



The Institute of
Chartered Accountants
in Australia



1 November 2006

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

Email: jdelbusto@treasury.gov.au

Dear Mr del Busto

THE USE OF A SECTOR-NEUTRAL FRAMEWORK FOR THE MAKING OF AUSTRALIAN ACCOUNTING STANDARDS

CPA Australia, The Institute of Chartered Accountants in Australia and the National Institute of Accountants (the professional accounting bodies) appreciate the opportunity to comment on *A review of the policy of sector-neutral accounting standard-setting in Australia* which we have referred to as the 'Simpkins Report'.

The professional accounting bodies see the Simpkins Report as exploring issues of great importance to the profession and have therefore decided to respond jointly to the Financial Reporting Council's (FRC) request for comments on the review of sector neutral accounting standard setting conducted earlier this year by Kevin Simpkins.

The pages following this letter contain the responses to the various questions put to constituents by the FRC regarding the report. We would, however, like to amplify some of the points at the outset.

One of the disappointing aspects of the report is the absence of firm recommendations. While the general inventory of facts and analysis is useful and commendable, the absence of firm recommendations from the author has resulted in some level of confusion about the intention of the report in the first instance. We would have preferred a report that provided a stronger policy direction in the area.

The Simpkins Report does not acknowledge the Australian Accounting Standards Board's (AASB) work program that was issued early this year giving prominence to public sector and not-for-profit issues. We wish it to be noted that the AASB has focused on these areas more intensely over the past 12 months. Our remarks in the submission should be read in this context as we support the AASB in its present efforts.

The professional accounting bodies would also strongly encourage the AASB to continue its work in monitoring and engaging with the International Public Sector Accounting Standards Board (IPSASB). The work being done by IPSASB provides a precedent for the board's work in setting accounting requirements for the public sector and other not-for-profit entities. Where the AASB detects any greenfields territory where guidance is yet to be provided by the IPSASB and it deems the treatment under standards issued by the International Accounting Standards Board (IASB) as inappropriate, suitable domestic guidance should be developed and provided to other standard setters. As we are all members of the International Federation of Accountants (IFAC) we are keen to ensure that the work of the IPSASB is used wherever possible, and from an accountability perspective, we suggest that there should be a Statement of Compatability with each of the IPSASB Standards included in the Australian Standards.

Please contact our policy advisers Chee Ng from CPA Australia on 03 9606 9933, Keith Reilly from The Institute of Chartered Accountants in Australia on 02 9290 5703 or Tom Ravlic from the National Institute of Accountants on 0407 408 000 should you wish to discuss this submission further.

Yours sincerely



Geoff Rankin FCPA
Chief Executive Officer
CPA Australia



Graham Meyer
Chief Executive Officer
The Institute of Chartered
Accountants in Australia



Roger Cotton
Chief Executive Officer
National Institute of
Accountants

cc: C Ng
K Reilly
T Ravlic

THE USE OF A SECTOR-NEUTRAL FRAMEWORK FOR THE MAKING OF AUSTRALIAN ACCOUNTING STANDARDS

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 professional accounting bodies agree with Kevin Simpkins that needs of users of public sector and other not-for-profit entities are not being met to the extent they ought and their needs are not being met as well as those of profit-oriented entities.

The professional accounting bodies have, for sometime, supported the approach of developing accounting standards meeting the needs of users of reporting entities in all sectors of the Australian economy. We support any initiatives that result in improved financial reporting in all sectors, but we consider it a priority for the AASB and its equivalent bodies internationally to focus on building a robust reporting framework that is relevant to the public sector and other not-for-profit entities.

The IPSASB's *IASB/FASB Conceptual Framework Monitoring Group* has highlighted that not-for-profit entities have different objectives, different operating environments and other characteristics as distinct from that for the for-profit entities.

The United States' Government Accounting Standards Board (GASB), in its publication *Why Governmental Accounting and Financial Reporting is and should be different*, sums up these differences as "they have different purposes, processes of generating revenues, stakeholders, budgetary obligations, and propensity for longevity." The GASB concludes that "general purpose governments cannot simply apply the standards established for business enterprises".

While good progress has been made in the Australian accounting standards and accounting reforms, it is important that the accounting standard setting framework and the resulting standards should take account of the differences between sectors to ensure the general purpose financial reports meet the needs of the users. Any work in this area, however, needs to proceed with a strategic focus on the development of a conceptual framework that copes better with the differing information needs of dependent users of the reports produced by entities in the sector. A revised conceptual framework is necessary to provide greater detail on the information needs of users of financial statements produced by non-business organisations.

Needs of users of public sector and other not-for-profit entities for financial information are not being fully met by the current suite of reporting standards. The needs of users of financial reporting information ought to drive the development of reporting requirements embedded in the standards. The standards can only do this if the conceptual framework addresses stewardship and accountability as being objectives of financial reporting. Amongst the issues that would need to be considered in the development of any body of unique requirements is the need for users of financial statements produced by these entities.

A central theme emerging during the discussion with constituents of other not-for-profit entities was the need to review the existing standards to ensure aspect of operations of not-for-profit other entities are faithfully represented by the financial statements prepared for resource providers, constituents, managers and governing or oversight bodies associated with a not-for-profit entity. While cash flows are important for the public sector and other not-for-profit entities, other information, including service performance and service delivery, is primary focus for public sector entities. Other differences that have been highlighted include the limited relevance of profit and equity, different funding methods, government restructuring arrangements are different, and service capacity of asset instead of future cash flows.

Many in the other not-for-profit entities criticised the irrelevance of some of the accounting and reporting requirements for their entities. The constituents questioned the relevance of applying the same standards to all entities without regards to size, legislative environment, listed or unlisted status.

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 following FRC Direction issued in 2002 on adoption of IFRSs was aimed at Corporations Act entities instead of all entities:

‘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 Corporation Act entities for accounting periods beginning on or after 1 January 2005.’

The approach adopted by AASB since 2005 has been:

- adopting and adapting the International Financial Reporting Standards (IFRSs) developed by IASB for for-profit entities;
- including ‘AUS’ paragraphs in some standards to address issues specific to the public and other not-for-profit sectors.

The adoption of IFRSs has resulted in a number of concerns for public sector and other not-for-profit entities. Based on the feedback received during our consultation events the key concerns raised by constituents include:

- inappropriate language and terminology in standards and conceptual documents for the public sector;
- loss of some guidance and examples on application;
- many significant issues continue to be unresolved.

With the benefit of hindsight, one often wonders whether the following alternative approach would serve Australia better:

- adopt and adapt IFRSs developed by IASB for for-profit entities for Corporation Act entities pursuant to FRC Direction with consideration given to the differing characteristics of not-for-profit entities, and the size of various entities;
- adopt and adapt International Public Sector Accounting Standards (IPSASs) for public sector and other not-for-profit entities.

A number of recent IASB and IFRIC initiatives confirm that IASB will continue its focus on the for-profit sector especially the listed entities, and therefore it is questionable whether the AASB should continue to rely on IASB and amending its standards to meet the needs of public sector and other not-for-profit entities.

The professional accounting bodies agree with the issues raised in paragraphs 8.34 to 8.37 of the Simpkins Report including the likelihood of increasing differences between the standards of IASB and IPSASB.

With an increasing number of countries and organisations, including the United Nations, adopting the IPSASs, the professional accounting bodies suggest the way forward for the AASB is for it to work closely with IPSASB on addressing issues and standards that are applicable to the not-for-profit entities.

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?

It is important to have a conceptual framework that is applicable and appropriate to all entities. The conceptual framework is a necessary element in Australian standard-setting for all sectors.

The professional accounting bodies support the view of the IPSASB's IASB/FASB Conceptual Framework Monitoring Group that:

- public sector and other not-for-profit entities have a wider group of users;
- it is inappropriate to be too cash flow focused for public sector and other not-for-profit entities;
- service performance information is important;
- there is "a risk that the boundaries of the objectives of financial reporting for private sector businesses may implicitly be narrower than is necessary for it to meet the needs of users in the public sector and other not-for-profit entities".

The professional accounting bodies consider the conceptual framework is the foundation for, and an integral part of the development of accounting standards. It is important that the conceptual framework be able to accommodate the differences specific to the public sector and other not-for-profit entities and the needs of their users.

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)**

The professional accounting bodies support the existing approach of single set of standards with due consideration given to differences of the various sectors. Moving forward, we suggest the approach for future standard-setting in Australia should be: IFRSs as the basis for all entities with adoption of the IPSASs where appropriate for public sector and other not-for-profit entities with a Statement of Compliance for accountability purposes.

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?**

See our response to Question 4.

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?***

The professional accounting bodies view the existing approach of the AASB as more of a matrix approach in that there are specific standards relating to specific sectors, e.g. AASB 1023 *General Insurance Contracts*, AASB 1038 *Life Insurance Contracts*, AASB 130 *Disclosure in the Financial Statements of Banks and Similar Financial Institutions* and AASB 1049 *Financial Reporting of General Government Sectors by Governments*.

With the likelihood of differences between IFRSs and IPSASs increasing, the professional accounting bodies are of the view that the industry specific standards are neat repositories for future public sector changes as they quarantine the other standards from impending public sector changes.

There is urgent need for the AASB to address several public sector issues. These issues are in the AASB's work program and they include:

- Administered items;
- Budget reporting;
- Consolidation of for-profit entities into a not-for-profit group;
- Contribution by owners;
- Disaggregated information;
- Financial instruments;
- Future cash flows and cash generating unit;
- Infrastructure, heritage and cultural assets;
- Land under roads;
- Question of control;
- Service concession arrangements;
- Related party transactions;
- Restructure and administration arrangements.

The needs and issues of the other not-for-profit entities should not be ignored. Judging from the issues raised at the consultation events held by the professional accounting bodies, there is urgent need for AASB to address their needs. The constituents have raised many issues. These issues include:

- Absence of guidance and examples in the standards;
- Accounting and the treatment of grants;
- Amendments to Accounting Standard AASB 101 Presentation of Financial Reports so that the Balance Sheet and Profit & Loss Statement are re-formatted so financial statements reflect the fact other not-for-profit entities provide services to the community rather than generate profits for distribution;
- Additional guidance on how to account for contributions (e.g. donations and grants). This may require some amendment to AASB 1004 Contributions and AASB 118 Revenue;
- A Statement of Service Potential or equivalent statement would be more relevant than a Statement of Changes in Equity;
- Budget-based information should be considered as a critical part of financial statements for not-for-profit entities;
- Common format for reporting and a common information database to be provided so that various reports could be conveniently prepared;
- Conceptual framework;

- Definitions of not-for-profit and for-profit entities need to be spelt out more clearly so users of the standards are able to apply principles accurately;
- Need to consider the diverse range of entities;
- Need to review the current Reporting Entity Concept with perhaps some differing requirements, e.g. accountability, the size of the organization, its activities and different degrees of disclosures;
- Relevance of existing standards;
- Reporting of non-financial information;
- Specific disclosures on restricted funds including further explanation of funding utilisation and the disclosure of any administration costs.

There is a wealth of material both locally and internationally on not-for-profit issues and the AASB should endeavour to use these references to develop proposals for change in Australia.

The professional accounting bodies recognise the significant role of the other not-for-profit entities and support the view that there might be a need for a specific standard for these entities.

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?

The professional accounting bodies support the incorporation of a requirement for the standard setter to indicate it has considered user needs in the development of an accounting standard for the public sector and other not-for-profit entities that are the subject of this review. However, the most effective means of doing this should be the domain of the AASB and achieved through a due process related to its own procedures.

There are two ways in which the incorporation of such a principle may take place. The first is the development of a separate document that sets out user needs. The second is for the AASB to embed it as a part of its operating policies that all exposure drafts should contain a reference to how a proposal meets the needs of users. Both of these should not take place without further consultation on the development of a conceptual framework dealing with the objectives of financial reporting for the public sector and other not-for-profit entities.

The recent creation of a not-for-profit user group by the AASB is a positive step to enable the initiatives above to be executed efficiently.

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?

The constituents at the consultation events have indicated that there is insufficient clarity on the direction that the AASB is taking and that the constituents need to be better informed by the AASB.

At the operational level, a specific area requiring clarification are the reporting and disclosure requirements post AASs 27, 29 and 31 in the light of AASB 1049. The professional accounting bodies are of the view that the entire review/withdrawal has to be an integrated approach instead of piece-meal process.

Further communication from the AASB is necessary to assure the constituents in the public sector and other not-for-profit sector that the board is interested in both informing and seeking feedback from the sector. This is starting to occur more frequently but expressions of concern from constituents suggests more can be done.

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?

The professional accounting bodies recognise that considerable resources and enhancements are needed for the initiatives recommended in our response. We recommend that:

- A board representation with sufficient members from the public sector and a member from the other not-for-profit sector¹;
- Establishment of sector-specific committees or panels to advise the board on issues relating to their sectors; and
- A review of staffing requirements and ensure adequate resources are available to address the public sector issues.

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

The professional accounting bodies recommend that the FRC encourage the Australian and the State Governments to increase their funding to the AASB to enable the Board to have adequate resources to address the pressing issues confronting the public sector and other not-for-profit entities. This resource allocation exercise will go a long way to address the accounting and reporting issues in the 'back-yards' of the respective governments. This is a win-win situation as the givers and the beneficiaries are the same. Part of the increased funding can also be used to enable the AASB to provide some forms of technical support to the various IPSASB projects, in a similar manner to that it provides to the IASB. This in turn will provide the AASB with an opportunity to better lead and promote those aspects of the IPSASB's work that are relevant to the Australian public sector.

The professional accounting bodies suggest that the Australian Government consider a financial commitment to the IPSASB, similar to that of the Canadian Government, i.e. at US\$200,000 per year for the next five years.² This together with the financial initiative suggested above will enable Australia and the AASB to continue to play a significant role in the global public sector standard-setting scene.

¹However, the National Institute of Accountants is of the view that a board that incorporates an understanding of not-for-profit reporting needs in its membership in some way is adequate. This may be by way of direct representation or via existing members who have a role in other not-for-profit entities.

² In 2005, AASB made a contribution of \$1 million to International Financial Standards Committee Foundation the governing body of the IASB..