged, for example, in the IASB’s recent work on Management Discussion and Analysis. However for not-for-profit entities, the surplus or deficit is frequently not a significant indicator of financial performance. It is better viewed in these sectors in most circumstances as a starting point for analysis of financial performance. Taking this view would perhaps lead standard-setters, concentrating on the interests of users, to require disclosures about the significant factors that have contributed to the surplus or deficit as an integral part of the financial report. The controversy

about surpluses of some government departments, including the Department of Defence, provides an illustration of this point.

- 7.35 A consequence of these pervasive influences is that there is a risk that the needs of users of other sectors are overlooked because the perspective with which the AASB commences its work is so concentrated on profit-oriented entities. Less importantly, the standards are not always user friendly to those who must consider accounting and reporting issues for application in the public and other not-for-profit sectors¹⁰⁴.

Examples and illustrations not sectorally balanced

- 7.36 Examples and illustrations offered in IFRS are of course designed for profit-oriented entities. A number of these examples are relevant also to not-for-profit entities. However there are examples of most issues which are particularly relevant to not-for-profit entities but which are not found in Australian Accounting Standards. As a consequence, the acceptability of the standards in the not-for-profit sectors is reduced and, on occasions, it is possible also that the application of the standards may be inhibited because helpful guidance relevant primarily to not-for-profit entities is not provided.
- 7.37 Throughout the standards examples are given of the types of items being addressed. In most cases additional public sector examples could be added which would ensure that the public sector users of the standards have a clearer indication of the sorts of matters being covered by the standards. Areas where such examples would, in my view, be helpful would be in relation to inventories, property, plant and equipment and intangibles. There are also circumstances in which the application of requirements may differ slightly in the public-sector context. Examples include consideration of the going concern assumption (AASB 101), what are non-adjustable events (AASB 110) and the types of operating cash flows a not-for-profit entity (within the public sector or private sector) might report (AASB 107).

Provisions which may be inappropriate in some sectors

- 7.38 I have identified a small number of examples of requirements which, in my opinion, are inappropriate in one or more sectors.
- 7.39 In AASB 101, the notion of a “normal operating cycle” is a key part of the basis for distinguishing current and non-current items. Paragraph 59 of that standard states:

“The operating cycle of an entity is the time between the acquisition of assets for processing and their realisation in cash or cash equivalents.”

¹⁰⁴ The IPSASB has made changes to this part of IAS 1 in developing IPSAS 1 *Presentation of Financial Statements*.

This, another example of the cash focus in the standards, is clearly not able to be applied by many not-for-profits. While the paragraph continues on to indicate that when the operating cycle is not clearly identifiable, its duration should be assumed to be 12 months, there does not appear to have been any consideration of the meaning of the term in not-for-profit entities and the consequent impact on the distinction between current and non-current assets and liabilities.

7.40 AASB 3 *Business Combinations* applies to all entities undertaking a business combination. However the definition of “business”, states it is:

“an integrated set of activities and assets conducted and managed for the purpose of providing:

- a) *a return to investors; or*
- b) *lower costs or other economic benefits directly and proportionately to policy holders or participants.”*

While I am sure not-for-profit entities will follow the standard (perhaps without reference to the definition!), there are at least some circumstances in which not-for-profit entities will acquire an integrated set of activities and assets which ought to be accounted for under this standard but where the definition of business may not be met.¹⁰⁵

7.41 I note that, in contrast with the New Zealand accounting standard-setters and the IPSASB, the AASB has not excluded social policy obligations from AASB 137 *Provisions, Contingent Liabilities and Contingent Assets*. I acknowledge that there is limited guidance provided in AAS 31 *Financial Reporting by Governments* but I am surprised that obligations of governments of this nature were not excluded from AASB 137. They are of significant impact and the appropriate accounting for them is far from clear.¹⁰⁶

7.42 As reported in Part 6¹⁰⁷, many stakeholders have concerns about display issues in relation to public sector not-for-profit entities. One such concern is the manner of presentation of the income statement. This is prescribed in paragraph 81 and subsequent paragraphs of AASB 101 *Presentation of Financial Statements*. In particular, I note that entities are required to present an analysis of expenses using a classification based on either the nature of expenses or their function within the entity, whichever provides information that is reliable and more relevant. For public sector not-for-profit entities, the predominant approach is to identify outputs and to measure

¹⁰⁵ AASB staff consider b) would capture not-for-profit entity circumstances but acknowledge this is not how you would define the term best for those entities.

¹⁰⁶ I have been advised that as part of the review of AAS 27, AAS 29 and AAS 31 such obligations are likely to be excluded from AASB 137.

¹⁰⁷ See paragraph 6.33 and following.

and report them. This would appear to provide a more meaningful presentation of expenses than either of those required by AASB 101. I was surprised this was not considered as an acceptable alternative for at least public sector not-for-profit entities.¹⁰⁸ If it were, then it would have also been appropriate to include an additional format in the Appendices – noting that under Aus83.1 entities are encouraged to adopt the income statement format presented in the Appendix unless an alternative is more relevant to users. An output approach would, in my view, frequently be more appropriate to the users of public sector not-for-profits.

7.43 I also have reservations about paragraph 43 of AASB 116. This requires that each part of an item of property, plant and equipment with a cost which is significant in relation to the total cost of the item shall be depreciated separately. While I believe this is a test that is valuable and will ensure appropriate expense recognition in most instances, in the case of infrastructure assets it seems unlikely that it will achieve the appropriate expense recognition. Infrastructure assets will frequently comprise numerous components whose cost is insignificant in relation to the total cost of the item. If these items are not depreciated separately, and consequently treated as part of the “core asset”, it is unlikely that there will be appropriate expense recognition. This is because the individually insignificant items will often, in total, comprise most of the cost or value of the asset and will generally have very different individual useful lives. This is an example of a sub-optimal test which works for the assets in the mind of the IASB – Airframes and Engines of an Aircraft and the like – but does not seem to be effective for infrastructure assets which may of course be held by all entities. They are however the most significant asset of many public sector not-for-profits.¹⁰⁹

7.44 Paragraph 10 of AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* requires, amongst other things, that in developing and applying an accounting policy in the absence of an Australian Accounting Standard, management should ensure the policy results in information that is relevant to the economic decision making needs of users. As already noted, this is inappropriately narrow for not-for-profit entities.

7.45 I note a similar issue in relation to the treatment of materiality in the standards. While I support the retention of the former standard on materiality AASB 1031, the additional

¹⁰⁸ I have been advised that the AASB considers this approach is possible under the functional alternative and that the same classification approach has applied since 2001 under AAS 1 *Profit and Loss or Other Operating Statements* without apparent difficulty. I disagree and note that both IPSASB and the FRSB have felt it necessary to amend this to permit the output approach in their equivalents to IAS 1 *Presentation of Financial Statements*.

¹⁰⁹ I note that UIG Interpretation 1030 applies a far preferable test in discussing depreciation of long-lived physical assets. Paragraph 8(e) says that depreciation methods which have the following characteristic shall not be adopted: “the major components of complex assets are not identified and are not depreciated separately where this is necessary to reliably determine the depreciation expense of the reporting period”.

guidance in AASB1031 sits uncomfortably with the definition of “material” in AASB 101 paragraph 11, a narrower definition.

Not-for-profit guidance not provided

- 7.46 There are some standards which exclude not-for-profit entities or public sector not-for-profit entities from their application. As a consequence, there is no guidance on the topic for these entities.
- 7.47 One such example is the related parties standard¹¹⁰ which does not apply to public sector not-for-profit entities. Related party disclosures are important in meeting user needs and, in my experience, are one of the more valued disclosures by users. There is an IPSAS dealing with this topic and, in my view, there ought to be guidance for public sector not-for-profit entities.
- 7.48 Not-for-profit entities are also excluded from the application of AASB 114 Segment Reporting. I support this exemption because application of this standard in its current form (or the exposure draft currently under consideration) would be unlikely to provide the most appropriate form of disaggregated reporting for not-for-profit entities. Some disaggregated information is required to be disclosed by governments under AAS 31, paragraph 15.12 and by government departments and local authorities under their respective standards. However I do consider, and a number of stakeholders also proposed, that comprehensive requirements in relation to disaggregated reporting by not-for-profit entities need to be developed. It may be that different requirements should apply to public sector not-for-profits and to other not-for-profits.
- 7.49 Not-for-profit entities are also excluded from the application of AASB 120 *Accounting for Government Grants and Disclosure of Government Assistance*. This is an exclusion that is also welcomed because if this standard applied to not-for-profit entities it would likely result in the assets of many entities being significantly understated as well as other consequential impacts. Some guidance is available to not-for-profit entities on non-exchange revenues in AASB 1004 *Contributions*. This is an area where comprehensive guidance to not-for-profit entities is essential, bearing in mind that a high proportion of their revenue is of this nature. I am aware the AASB is considering this issue and has recently issued the IPSASB exposure draft for comment in Australia.
- 7.50 There are other parts of standards where guidance on issues of particular relevance to not-for-profit entities is minimal in contrast with that provided to profit-oriented entities. Examples are:

¹¹⁰ AASB 124 *Related Party Disclosures*.

- guidance on reporting equity in a way which is meaningful to users under AASB 101 *Presentation of Financial Statements*;
- determining the impairment of assets under AASB 136 *Impairment of Assets* (noting that there are two paragraphs of guidance dealing with assets which do not generate net cash inflows, in contrast to extensive guidance on assets where they do generate cash inflows). There are also a number of illustrative examples following this standard but none assist entities with non-cash generating assets;
- guidance on determining “depreciated replacement cost”, a key valuation method for public sector assets, in AASB 116 *Accounting for Property, Plant and Equipment*;¹¹¹
- addressing the difficult issues in relation to cultural and heritage assets under AASB 116;
- application of the control concept under AASB 127 *Consolidated and Separate Financial Statements*;
- clarity on the meaning of paragraph 28 of AASB127 which requires consolidated financial statements to be prepared using uniform accounting policies for like transactions and other events and similar circumstances. The meaning of this requirement has been questioned in the context of not-for-profit entities required to consolidate profit-oriented entities into a set of consolidated financial statements. The issue arises because of the different treatments under particular standards including treatments of revaluation increments and decrements for property, plant and equipment and tangible assets, treatments of non-cash generating assets for impairment purposes, treatments of grants received, treatments of assets received at no cost or nominal cost, treatments of inventories held for distribution and differing disclosures including specifically a requirement to report carrying values under the cost model where certain assets are revalued.¹¹²

7.51 Another area where guidance seems necessary is the meaning of “not-for-profit”. The definition is not sufficiently clear to ensure consistent treatment and stakeholders drew attention to difficulties in application¹¹³. I am aware that HoTARAC and ACAG have

¹¹¹ A decision to withdraw the limited existing guidance on this topic in AASB 116 has recently been made by the AASB.

¹¹² AASB staff have published an article on these matters.

¹¹³ See paragraph 6.45.

developed material on this matter but, in my opinion, clarity should be provided by the AASB to ensure users' interests are best protected.¹¹⁴

Extensive requirements for small entities

7.52 A complete review of the standards and associated material highlighted the difficulties of a small entity, which is a reporting entity, complying with all the standards. While this is an issue for all entities, it would seem particularly significant for other not-for-profit entities. Those entities typically have less resources and rely on volunteers in many cases to enable them to meet their responsibilities. It is perhaps this issue that has led to specific approaches in other jurisdictions for not-for-profit entities such as the Statement of Recommended Practice for Charities in the United Kingdom.

UIG material

7.53 UIG material tends to be targeted at specific issues and often to specific types of entity. Accordingly issues of sector application are far less significant than in the general suite of standards.

7.54 One issue relating to sectoral application of UIG Interpretations is whether, in the context of an environment driven far more strongly by the International Financial Reporting Interpretations Committee, necessary guidance will be developed for not-for-profit entities in Australia. In my view, it is important that interpretive guidance for not-for-profit entities is maintained and I note that amongst the existing set of Interpretations are some which are particularly important in ensuring consistent treatments in difficult circumstances for not-for-profit entities.

Sector-specific standards

7.55 There are three standards which are specific to the public sector – AAS 27 *Financial Reporting by Local Governments*, AAS 29 *Financial Reporting by Government Departments* and AAS 31 *Financial Reporting by Governments*. These standards effectively specify that all other applicable Australian Accounting Standards apply except where there is a conflict between AAS 27, 29 and 31 and other Australian Accounting Standards, in which case AAS 27, 29 or 31, as applicable, applies.

7.56 These three standards are out of date, and particularly so due to the adoption of new standards based on IFRS. As explained in Part 3, the AASB is proposing to withdraw these standards, relocate some requirements, change some requirements and remove requirements that duplicate requirements in other Standards.

¹¹⁴ At a recent joint meeting with New Zealand's FRSB, the AASB agreed to consider providing guidance on this matter, likely by issuing an ED based on the material finalised recently by the FRSB.

- 7.57 An exposure draft is to be issued later this year to propose the AASB's intentions with respect to material in these three standards. I therefore note simply that while some of the material was educative at its time and can comfortably be removed, other material was, and is still, helpful and other material remains essential in terms of the respective public sector entities.
- 7.58 I have reviewed the AASB's Strategy Paper in relation to the removal of these standards, in conjunction with the standards, and have some reservations. I note that a principle in a draft of this strategy paper (September 2005) was "minimise the use of not-for-profit Aus paragraphs and guidance in Australian equivalents to IFRS's". The impression I have is that while the principle has been removed a minimalist approach continues to have influence. In my view, a far more important principle should be stated in the Strategy Paper namely: "Re-assess all provisions of these standards in the light of the information needs of users of public sector financial reports."
- 7.59 Another issue that emerges from the paper is how provisions that could appropriately apply to other not-for-profits (or perhaps even to profit-oriented entities) will be dealt with. It would be unfortunate if issues which were equally relevant to other sectors were not considered during this process, with any necessary amendments to existing standards made wherever appropriate.

Summary

- 7.60 In summary, there are a number of issues in relation to the Australian Accounting Standards when viewed from a sector application perspective. I remind you that I have found the vast majority of the provisions in Australian Accounting Standards apply appropriately and properly to all entities in all sectors (paragraph 7.29). In relation to the issues I have raised, I believe that, in the interests of a sustainable approach to setting standards for all sectors, it is essential that real issues are addressed and addressed appropriately. It is my opinion that the number of areas where issues have not to date been addressed and the minimalist approach to changes to IFRS is at risk of compromising the credibility of the standard-setting process in the not-for-profit sectors, as well as potentially affecting application of the standards and the extent to which user needs are being met.

Part 8 – Issues and options – standard-setting for different sectors

- 8.1 This part of the report draws together the different strands of the review and:
- considers how effective the current approach to setting standards for sectors is in meeting different user needs;
 - explores issues relating to the future of the current approach; and
 - discusses alternatives to the current approach as well as possible changes to the current approach which could be considered to respond to the issues raised.
- 8.2 As explained in paragraphs 1.6 to 1.9, the functions of the AASB include to develop a conceptual framework, to make accounting standards for the purposes of the corporations law and to formulate accounting standards for other purposes. Accounting standards made by the AASB may be of general or limited application and in making accounting standards, the AASB must have regard to the suitability of a proposed standard for different types of entity, may apply different accounting requirements to different types of entity and must ensure there are appropriate accounting standards for each type of entity that must comply with accounting standards.

How effective is the current approach in meeting different user needs?

- 8.3 In the context of this review, the starting point for responding to this question is to consider whether there are in fact different user needs in the three sectors.
- 8.4 Part 4 of the report (paragraphs 4.25 to 4.30) discussed the users identified by the IASB and IPSASB and those users' information needs. In the context of profit-oriented entities, the IASB has identified investors as their primary focus. On the other hand, IPSASB has identified citizens, voters, their representatives and other members of the public as their focus. While both bodies agree that information is needed about financial position, performance and cash flows, IPSASB places additional emphasis on the discharge of accountability as well as on compliance information and non-financial performance information.

- 8.5 In Part 5 of the report the identified users and their information needs in each of the four selected countries were summarised, highlighting differences between the sectors in each country. While there are users and information needs which are common across the sectors in each country, there are also differences in the identified users and information needs in each country. A recent GASB Paper was summarised¹¹⁵ which argues for separate standards for government because the needs of users of governments differ. While the conclusion that different standards are the necessary consequence of there being some different needs is contestable, there is in my view no doubt that there are differences and the GASB Paper is helpful in explaining some of them.
- 8.6 In Part 6, those with an interest in public sector and other not-for-profit financial reporting in Australia expressed a clear view that there are additional users in these sectors and that those users have some different needs.
- 8.7 Finally, the AASB itself has acknowledged different users and different user needs in SAC 2 and in some of the modifications made to the IASB Framework in developing the AASB Framework (see Part 7).
- 8.8 In conclusion, there is a consistent view from each of the strands of this review that while there are common users across the sectors and there are certainly common information needs, there are also different users and some different information needs in the three sectors.
- 8.9 I now consider how effective the current approach to standard-setting is in meeting those different needs of users.
- 8.10 The adoption of IFRS for profit-oriented entities in Australia means that, subject to the removal of certain options, the AASB approach meets the needs of users of profit-oriented entities either to the same extent as or to substantially the same extent as the IASB. In general terms this is also true in relation to the four national standard-setters considered in this review. Furthermore, as profit-oriented entities under IPSASB's responsibility (government business enterprises) have been directed to follow the IASB standards, the same is true for these entities.
- 8.11 As reported in Part 6 of this report, stakeholders have not raised any issues of significance in relation to the implications of the AASB's current approach to setting standards for profit-oriented entities.

¹¹⁵ Refer to paragraphs 5.117 to 5.126.

- 8.12 In conclusion, the current approach to setting standards for sectors does not appear to be having any impact on the extent to which the needs of users of profit-oriented entities are met. That is of course not to say that there are not unfulfilled needs because there always will be.
- 8.13 I now consider public sector not-for-profit entities.
- 8.14 Part 4 of the report noted that IPSASB is considering proposals to address topics of particular public sector relevance which are not at present addressed in Australia. The provision of budget information is an example. Other areas where IPSASB is addressing issues which are relevant in the Australian context are non-exchange revenues, social policy obligations and heritage assets. The AASB is monitoring and involved in some of these projects. While finalised standards on each of these topics could be expected to contribute significantly to meeting public sector user information needs, the reality is that no jurisdiction has comprehensive standards on all of these topics. However it is important that these issues are addressed as soon as possible.
- 8.15 The review of standard-setting for different sectors in the four jurisdictions covered in Part 5 of this report has suggested that greater emphasis is given in standard-setting to the different needs of public sector users in other jurisdictions than in Australia. In the case of the USA, Canada and the UK this is in my view directly related to the structural arrangements whereby different boards have responsibility for different sectors. The limitations of this review do not allow any comments to be made on whether this greater focus on public sector user needs in these jurisdictions translates into a better meeting of user needs in financial reporting itself.
- 8.16 In Part 6, a strong view emerged from Australian stakeholders that public sector differences need to be better acknowledged and responded to by the standard-setting process. However most stakeholders consider that there is nevertheless a great deal of commonality between the sectors. Particular concerns were raised in relation to presentation or “display” issues in financial reports, as well as the absence of reporting requirements such as to report against budgets, to report information relevant to assessments of sustainability, compliance information etc. Part 6 also reported that there are a number of specific accounting issues that stakeholders consider need attention. There is a risk that user needs may not be being met as a consequence of lack of clarity in certain requirements, diversity of practice in application (without any guidance given to minimise this risk) or perhaps even the inappropriateness of a small number of requirements. Part 7 highlighted some specific issues under the current standards, mirroring in part some of the concerns raised by stakeholders and reported in Part 6. Particular concerns were raised about the suitability of the Conceptual Framework to respond to all sectors. Issues raised in

relation to the Australian Accounting Standards also have the potential to affect the extent to which user needs are being met.

- 8.17 In my opinion, there is at the very least the potential to significantly enhance the extent to which the needs of users of public sector not-for-profit entities reports are met. This would be achieved through more thorough consideration of whether requirements that are considered appropriate for profit-oriented entities will best meet user needs in the public sector and, in particular, through addressing areas that are currently not covered in Australian Accounting Standards thereby providing additional and/or better quality information to these users. I explore later how a sharper focus on legitimate user needs can be developed.
- 8.18 Finally I consider other not-for-profit entities. Neither of the international standard-setting bodies discussed in Part 4 currently issues standards for other not-for-profit entities. However, in the context of its joint conceptual framework project with the FASB, the IASB has indicated that it will consider the application of the concepts to the (other) not-for-profit sector. This is unlikely to occur for two to three years and it is not clear how it will be done or how this will translate into standards-level developments in later years.
- 8.19 In Part 5 of this report, it was found that some of the other jurisdictions examined place greater emphasis on considering the particular needs of the not-for-profit sector in their standard-setting activity. However, in most cases, this sector has been acknowledged as the sector given the least consideration and an area in which most other standard-setters consider there is “room for improvement”.
- 8.20 In common with Australia, there appears to be less input from users and other participants in this sector to standard-setting processes in these countries than from the for-profit environment. However, it would seem that as jurisdictions such as the USA, Canada and United Kingdom have specific requirements which apply to other not-for-profit entities that it is possible that specific user needs in this sector in these jurisdictions may be being better met.
- 8.21 In Part 6 the views of stakeholders in this sector were considered. It was noted that there have been some calls for a separate standard for this sector and that some specific needs have been put forward which the existing standards do not meet. The focus on “profit” in current standards is also considered unhelpful and the need for a focus on much wider dimensions of performance highlighted.
- 8.22 The AASB Chairman has acknowledged during the course of this review that relatively little specific consideration has been given to this sector.

- 8.23 In contrast with the situation in the USA, Canada and the UK, the review of Australian Accounting Standards in Part 7 highlights that there are very few provisions of Australian Accounting Standards that apply specifically to other not-for-profit entities. Many of the issues raised in that Part in relation to the Conceptual Framework and existing Australian Accounting Standards apply equally to other not-for-profit and public sector not-for-profit entities.
- 8.24 The fact that there is so little in the current Australian accounting standards to respond to the particular characteristics of this sector and its users' needs, when considered with the views of stakeholders described in Part 6, suggests strongly that the needs of users in the other not-for-profit sector could be better met.

Summary

- 8.25 While it will probably always be possible to better meet the needs of users of all entities, in my view the needs of users of public sector and other not-for-profit entities in Australia are not being met to the extent they ought. Furthermore, their needs are not being met as well as those of profit-oriented entities.
- 8.26 This is hardly surprising, bearing in mind:
- the manner in which the standards are being set (using IFRS as the foundation),
 - the limited development work which has taken place internationally in these sectors compared with development work related to profit-oriented entities (and therefore lesser opportunities for the AASB to learn from the work of others); and
 - in the case of the public sector, the very recent adoption of accrual accounting.
- 8.27 In reflecting on this conclusion, there are two observations I would like to make.
- 8.28 Firstly, views about whether there are real differences between the sectors often seem to be polarised. On the one hand, some argue that the differences are fundamental and cannot be ignored. On the other hand, others argue that most things are the same and that there are not many differences. In my opinion, both views have merit (albeit they come from different perspectives) and should be held in constructive tension in debating the appropriate approaches to setting standards for different sectors in Australia. The purposes and objectives of not-for-profit entities and the environment in which these entities operate are different to that in which profit-oriented entities pursue their business. Some have described this in part as relating to the different "business models" in the different sectors. To not give these

differences proper attention in financial reporting is surely to fail to respond to the legitimate needs of users. On the other hand, when viewed from the perspective of the financial accounting systems and the appropriate accounting for most transactions, most things are the same across the sectors. At the level of the underlying accounting recording and systems, the differences are not great. However, it is unhelpful to extend this perspective to such an extent that real differences in the objectives and environments of the entities are overlooked.

- 8.29 The second observation is that comparability appears to be given a greater weight than relevance in the setting of standards for different sectors in Australia. There would appear to be a range of evidence that suggests that the standard-setting process in Australia discourages recognition of differences in the sectors. The concerns raised by stakeholders about the prevailing mindset of standard-setting (refer to paragraph 6.46) and the minimalist approach to making changes to IFRS and applying them to other sectors (refer to paragraphs 7.13, 7.45-7.50, 7.58 and 7.60) support my contention. I note that this apparent prioritisation of comparability is inconsistent with the hierarchy of qualitative characteristics that have generally applied in financial reporting to date. In those hierarchies, relevance is a higher order characteristic than comparability. So it should be. I concur with the Canadian AcSB who have stated in their new Strategic Plan that the comparability of financial information is significant only when the information is relevant to financial statement users (see paragraph 5.76).
- 8.30 On the other hand, I do not suggest that comparability between entities is unimportant. However its importance is primarily between like entities and the same entity over time and it should be subject to relevance.

Consultation Issue 1

In your view, how well are the needs of all users of general purpose financial reports, including users of public sector and other not-for-profit entities in Australia, being met?

How well will the current approach to setting standards for different sectors be able to respond to user needs in the future?

- 8.31 The decision to adopt IFRS created a significant challenge to the, by then, established approach of a single set of standards in Australia. From the perspective of not-for-profit entities, this has resulted in a number of negative consequences:
- language and terminology in standards and conceptual documents that is not as appropriate to them;
 - the loss of some guidance and examples to assist in application; and
 - perhaps most significantly, a delay in addressing some of the very significant issues remaining unresolved.
- 8.32 The adoption of IFRS also means that a comprehensive sector-neutral (or transaction-neutral) approach is not possible and even if a single set of standards is maintained, differences between the sectors will and must remain.
- 8.33 The future environment for standard-setting for different sectors needs to be considered as we cast our eyes forward. In Part 4, some emerging issues in the international standard-setting scene were identified.
- 8.34 These issues can be summarised as:
- the forthcoming IASB Framework will be even more specifically targeted to profit-oriented entities than the existing framework;
 - any IPSASB Framework emerging from its recently initiated project, will likely differ in a number of important respects from that of the IASB;
 - there is a likelihood of increasing differences between the standards of IASB and IPSASB as IPSASB considers topics of particular public sector importance; and
 - there is a risk that public sector “gaps” will emerge because there is no public sector counterpart to IFRIC and IFRIC will only address issues from a profit-oriented entity perspective.
- 8.35 In my opinion, these issues make the task of developing a single set of transaction-neutral standards increasingly difficult for a national standard-setter.
- 8.36 The conceptual framework issue deserves particular comment. The focus of the IASB and its convergence partner FASB is on the capital markets and the work they are

doing to develop a new conceptual framework reflects that. As explained in Part 7, I consider the adaptation of the existing IASB Framework for other sectors in Australia has been less successful than it could. It will in my opinion be far more difficult to adapt the material emerging in the new IASB Framework to be appropriate for all sectors. It is conceivable that maintaining a single Framework may not be possible.

- 8.37 Publication of the first Preliminary Views document in the IASB/FASB Conceptual Framework project is scheduled for the end of June 2006. This document will propose the content of the first two parts of the conceptual framework – the first covering the Objective of Financial Reporting and the second the Qualitative Characteristics of Financial Reporting. Based on information that is currently available, it is expected that the objective of financial reporting will be to provide information that is useful to present and potential investors and creditors in making investment, credit, and similar resource allocations. There is no explicit recognition of an accountability or stewardship objective.
- 8.38 The IPSASB and each of the standard-setting bodies with responsibility for public sector and other not-for-profit entities considered in this review all give separate recognition to an accountability or stewardship objective. They rightly do so. Australian stakeholders (refer to paragraphs 6.41, 6.49, 6.77 and 6.78) have also emphasised the importance of accountability in the context of the objective of financial reporting.
- 8.39 I expect that there will be other material in the forthcoming IASB conceptual framework Preliminary Views document which is inappropriate for not-for-profit entities. Issues such as a predominant focus on cash flow prospects and a narrow primary user group are examples.
- 8.40 The conceptual framework is the foundation for development of accounting standards. If the objective of financial reporting that it enunciates is inadequate for other sectors, then this will inevitably have an impact on standards-level issues in the future. I note that the AASB's responsibility to develop a conceptual framework is "for the purpose of evaluating proposed accounting standards and international standards"¹¹⁶. In my view it is therefore necessary that the Australian Conceptual Framework is appropriate for all the entities for which standards are being developed.
- 8.41 Achieving such a conceptual framework will be a challenge and will in my view not be possible so long as the reluctance to make changes to IASB documents evident in the recent past in Australia is maintained. The development of a new IASB Framework is of itself therefore a sufficient development to justify reconsideration of

¹¹⁶ *Australian Securities and Investments Commission Act 2001*, section 227(1).

whether other options to setting standards for different sectors should now be explored.

Consultation Issue 2

Will the current approach of the AASB enable the standard-setter to respond to the more challenging environment of the future and ensure the needs of public sector and other not-for-profit users are appropriately met?

Consultation Issue 3

Do you consider that having a conceptual framework that is applicable and appropriate to all entities is a necessary element in Australian standard-setting for all sectors? What approach to establishing a conceptual framework(s) do you consider appropriate?

Identifying and evaluating other options for standard-setting

8.42 I note and strongly endorse the comments of stakeholders (reported in Part 6) which urge that the progress that has been made in the public sector not be overlooked or undervalued and the views that the current accounting standards have had a positive impact on financial reporting in the not-for-profit sector.¹¹⁷ These views need to be kept in mind in the consideration of other options.

8.43 However the extent of the concerns raised by stakeholders, particularly those from the public sector, should also be taken cognisance of when considering the future. It is important for good quality financial reporting in all sectors in Australia, as well as for the AASB itself, that the AASB's credibility is high in all sectors. It is with this in mind that the following section considers whether there are other options for the setting of standards for different sectors which might increase the likelihood that the needs of users would be met well.

¹¹⁷ Paragraphs 6.23 to 6.25.

Identifying Options

- 8.44 Firstly I consider what alternative options there are to the current approach of a single set of standards. As noted earlier, a single set of fully sector-neutral (or transaction-neutral) standards is not a realistic option post IFRS adoption. Accordingly for the purposes of this discussion and analysis, reference to a single set of standards refers here to the general approach of the AASB (as described in Part 3). In summary, this approach involves a series of topic-based standards applying generally to all entities; some variations in the series of topic-based standards for different sectors; some topic-based standards applying only to some entities; and possibly some multi-topic-based standards¹¹⁸.
- 8.45 One alternative to the current approach would be to have different sets of standards for each of the three sectors. However as will be noted from Part 4, even in the USA and Canada the standards relating to other not-for-profit entities are developed based on those applying to profit-oriented entities on what has been described as a “differences-based approach”¹¹⁹. A similar approach is followed in the UK where the Statements of Recommended Practice dealing with charities and other entities are generally consistent with the profit-oriented entity standards of the ASB.
- 8.46 One option involving three sets of standards does emerge from the international analysis in Part 5. In the USA there are two different sets of standards in the public sector – one relating to federal government and the other to state and local government – as well as standards for profit-oriented entities/other not-for-profit entities. In considering this possibility for Australia I find it significant that no stakeholders have put forward the suggestion that public sector not-for-profit entities should be further divided for the purposes of standard-setting. Furthermore, I doubt that such an approach is necessary, because the differences between the sub-sectors are not so fundamental as to justify entirely separate sets of standards. There are occasions when different issues will arise or issues will have different importance in different parts of the public sector, but I do not consider there is sufficient basis for doing other than treating public sector not-for-profit entities in most circumstances as one sector.
- 8.47 Assuming that an option for Australia involving two rather than three sets of standards was explored, there is another issue to consider - whether other not-for-profit entities would be better dealt with together with public sector not-for-profit entities or together with profit-oriented entities. In each of the USA, Canada and UK they are considered

¹¹⁸ See paragraph 3.10.

¹¹⁹ See paragraphs 5.53 and 5.99.

in conjunction with profit-oriented entities. However the nature of the objectives and environment of entities in this sector suggests a more comfortable “fit” with public sector not-for-profit entities. I also note that modifications for not-for-profit entities in Australian Accounting Standards to date almost all apply to **all** not-for-profit entities. This provides some additional support for other not-for-profit entities being dealt with together with public sector not-for-profit entities. In my opinion, user needs would be likely to be better met if other not-for-profit entities and issues were considered together with public sector not-for-profit entities and issues. I agree there are some differences but not sufficient to change my opinion. However I acknowledge the concerns of some stakeholders¹²⁰ about differences between the two not-for-profit sectors being recognised where appropriate.

- 8.48 In a brief diversion, it may be helpful to consider some possible reasons why different approaches to setting standards for sectors have emerged in different countries. As noted in paragraph 5.85, having two sets of standards and two separate boards in Canada is acknowledged to arise primarily from historical events and stimuli. The manner and timing of emergence of different standard-setting arrangements has surely played a key role in their form today.
- 8.49 In both New Zealand and Australia standards were set for profit-oriented entities in the private sector ahead of any standards for public sector entities. In the 1980s a separate body considered public sector issues in each country – a board in Australia and a committee of the then Accounting Research and Standards Board in New Zealand. However in the late 1980’s work began in both countries on conceptual framework matters and, in each country, the public sector and private sector bodies began to work increasingly closely together. By the end of the 1990’s this had led to single sets of standards and single boards in both countries.
- 8.50 In the USA and Canada, developments in public sector accounting commenced at an earlier date than in Australia and New Zealand. As already noted, in the case of Canada it was the AcSB’s reluctance to include governments within the scope of its requirements that led to the creation of a separate board in the early 1980s. In both these countries public sector accounting has developed separately to accounting for profit-oriented entities – there has been far less working together across the sectoral divide. As one example, in Canada a modified accrual basis of accounting has been followed until very recently in the public sector in contrast with accrual accounting in the private sector. Separate development of the streams of accounting has I think led to a greater concentration on differences – sometimes too great a concentration I think – whereas perhaps it could be said that in Australia and New Zealand there has

¹²⁰ See paragraph 6.73.

been a greater concentration on the similarities – and as this review has revealed perhaps too great a concentration in some respects as well.

8.51 Another factor that seems to have been influential in developments in Australia has been the close link to the accounting profession and the manner in which the standard-setting process has been resourced. Until 2000, the key driver of developments in accounting in Australia was the Australian Accounting Research Foundation, an organisation jointly supported by CPA Australia and the ICAA. Both public sector and private sector members of the professional bodies had an interest in the Foundation which equally had a responsibility to them. This seems to have influenced the drawing together of public and private sector over the past 20 years. A similar pattern can be discerned in New Zealand where during this period the single professional accounting body with responsibility for accounting standards development had all public and private sector accountants as members. Rather than views being formed separately in relation to each sector, the views on an accounting issue were always being tested against similar circumstances in the other sector. The fact that the same broad group of people were staffing the work of both public and private sector standard-setting through these years also seems likely to have had an impact on the direction in which the process evolved in both Australia and New Zealand.

8.52 It is possible that another dimension of resourcing may also have had an influence. Neither Australia nor New Zealand has the extent of available resources of the USA or Canada. The limited resource may have encouraged looking at common issues for all sectors at the same time. There has also been an indirect impact arising from the same staff working across both sectors - this seems to have encouraged a focus on identifying commonality of issues rather than differences.

8.53 While the above analysis is only partial, it is I think important to recognise the evolution of standard-setting arrangements in Australia and some of the influences that have helped shape the current arrangements. The fact that the arrangements, both now and in the future, may differ to those in other countries may not necessarily be an indication of the strength or weakness of the Australian arrangements. Rather they may simply reflect history, current circumstances and timing.

Evaluating Options

8.54 I now consider the advantages and disadvantages of two different approaches namely:

- the current approach of the AASB – with a single set of standards; and

- an approach involving two different sets of standards, one dealing with profit-oriented entities and the other with (all) not-for-profit entities.

A number of different criteria are used for the purpose of this evaluation.

Responsiveness to Users

- 8.55 Intuitively and based on the observations from overseas jurisdictions, an approach involving two sets of standards would seem likely to result in standards which are more responsive to the needs of users in the different sectors. This would arise partly due to the removal of any pressure to maintain consistency (even where differences are justified) and partly due to the necessity to concentrate on the particular needs of the sectors which are the subject of the separate standards.

Standard-setting efficiency

- 8.56 Dealing with issues which are common to different sectors together is more efficient than addressing the issues separately. On the other hand, there is some evidence that dealing with difficult issues across all sectors can significantly slow down the standard-setting process and demand greater resources. On balance however it seems likely that the single set of standards approach will be the more efficient standard-setting approach in the long-run. That does presume careful planning and resourcing by the standard-setter to minimise the risks of inefficiently consuming substantial resources searching for answers to complex cross-sectoral issues.

User friendliness for preparers and auditors

- 8.57 Advocates of sector-neutral standards often contend that having a common set of requirements is user friendly for preparers and auditors. While this is true, the complexities of standard-setting associated with the IFRS environment (in particular the increasing occurrence of certain parts of standards applying only to certain entities) may well negate or at least diminish this advantage. Preparers in particular may well consider it preferable to have standards targeted at only their particular sector.

Robustness in standard-setting

- 8.58 There is a risk in standard-setting for specific sectors that an issue is considered until a solution that appears to be effective for that sector is found. However where that solution is applied in the context of the different circumstances that arise in another sector, the solution is found to be suboptimal. This was illustrated through developments that have taken place over the last 15 years in accounting for property, plant and equipment where earlier private sector standards were tested against the

more complex assets held by public sector entities. Deficiencies were identified leading to changes in requirements. While issues remain (including one noted in Part 7 of this report) significant progress has been made towards higher order and better quality solutions by ensuring that proposals are tested against all transactions and events which may arise. An approach which does not consider all transactions and events is at risk of arriving at inferior solutions to accounting and reporting problems.

Credibility for not-for-profit reporting

- 8.59 It has been argued that a great deal of credibility has been gained for reporting by not-for-profit entities and particularly public sector entities because their reporting is generally familiar to users who are familiar with reporting by private sector businesses. Adopting different standards could result in an erosion of this credibility. As noted in relation to the USA in Part 5¹²¹ the approach may necessitate education of preparers and auditors regarding differences and can create an appearance that sector-specific standards are used to diminish accountability.

Cross sectoral transfer of skills and ideas

- 8.60 Where accounting and reporting requirements across sectors are substantially the same, the transfer of skills between the sectors is facilitated because the basics are common. Having substantially the same requirements across sectors also improves the mobility of professionals and others working in the financial reporting environment.

Impact on IFRS compliance for profit-oriented entities

- 8.61 A set of standards which applied to profit-oriented entities only would be able to be presented in such a way as not to create any doubt as to whether compliance with the standards would result in compliance with IFRS. A separate set of standards applying to not-for-profit entities would not result in compliance with IFRS, nor is that a particular concern of these entities. On the other hand, the possibility of more and more modifications to IFRS standards to enable them to apply across sectors as part of a single set of standards may create a perception risk that Australian standards are not necessarily fully compliant with IFRS. A further consequence, and one noted by New Zealand standard-setters in paragraph 5.43, is that changes which ought to be made for other sectors in a single set of standards are not made because of the tendency to minimal change because of the IFRS compliance perception risk. In my opinion the minimalist approach to changes to IFRS in Australia has been driven primarily by this concern and without adequate consideration of the impacts on reporting for not-for-profit entities.

¹²¹ See paragraph 5.115.

Contributing to a single set of standards for world-wide use

- 8.62 The AASB has a specific function to participate in and contribute to the development of a single set of accounting standards for world-wide use (refer to paragraph 1.6) Maintaining a single set of standards at this time is more consistent with this responsibility than moving to two sets of standards.

Determining which standards apply to which entities

- 8.63 Issuing two sets of standards creates a need to determine precisely which standards apply to which entities. This has been argued as an advantage of a single set of standards. It is true that creating precise definitions of sectors is difficult. However, I note that even with a single set of standards, there is the need to define which provisions apply to particular entities and the definitional issues are therefore similar¹²².

Summary

- 8.64 The above analysis shows advantages and disadvantages of each of the two alternatives discussed. In forming a view on which approach is preferable in the Australian context in 2006, I offer that the primary test should be which approach is likely to best meet user needs.
- 8.65 It is also relevant that the general view of stakeholders consulted during this review is that a single set of core standards remains appropriate in Australia.¹²³ Even a substantial majority of public sector stakeholders consulted supported this view.¹²⁴
- 8.66 Furthermore, while issues have been raised in Part 7 from the review of Australian Accounting Standards and Conceptual Framework documents which should not be downplayed, I found that the vast majority of provisions in Australian Accounting Standards apply appropriately and properly to all entities.¹²⁵

¹²² See paragraphs 6.45 and 7.51.

¹²³ See paragraph 6.89.

¹²⁴ See paragraph 6.53.

¹²⁵ See paragraph 7.30.

Consultation Issue 4

Different approaches could be used to set standards in Australia. Which approach do you consider the most appropriate:

- ***to continue to develop a single set of standards;***
- ***to develop two separate sets of standards: one for profit-oriented entities and the other for not-for-profit entities; or***
- ***another approach e.g. three sets of standards (profit-oriented, public sector not-for-profit and other not-for-profit sets) or two sets of standards with other not-for-profit entities being addressed together with profit-oriented entities? (If you prefer this option please describe the approach you prefer).***

Specific options for a two sets of standards scenario

8.67 If it were decided to adopt an approach of developing two sets of standards, then one of those sets would focus on profit-oriented entities and be almost entirely consistent with IFRS. Three options for development of a set of standards applying to not-for-profit entities are discussed here.

GFS Based Standards

8.68 One option that some have put forward is that not-for-profit standards could be based on (rather than harmonised with) GFS.

8.69 The major advantage of such an option would be full alignment of the different financial information currently published by governments. This has been a key driver of the GFS harmonisation strategic direction.

8.70 Reporting entities should, at some level, report information about all their activities in order to be accountable to their stakeholders. The GFS reporting unit differs from the conventional accounting reporting entity¹²⁶ and, in my view, creates an impediment to basing not-for-profit standards on GFS. While GFS could, with some adaptations provide a basis for reporting at a whole of government level, it would require significant further work to enable it to be applied to other public sector entities. The

¹²⁶ I acknowledge that this view is not shared by all commentators.

format of the accounts under GFS is not familiar to users except in the context of governments and is not suitable for other not-for-profits.

- 8.71 As reported in Part 5 of this report, none of the other jurisdictions are considering adoption of GFS or harmonisation with it. While all are aware of the issues and some are monitoring the IPSASB project on the General Government Sector, it does not seem to be a significant issue in any of these countries. This is not to downplay the reasons the issue has received such prominence in Australia. It is certainly unhelpful when different key numbers are being publicised and this is hardly in the interests of users. It is simply to highlight that if this option was followed, Australia would likely be alone in doing so.
- 8.72 Basing standards on GFS would require a decision as to whether the requirements would be based directly on those of the IMF or those of the ABS. The ABS has strongly advocated that its version should be followed in Australia (see paragraph 6.67).
- 8.73 Another significant issue is however that while GFS represents an alternative for financial information, it does not address issues such as non-financial and compliance aspects of reporting. Such matters are of particular importance in responding to user needs and would need to be met in another way. In essence, GFS would only be a partial alternative.
- 8.74 Furthermore GFS would need significant modification for not-for-profit entities. In fact, if this option was preferred for public sector not-for-profit entities then it would be more appropriate that not-for-profit entities were addressed together with profit-oriented entities. However I re-iterate my comments about the similarities in the objectives and environment of public sector and other not-for-profit entities which, in my view, provide a strong reason why they are best dealt with together.

IPSAS Based Standards

- 8.75 The second alternative is to develop standards for not-for-profit entities in Australia based on IPSAS. As these standards are in turn based on IFRS this approach would mean that to some extent at least there would be a common base for reporting by all entities in Australia. However adaptation would be needed to IPSAS to address particular issues in the other not-for-profit sector and harmonisation with GFS. By way of example, I note that the recent exposure draft published by IPSASB concerning *Revenue from Non-exchange Transactions (including Taxes and Transfers)* includes significant guidance for public sector entities but relatively little that would be relevant to, or of value in the context of, other not-for-profit entities.

8.76 As noted in Part 6, some stakeholders consider that IPSAS should be given higher priority and some have even suggested that there should be a rebuttable presumption that standards should be based on IPSAS unless the circumstances require otherwise.¹²⁷ On the other hand, there is no compelling driver which would require standards to be based on IPSAS in Australia at this time.

Standards Based on a Range of Sources

8.77 A third approach to developing a second set of standards for not-for-profit entities would be an approach which draws from the most appropriate sources depending on the issue being considered. This approach could, for example, draw on IFRS and apply it wherever appropriate subject to terminology changes, additional examples and more not-for-profit specific guidance. However, where appropriate, IPSAS could be the base for a particular topic. The non-exchange revenue topic referred to in the previous paragraph could be such an example. Furthermore, reference could continually be made to GFS and modifications made to minimise differences between this set of Australian standards and GFS.

8.78 A downside of this approach would be the effort required from standard-setters and staff as well as from constituents and the inherent lack of clarity about the overall direction of standard-setting for the sector. On the other hand, the approach does facilitate targeting and responding to particular needs of Australian users in the development of Australian standards.

Consultation Issue 5

If, in response to Consultation Issue 4, you considered standards different from those applying to the for-profit sector should be developed for one or more sectors please indicate, for each such sector, what the primary base should be for those standards:

- ***Government Finance Statistics (GFS);***
- ***International Public Sector Accounting Standards (IPSAS); or***
- ***a range of sources, including International Financial Reporting Standards, IPSAS and GFS, depending on the particular issue being considered?***

¹²⁷ See paragraph 6.95.

Alternative approaches to a single set of standards

- 8.79 I now return to consider issues related to a single set of standards.
- 8.80 There are a range of options for dealing with different sectors within a single set of standards approach and those options are considered here. The first option is the **current approach** of the AASB as described in Part 3. The second option is the **matrix approach** advocated by some stakeholders and outlined in Part 6 of the report.¹²⁸ This approach would retain specific standards for types of public sector entity (and could also include a standard for not-for-profit entities) while retaining a general set of topic-based standards which are applicable to all entities. A third approach would be to have a **single set of standards with non-standard level guidance** applicable to particular sectors or groups of entities in sectors. This option has emerged from consideration of the UK approach of Statements of Recommended Practice.
- 8.81 A matrix approach appears to have one key advantage over the intended AASB approach, namely that it demands consideration of particular sectors or groups of entities in sectors. In that respect, it shares some of the advantages of having two sets of standards. On the other hand, there is greater complexity in the matrix approach which is likely to be less user-friendly for preparers, auditors and users and there is a need for regular updating of the sub-sector specific standards. I see no need for a hierarchy of the specific over the general standards. It should be possible, at all times, to ensure that the specific and general standards are consistent with one another.
- 8.82 The third alternative is that of developing something akin to the UK's SORPs in addition to one general set of standards. SORPs are primarily "one-stop-shops" providing guidance on the application of the general standards to specific groups of entities. The approach has been reasonably successful in the UK in addressing a range of particular industries, and for that reason cannot be dismissed. In the context of this review, the stakeholder concerns that could perhaps best be addressed by a SORP are those raised by the not-for-profit sector who would I think welcome guidance of this type. In New Zealand guidance is being developed for other not-for-profit entities recognising some of the unique issues for these entities.
- 8.83 In considering these options, it is important to remember that many public sector stakeholders were more concerned that the issues relating to their particular sector were addressed than where those issues are addressed.¹²⁹

¹²⁸ Paragraph 6.59.

¹²⁹ Paragraph 6.57.

Consultation Issue 6

If a single set of standards continues to be developed in Australia, do you prefer:

- ***the current approach of the AASB;***
- ***a matrix approach, retaining specific standards for types of public sector and possibly also other not-for-profit entities while maintaining a general set of topic based standards applicable to all entities; or***
- ***an approach involving a single set of standards but with non-standard level guidance (such as the Statements of Recommended Practice in the United Kingdom) applicable to particular sectors or groups of entities in sectors?***

One or more boards?¹³⁰

8.84 If a single set of standards is maintained, then there is probably no need to consider alternatives to a single board. However if two sets of standards were developed, then it would be necessary to consider whether those standards should be developed by two separate boards or by one board as at present. In this regard I observe that none of the standard-setting bodies examined in this review sets two full sets of standards.

8.85 There are advantages and disadvantages of having two boards when two sets of standards are being set and some of these advantages and disadvantages replicate, or at least overlap with, those considered in comparing the two primary standard-setting approaches¹³¹.

Responding to user needs

8.86 As identified above, having a separate set of standards for not-for-profit entities would increase the likelihood that standards developed would be responsive to user needs. However establishing a separate board would increase further the natural focus on users in the particular sector and in this respect is a stronger alternative than having two sets of standards with one board. This strength is however subject to the strength and balance of the not-for-profit board itself. The presence of those with particular expertise in the profit-oriented sector challenging purported differences to

¹³⁰ In contrast with other issues raised in this Part, a move to more than one Board would require a legislative change.

¹³¹ See paragraphs 8.54 to 8.66.

ensure that they are real and justify different reporting or accounting requirements is a strength of a single board which can be lost in a sectoral board. Comments made in relation to the Canadian standard-setting arrangements are relevant¹³².

Resourcing

- 8.87 Two boards will necessarily require additional resources when contrasted with a single board. Costs directly associated with the boards will be duplicated, as would due process costs and, to some extent at least, staffing costs.

Board participation

- 8.88 There is some evidence in boards dealing with all sectors that some members contribute only in their areas of particular knowledge and expertise. This can nullify one of the strengths of a single board. The establishment of two boards with members with a specific interest in the particular sector covered would address this issue. Furthermore as argued by Canada, specialist expertise adds to the credibility of Boards and increases legitimacy¹³³.

Robustness in standard-setting

- 8.89 Having the full range of transactions and events considered by members of boards who understand the different contexts and are prepared to debate the issues is a significant strength of a single board. On the other hand, as noted immediately above, if board members do not make the necessary contribution then there is a two-fold risk. Firstly, where the board has a predominance from one sector there is the risk that valid issues being raised from the other sector are not considered adequately. Secondly, there is the risk that issues germane to a particular sector are viewed as the domain of the specialists in that sector and given less scrutiny than they would be given by the members of a sector-specific board.
- 8.90 Some stakeholders drew attention to the fact that the decision to establish a single standard-setting board in 2000 was at least in part a response to experiences with two boards in the 1990's. Furthermore, Australian stakeholders have not raised any significant concerns about having a single board as part of this review process. These comments should also be considered in evaluating whether, in the context of any decision to have two sets of standards, there would also need to be two boards.

¹³² See paragraph 5.84.

¹³³ See paragraph 5.83.

Options to enhance the current approach

8.91 In this section options to enhance the current approach are considered. This section generally presumes that there is no wish to move to two sets of standards or two boards but that the issues raised earlier in this report require some response. A number of the options below could however also be considered in the two standards and two boards scenarios.

Increasing input from users and consideration of their needs

8.92 An issue of concern emerging from this review is the limited input from users to the standard-setting process and the relative lack of knowledge of what user needs are. User needs need to be continually monitored and assessed in an effective standard-setting system and mechanisms need to be established to obtain this ongoing input and ensure its relevance.

8.93 A review of the submissions on exposure drafts over the past two years has identified very few submissions from users in any of the sectors. However this is particularly an issue in relation to the public sector and other not-for-profit sector.

8.94 There is in my view a need for research on the needs of users in the different sectors in Australia, but particularly the not-for-profit sector¹³⁴. That research could be used as a basis for developing a Statement of User Needs and documenting how those needs impact the standard-setting process. This Statement could be part of the Conceptual Framework but need not necessarily be so, as long as it was not inconsistent with the identification of users and explanation of their needs in any conceptual documents. This Statement would be a primary guiding document for the AASB. There is at present a lack of agreement on what the differences are between the sectors and this work and proposed Statement could assist in establishing a consensus on these matters. This work could also link to the idea of a Strategic Framework for standard-setting discussed later in this Part.

8.95 As noted in paragraph 6.98, the Consultative Group appears to have had relatively little impact from a user perspective. In April 2006, the AASB announced that it had established a User Focus Group to increase participation by analysts in the accounting standard-setting process. It also anticipated that the User Focus Group would be a key source of information for providing feedback to the IASB on selected projects.

¹³⁴ I am aware that some research is currently being done in this field supported by the Centre of Excellence for Financial Reporting and Governance of CPA Australia and the Accounting and Finance Association of Australia and New Zealand.

- 8.96 A number of stakeholders proposed a “User Council” or User Focus Group/s to increase input to the accounting standard-setting process from the not-for-profit sector.¹³⁵ A companion group to the already established User Focus Group would provide a helpful counterbalance to ensure that issues relevant to not-for-profit users were also given appropriate attention. The AASB has advised of its intention to establish a Not-for-profit User Group in the near future.
- 8.97 Some standard-setters are increasing their face-to-face dialogue with user groups and the New Zealand FRSB has indicated it is exploring this.¹³⁶ Bearing in mind the challenges of obtaining views from users such as Public Accounts Committee members, fiscal analysts, the media etc face-to-face meetings may prove more effective. Such smaller group meetings provide an opportunity not only to explore views on standard-setting priorities, specific issues in current projects and problems in the application of existing standards but also provide an opportunity for standard-setters to enhance stakeholders’ understanding of the standard-setting process, encourage formal feedback to the process such as through submissions and to encourage the effective use of high quality financial information. Such meetings also provide an opportunity to enhance users’ capacity to contribute to the standard-setting process by acknowledging their different context and enhancing their awareness of the issues the standard-setter is considering.
- 8.98 Some have suggested the possibility of the inclusion of more users on the AASB and on the AASB staff. This is a desirable objective for any international or national standard-setter but is not easy to achieve. Opportunities to increase user input in all parts of the process should be taken whenever opportunities arise.

Consultation Issue 7

Would developing a Statement of User Needs for the public sector and other not-for-profit sectors, based on research, and including an analysis of how any different needs impact financial reporting be useful? If so, please suggest how that Statement of User Needs could be developed and maintained. Do you have any other views on how user input could be enhanced?

¹³⁵ See paragraphs 6.50 and 6.98.

¹³⁶ See paragraph 5.37.

Develop and communicate a strategic framework for each sector

- 8.99 As discussed in Part 4, changes in the international standard-setting scene are making standard-setting for standard-setters such as the AASB more challenging. In this environment, clarity of intentions is important and some stakeholders consider that greater clarity is needed about the AASB's intentions, in particular in relation to the public sector. This is likely to result to some extent from the fact that this is the sector in which there are competing sets of international standards. As noted in Part 6, a number of stakeholders have called for a "strategic framework" (or similar) to indicate the direction the AASB intends to take in establishing requirements for the public sector, having regard to both IASB standards as well as IPSASB standards.¹³⁷
- 8.100 A strategic framework could for example cover which standards the AASB intends to refer to in developing Australian guidance in particular circumstances, how the AASB intends to assess the need for different requirements of users in the different sectors and how the AASB will assess the benefits and costs of different requirements in the different sectors.
- 8.101 In relation to assessing the different requirements of users, work on identifying the sector differences and consequential impacts on financial reporting could be a part of this. What must be borne in mind is that as the FRSB and ASRB have noted, IASB standards are not developed for not-for-profit entities¹³⁸ and are accordingly not necessarily the optimal requirements for all entities.
- 8.102 In relation to assessing the benefits and costs for different entities¹³⁹ I note that benefits and costs do differ for different sectors and that there should be an assessment made of the benefit-cost relationship for each of the sectors. The Canadian AcSB has expressed this well in stating: "Therefore, in developing an accounting standard, the Board considers whether the requirements of that standard should apply to all entities or whether different requirements should apply to different types of entities for which the cost / benefit trade-off differs significantly."¹⁴⁰
- 8.103 A strategic framework would be likely to increase stakeholder confidence in the AASB's approach to the public sector part of the not-for-profit sector and may increase the contribution from various constituencies to proposals put forward by the AASB.
- 8.104 While no similar idea was specifically suggested by stakeholders in the other not-for-profit sector, a framework for standard-setting for that sector may also be beneficial.

¹³⁷ See paragraph 6.96.

¹³⁸ See paragraph 5.26.

¹³⁹ See paragraph 6.74.

¹⁴⁰ Paragraph .17 of Section 1000 *financial statement concepts*.

Consultation Issue 8

Do you consider that there is enough clarity on the direction that the AASB is taking in establishing requirements for the public sector and other not-for-profit sector, including identifying the base set or sets of standards which will be adopted?

Enhancing recognition of different environments and acknowledgement of issues across all sectors

8.105 This review has revealed concerns that issues in the not-for-profit sector, and in particular the public sector part of that sector, are not being addressed to the extent desirable. There are some structural, resourcing and process options which might increase the likelihood of these issues being addressed.

Board membership

8.106 Increasing the numbers of members who have awareness of the issues and are familiar with the needs of users in the not-for-profit sector would be likely to enhance the credibility of the AASB and enhance its consideration of issues across the different sectors.

8.107 While the balance of board membership will always be a matter of judgement, I observe that the AASB is increasingly a “taker” of standards for profit-oriented entities, whereas at present it continues to be a significant player in the development of requirements for not-for-profit entities, in particular the public sector. That would suggest that an increase in the not-for-profit board membership may also be appropriate.

Sub-boards or committees

8.108 The review of other jurisdictions has identified the existence of committees or panels which advise the standard-setting boards in relation to issues in particular sectors. Examples are found in the UK, Canada and New Zealand. The most relevant example for the Australian situation is the establishment of a Public Benefit Entity Working Group in New Zealand to advise the FRSB on issues relating to public benefit entities.¹⁴¹ While that working group has only been in existence for just under a year, it is making progress on issues particularly relevant to public benefit entities.

¹⁴¹ As noted earlier in the report, in general terms public benefit entities equate to not-for-profit entities in Australia.

Specifically it is taking initiatives which are intended to enhance financial reporting in the other not-for-profit sector. A group of this nature may assist in ensuring a wider consideration of all the sectors in Australia.

- 8.109 Some stakeholders have also proposed establishment of two sub-boards, one dealing with profit-oriented entities and the other with not-for-profit entities. While two sub-boards would be able to ensure issues for each of their areas of sectoral responsibility were given consideration, this structure would raise some difficulties. Would the statutory board comprise both sub-boards together? If that were the case would that not create issues of re-litigation and ongoing debate which would be resolved more efficiently by all debating the issues around the table at once? If the statutory board was separate to the sub-boards or comprised only some members of the sub-boards then it would seem inevitable that that board would re-debate issues creating significant inefficiencies as well as frustrations for participants in the process. Increasing the board representation of the not-for-profit sector and/or establishing something akin to a public benefit entity working group may be more likely to address the issues than two sub-boards.

Establishing expectations of board members

- 8.110 The Nominations Committee of the FRC noted, following peer evaluations carried out by AASB members late in 2005, that there was an opportunity “for some board members to increase their focus on the public interest responsibilities of the boards and to tackle issues beyond their own immediate professional interests”.¹⁴² The breadth and extent of material board members are expected to cover is extensive and the task cannot be done well without a significant personal commitment. There may be a case however for explicit expectations of board members in relation to their consideration of issues across all sectors to ensure that the potential strength of a single board considering issues across all sectors is achieved. This could involve modifying the FRC’s Criteria for Appointment to the AASB.

Staffing matters

- 8.111 Some stakeholders consider that there is insufficient understanding of not-for-profit sector issues amongst the AASB staff.¹⁴³ Ensuring a suitable balance of staff in a relatively small standard-setting operation will always be a challenge and technical competence cannot be compromised. However there does seem to be some

¹⁴² Minutes of a meeting of the FRC on 16 December 2005 – see www.frc.gov.au/minutes/2005/16_12.asp

¹⁴³ See paragraph 6.93.

capacity for a particular effort to increase the public sector and other not-for-profit expertise on the staff as opportunities arise¹⁴⁴.

- 8.112 The review of other jurisdictions has highlighted another idea. In the USA¹⁴⁵ and Canada¹⁴⁶, in relation to particular designated sectors or sub-sectors, individual staff are given responsibility to monitor all board projects from the particular sector or sub-sector perspective. Furthermore the staff members lead liaison efforts with the organisations in that sector or sub-sector. The role is formally recognised as part of the overall process.
- 8.113 The possibility of designating particular staff to consider all issues through a particular sectoral lens and, in effect, act as the “conscience” of the standard-setting body in relation to that sector is one which seems worthy of consideration. However I acknowledge that a degree of specialisation already occurs amongst the staff of the AASB.
- 8.114 There is perhaps also some capacity to broaden the resource base through a range of different arrangements than full-time staff. This could include contracting specialists for particular projects, sharing resources with other standard-setters or other arrangements to resource work across all sectors well.

Explicit board sign-offs

- 8.115 In some circumstances, AASB exposure drafts discuss the issues which have been considered in relation to particular sectors. It might be helpful if each proposed and final standard included a statement by the board concerning how it had assessed the particular needs of users in the different sectors and how it had responded to those needs. Such a statement might also usefully advise how the board had considered different benefit and cost impacts in the different sectors and, less frequently, how it had considered any need to respond to the environment of a particular sector, such as by transitional provisions, delayed application or other variations within the standards.
- 8.116 To the extent that stakeholders’ concerns of a prevailing profit-oriented mindset have validity, such a formal statement by the board might assist in reducing the risk that issues in other sectors may be overlooked or not given adequate consideration.

¹⁴⁴ As one who has interacted with AASB staff over many years and observed staff members in international contexts, I consider Australia has been fortunate to have had such a committed and competent staff which has also represented it well internationally.

¹⁴⁵ See paragraph 5.106.

¹⁴⁶ See paragraph 5.69.

Consultation Issue 9

A number of options to enhance the recognition of different environments and issues in sectors have been identified in the Report. Do you consider any of the options, including those relating to board membership, sub-boards or committees, expectations of board members, staffing or explicit board sign-offs would enhance the ability of the standard-setting process to meet user needs?

Adjusting the focus of work

8.117 There is a natural inclination for board members and staff of the national standard-setting bodies working closely with the IASB to spend most of their time working on IASB projects and ensuring they keep up to date with the IASB programme. The resources being applied by the IASB, particularly when the convergence programme with the FASB is taken into account, are substantial and developments are both quick and often significant. It is seen as important to keep up to date.

8.118 However, for those national setters who also have responsibilities for other sectors, they need to ensure that they pay sufficient attention to those other constituencies and balance their work appropriately. An extreme case could be put forward that standard-setters such as the AASB should concentrate most of their effort on national issues seeing as in the end they are takers of the IASB standards. The Chairman of the AcSB of Canada expressed the view that well over half of the board's time under its new Strategic Plan will be spent on national issues (noting of course that that will include work on non-publicly accountable enterprises as well as not-for-profits). He considers there will also be a change in the mix of staff work as well, although staff would need to continue to invest a significant amount of time in monitoring and contributing to the IASB programme.

Closer cooperation with New Zealand

8.119 As noted in Part 7, there are a great deal of similarities between the standards of Australia and New Zealand¹⁴⁷. While there are differences in the standard-setting structure and differences in the reporting requirements that apply to some entities, there is much more that is similar than dissimilar. This will be apparent from the consideration of New Zealand arrangements in Part 5.

¹⁴⁷ See paragraph 7.33.

8.120 While Australia has significantly more resources applied to standard-setting, it seems that there could be significant benefits from working together on issues related to the public sector and other not-for-profit sector. Some of the experience gained in each country in dealing with the different sectors would in all probability be beneficial to the other country. While the possibility of working more closely together with New Zealand could be viewed as entirely an efficiency matter, in my opinion the benefits to better standard-setting for all sectors would be the most significant.

Concluding Comments

8.121 Australia has been a significant contributor to international accounting standard-setting over many years. It has also been one of the major contributors to developments in public sector accounting.

8.122 The adoption of IFRS and the simultaneous direction to harmonise with GFS have created new challenges for standard-setting. This review has examined issues relating to the setting of standards to meet the needs of the users of all sectors. The review has identified issues that deserve consideration and, in my view, a response in the form of adjustments to the standard-setting arrangements. I hope it contributes to a constructive discussion about future arrangements and leads to changes or adjustments which enable standards to be set for all sectors in Australia which enhance the quality of financial reporting and increase the extent to which the needs of the users of that information are met.

Consultation Issue 10

Are there any other matters that you would like to suggest for consideration by the FRC?

Appendix 1: Review of sector-neutral accounting standards – statement of requirements

In the context of Australian accounting standards, the consultant will review whether the information needs of users can be met within a framework of concepts and standards which are sector neutral. A written report including research outcomes is to be made available to the FRC at a mutually agreed date.

Without limiting the scope of the review, it is expected that the consultant will:

- Undertake a review of other relevant countries and document their approach to standard setting for different sectors, and most importantly where their standard setting may be heading. Such a review should be limited to a small number of relevant countries and may primarily be completed through desk top research.
 - Ideally, explanations should be provided as to why different jurisdictional approaches may or may not be appropriate or applicable to the context of Australian accounting standards. An outline of different standard setting structures is also desirable, for example, whether non sector neutral accounting standard countries have separate boards operated by different organisations.
 - In particular, the New Zealand approach should be considered given the close ties between Australia and New Zealand from a policy perspective.
 - Regard should be given to where the International Accounting Standards Board (IASB) and the International Federation of Accountants (IFAC) appear to be heading.

- Review the existing Australian accounting standards and comment on the importance or otherwise of their sector specific nature, including:
 - Assessing the efficacy of whether the existing Australian accounting conceptual framework is equally relevant to all sectors, and in doing so, clearly defining what is meant by 'sector';
 - Assessing the effectiveness of the existing sector neutral and sector specific Australian accounting standards;
 - Undertaking a cost-benefit analysis of sector neutral and sector specific accounting standard approaches in the context of Australian accounting standards;
 - Analysis of the potential problems or issues associated with existing contentious sector neutral and sector specific Australian accounting standards; and

- Whether the information needs of users are being met within a framework of concepts and standards which are sector neutral, and if not, what improvements can be made.
- Liaising with key stakeholders to survey their views on research issues.

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