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Dear Mr del Busto

## **The Use of a Sector-Neutral Framework for the Making of Australian Accounting Standards (The Simpkins Report)**

Thank you for the opportunity to comment on the Simpkins Report.

The comments that follow represent the views of Australian Auditors-General, with the exception of the Auditor-General for South Australia who reserves the right to respond separately on matters such as this.

The purpose of the Simpkins Report was to undertake research as to 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. We are aware that the project may assist the FRC in considering possible modifications to its strategic direction to the AASB in relation to IASB standards, especially in relation to the public and other not-for-profit sectors.

At the outset ACAG acknowledges that the existing standards setting regime has brought benefits to both the users and preparers of public sector financial statements in that the standard-setting process is independent and rigorous in its due process. The experience of ACAG is that while the existing framework of accounting standards has proved capable of dealing with many of the financial reporting issues that arise within the public sector, there is a range of issues where the standards provide insufficient guidance. In this regard ACAG has developed a joint paper with HOTARAC, titled *Gaps in Australian Generally Accepted Accounting Principles (AGAAP)*, which has been submitted to the AASB for its urgent consideration. The paper identifies a number of public sector specific financial reporting matters that, in our view, need attention.

The recent concentration by the AASB on adopting, and keeping up with changes in, international financial reporting standards has affected the degree of attention being given to not-for-profit entities. To the extent that the needs of the public and other not-for-profit sectors are considered by the AASB it has often been by way of “Aus” paragraphs inserted into the standards. To date this approach has only provided a partial solution to the reporting issues that confront the public sector.

ACAG has previously expressed reservations to the AASB about the effects of the government specific standards being withdrawn. It is pleasing to note that recent announcements by the AASB in relation to its proposed work plan should provide a greater focus on public sector specific areas of financial reporting, including consideration of AGAAP/ GFS Harmonisation in relation to whole of government reporting and reporting by individual government entities.

In dealing with the many issues to be addressed, the AASB needs to ensure that standards will meet the information needs of the wide range of users of public sector financial reports. These information needs should be clearly and comprehensively articulated in the Conceptual Framework, with their implications being reflected in the resulting standards.

As a general principle, ACAG continues to support a single accounting standards framework and one set of standards based on an approach giving full and appropriate attention to the financial reporting needs of both the for-profit and the not-for-profit sectors. Nevertheless, it remains possible that an enhanced Conceptual Framework may reveal sufficient divergences between public and private sector reporting needs to warrant public sector specific standards on certain topics.

ACAG is encouraged by the AASB’s work program that would see public sector issues given greater prominence. The Simpkins Report starts to address this and ACAG’s attached responses to this Report are aimed at enhancing the capacity for financial reporting, and other non-financial measures for reporting and assessing performance, to improve stewardship and accountability in the public sector.

Yours sincerely

Frank McGuinness  
Auditor-General for the Northern Territory

### ***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?***

The current financial accounting standards would appear to result in general purpose financial reports that meet the needs of sophisticated private sector investors quite well. Certainly, a great deal of resources is devoted around the world to this end.

However, ACAG believes that compliance with accounting standards falls short of meeting the needs of users of public sector financial reports.

It is generally accepted that all users require information that assists them in making economic decisions for the future and in evaluating past decisions. However, the accountability relationship in the public sector is broad. A range of non-financial performance and compliance information is necessary to provide stakeholders with the information they require to evaluate a government's management of the public sector and to ensure that stewardship obligations are discharged. (It would appear that the AASB has not yet considered the extent to which it should deal with non-financial information. SAC 2, which was issued in 1990, signalled at paragraph 30 that the 'extent to which non-financial performance can be considered to fall within the scope of general purpose financial reporting will be the subject of a separate Statement of Accounting Concepts').

It is accepted that financial information about assets and liabilities, revenues and expenses and cash flows lies at the heart of general purpose financial reporting. However, in the case of the public sector, there remain to be addressed a range of issues dealing with measurement and recognition and the extent to which general purpose financial reports should be aligned with statistical frameworks. At the same time, a number of specific issues have been identified which are important in the context of reporting by the not-for-profit public sector, but which have remained unresolved for an extended period. An example is the accounting for non-exchange revenue, including taxes and transfers, and accounting for social policy obligations and other grants. The manner of recognition of taxation or rates revenue in an accrual environment has been a contentious issue, as has the determination of when a government recognises a present obligation.

One specific aspect of the current standard setting criteria that creates difficulties is the for-profit/not-for-profit distinction in the public sector. Whilst the public sector contains entities the primary objective of which are to operate in a "business-like" manner and to operate at a profit, there is an inherent tension between the profit seeking activities of these entities and their role as subsidiaries of the whole-of-government reporting entity, which is not-for-profit.

Given that many of the goods and services provided by governments fall within the definitions of public goods or quasi-public goods, many of the recognition and measurement principles established for not-for-profit entities may provide more meaningful information to users of public sector reports. For example, information about current costs of assets may be more useful than value in exchange or the extent to which those assets abilities to generate positive cash flows. Requirements to disclose information about the maintenance of infrastructure assets may allow users to draw inferences about issues of inter-generational equity than do the more traditional depreciation concepts.

In this regard, the ACAG/HOTARAC *Gaps in Australian Generally Accepted Accounting Principles* listed a large number of issues of concern (some of which overlap the AASB's identified issues in its Public Sector Policy paper).

The question of how best to address the information needs of users of public sector general purpose financial requires that attention be given to the Conceptual Framework (Refer to answers to Question 3 on the Framework and Question 7 on a Statement of User Needs). The Conceptual Framework is the document where the primary users of public sector financial reports and their information needs should be identified if standards appropriate to the public sector user are to be developed. As it currently stands, the public sector perspective can be viewed as little more than an 'add-on' to the over-riding focus on the commercial perspective. There is a strong sense of public sector perspectives being 'shoe-horned' into standards intended to deal with reporting by corporate entities.

ACAG acknowledges that the present standards setting regime has been beneficial to the public sector users of financial reports in that it provides a standard setting mechanism that is independent, rigorous in its due process, expert in accounting and that deals adequately with many of the transactions that are encountered in the public sector.

### ***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?***

The current approach to using the for-profit orientated IASB standards as the basis of the AASB standards is likely to inhibit the AASB's ability to adequately address the needs of public sector users in the future.

The accounting and reporting issues that arise in the public sector can be quite different from those faced by a corporation, for example. This often results in the meaning embodied in accounting standards being interpreted in such a way as to accommodate a particular event, a search for alternative, or authoritative sources of accounting guidance that may be deemed to be more appropriate in the circumstances and is sometimes accompanied by the issue of local policy papers to fill the gaps. It is our view that this type of response cannot deal effectively with issues where the fundamental appropriateness of a treatment is in question and it has the potential to hinder comparability between jurisdictions.

Some of the issues of concern to both ACAG and HOTARAC were set out in a joint paper titled "*Gaps in Australian Generally Accepted Accounting Principles*" which was provided to the Australian Accounting Standards Board. A number of the issues identified in that paper represent fundamental differences between public sector not-for-profit entities and for-profit entities, which are unlikely to be adequately addressed through the inclusion of an AUS paragraph as is present practice.

Given that IASB standards are specifically developed for profit seeking entities in the private sector, the current AASB approach of inserting "Aus" paragraphs to address local issues risks a failure of the standard-setting process if it fails to deal adequately with the issues that are of concern to the public sector and to other not-for-profit entities.

The fundamental change ACAG is proposing is not one that would see the abandonment of the sector-neutral approach of the AASB but one that would see more resources devoted to address public sector issues in a more comprehensive way, beginning with the conceptual framework. Flowing from this, it needs to be recognized that an enhanced Conceptual Framework may indicate a need for specific public sector standards.

### ***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?***

As previously stated, ACAG supports the continuation of the existing institutional arrangements for standard setting in Australia.

ACAG believes that the arrangements can be made to work better to meet the needs of users in addition to those whose interests are in the for-profit private sector. To do otherwise would also be to invite dilution of accounting expertise, divergence where none is warranted, and duplication of costs.

Accordingly, ACAG considers that having one conceptual framework that is applicable and appropriate to all entities is a highly desirable objective for Australian standard-setting for all sectors.

Such a conceptual framework needs to fully reflect the different reporting objectives of the various types of entities in the Australian economy. It must meet the information needs of all users across all sectors.

The existing *Framework for Preparation and Presentation of Financial Statements*, even when read in conjunction with SAC 1 and SAC 2, does not do this. Both the Consultation Paper and the *Gaps in AGAAP* Paper indicate areas where divergence between the users of public sector and private sector financial reports could arise.

ACAG recognises that a unified conceptual framework may not be possible in the shorter term. ACAG notes that the IASB/FASB framework project is focused on private sector for-profit reporting (despite the efforts of the AASB and others to widen its scope) and that the IPSASB is to commence its own public sector framework project.

ACAG agrees with and commends the initiative of the AASB (and the other national standards setters) in their active monitoring of the IASB/FASB project as it affects not-for-profit entities) and the AASB's participation in the IPSASB project.

ACAG agrees that the AASB should pursue both paths in the short term and aim to have a unified document in due course.

ACAG believes that it may be worthwhile for the AASB to increase public sector representation on the Board and/or seek greater public sector representation on advisory panels while it is focussed on this work.

#### ***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).***

ACAG supports sector neutrality, or more correctly transaction neutrality, and agrees that this is best facilitated by a single set of standards. ACAG support for sector neutrality is based on the continuing assumption that public sector issues would be afforded similar priority as those in the for-profit sector. Recent experience shows that this approach has had difficulties. It is pleasing to note from recent AASB announcements that the AASB is seeking to redress the imbalance.

A single set of standards depends on a single Conceptual Framework. Work on enhancing the Framework to deal with public sector fundamentals, and consideration of the completion of GFS GAAP Harmonisation, may in due course suggest public sector specific standards for particular topics.

ACAG has no experience that would enable it to discuss the appropriateness of the current AASB standards to the not-for-profits in the private sector, but it has a general awareness that this sector and the small-medium-enterprise (SME) sector also have unique issues, which are not receiving the same level of attention as the for-profit sector. Therefore, these sectors may also need greater attention by the AASB.

#### ***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?***

As noted, ACAG supports the continuation of transaction neutral standard setting provided that appropriate attention is given to public sector considerations.

Accordingly, ACAG believes that a range of sources should form the basis for Australian accounting standards. ACAG notes that the IPSASB continues to develop standards based on IASB standards, but that the work that the IPSASB is doing here lags behind the current set of IASB standards. Nevertheless, the IPSASB work on public sector-specific issues is valuable and this work should continue to influence the AASB in considering public sector issues, and also be influenced by AASB.

ACAG has supported the development of AASB 1049 *Financial Reporting of General Government Sectors by Governments*. ACAG believes that it remains appropriate to continue

to draw on GFS as one source for the development of public sector accounting standards. The extent of the future influence of GFS in the setting of public sector standards needs now to be considered by the AASB as part of the existing strategic direction given by the FRC. Arguably, these decisions should in part hinge on the enhancement of the Conceptual Framework by identifying the range of users and their information needs with regard to public sector financial reports.

We understand that the introduction of IFRS may have reduced the differences that had existed previously between GFS and Australian GAAP standards. If that is indeed the case, the question of the role of GFS would seem to be one of presentation rather than one of measurement and recognition.

#### ***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?***

ACAG has previously expressed to the AASB that it favours a matrix approach to setting standards for the public sector, which would involve retaining government specific standards. Retaining those standards would recognise the influence that those standards have had on public sector budgeting as well as reporting, and would help ensure that public sector issues are dealt with holistically.

The proposed degree of attention the AASB now has for public sector issues may offset these concerns. Nevertheless, in due course, the enhancement of the Conceptual Framework may indicate a need for public sector specific standards in the future.

#### ***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?***

ACAG believes that the development of a *Statement of User Needs* based on research would be useful as long as it informs the Conceptual Framework.

Preferably, it would undertake by an academic and subjected to the usual academic rigour in its development.

Such a project should be scoped as soon as possible to see if any useful outcomes can be identified in time to fit in with the timetables for the development of the Conceptual Framework. We do not propose holding up the framework projects.

***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?***

ACAG believes some of the confusion in relation to the approach being taken by the AASB has arisen partly out of the use of the term 'sector neutrality' and partly out of the AASB treating the withdrawal of the government specific standards as a *fait accompli* in earlier versions of its public sector policy paper. These matters have been clarified.

Nevertheless, there remain sources of uncertainty. While ACAG welcomes the release of AASB 1049, there remains a serious lack of consistency between the accounting policies required by this standard and those required by the other government-specific standards. For example, GFS consistent policies are required under AASB 1049 where policy options exist under GAAP, but not under AAS 31.

Decisions also need to be expedited in relation to the remaining aspects of the implementation of the GFS/GAAP strategic direction.

***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?***

Consideration of public sector issues would possibly be enhanced if there was greater equality of input into the creation of the Conceptual Framework and accounting standards, at least while these issues are scheduled for greater attention by the AASB. This might be done by increased representation on the AASB or in assistance to possible AASB sub-committees on public sector issues.

***Consultation Issue 10***

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

No.