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Comments on:

## **The Use of a Sector Neutral Framework for the Making of Australian Accounting Standards**

Issued by the Financial Reporting Council

*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?*

As outlined in the Kevin Simpkins' paper, General Purpose Financial Reports (GPFR) are designed for, and respond to influences from, the investment community, particularly professional investment analysts.

GPFR/AIFRS provide a transparent and standardised method and format for reporting, in a comparable way, information about the financial position and financial results of entities whose purpose is to deliver profits and dividends.

However applying this format to the not-for-profit sector is not achieving "sector-neutrality", or even "transaction- neutrality", but rather "sector-domination", that is, the information needs of professional investment analysts are dominating the information domain of users of information about entities for whom profit and dividend is not an objective.

Unfortunately the emotive and non-evidenced based view identified on page 71 of Kevin's paper "if it is good enough for profit entities it is good enough for not-for-profits" took hold in Australia in the early 1980's and has increasingly dominated the not-for-profit reporting sectors, without the sensible assessment of whether this view was valid. It is pleasing to see that Kevin's paper is at last illuminating the falsity.

My preference for distinguishing the reporting sectors is not as "for-profit" or "not-for-profit", but rather: "**profit-delivery**" or "**policy delivery**".

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“Policy-delivery” aggregates all entities whose role is to deliver a policy of societal improvement, whether this be health, education, sporting, cultural, environmental philosophical or indeed policy design and advice services.

For policy-delivery sector entities, finances are a resource to marshal and manage in delivering the policy goals and the associated program interventions that have been devised to implement the goals. The information relevant to users is more cash flow based, and in this regard, I disagree with Kevin Simpkins’ assessment on pages 90 and 91 of his paper.

The financial information needs of users of policy-delivery entities is about how closely the approved funding budget was achieved, in delivering the level of services intended by the operating plan underpinning the budget. While it is easier then to align the financial inputs with declared levels of outputs in the operating pan, the impact of the policy interventions can be assessed through program evaluation techniques.

So, in summary, GPFR under-deliver information to users of policy-delivery entities because they are not aligned to the inputs/outputs/outcomes performance reporting structure which is fundamental to that sector.

***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?***

No. Until the domination of standard setting by the requirements of the professional investment funds analysts is removed from its influence over not-for-profit/policy-delivery entities, the approach of the AASB to minimally modify IASB standards for a ‘for-profit’ view of what’s best for the not-for-profit/policy-delivery sector will not give that latter sector the opportunity to articulate and own its reporting solutions.

***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 identified in paragraph 8.37 of Kevin’s paper, the conceptual framework thinking is dominated by profit-delivery thinking.

A conceptual framework should start with a clear focus on the purpose of the reporting. This will clearly require a different thinking around the reporting needs of users of:

- profit-delivery entities, for whom the profit measurement and financial position calculation is of high priority, and
- policy-delivery entities, for whom the financial stewardship and inputs/outputs accountability is important, but even more so is the impact evaluation of the program interventions designed to implement the policy goals.

Separate starting points to designing conceptual frameworks for each sector should be adopted, allowing them to converge where appropriate. This would be preferable to a common starting point, for which the risk of domination by profit delivery sector thinking will remain.

***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)*

As outlined in the above comments, I see only two sectors requiring different starting points for their conceptual framework and standard setting. As highlighted, these sectors would be:

- profit-delivery entities, for whom the profit measurement and financial position calculation is of high priority, and
- policy-delivery entities, for whom the financial stewardship and inputs/outputs accountability is important, but even more so is the impact evaluation of the program interventions designed to implement the policy goals

Standards would be established to support the conceptual framework for each, but it is likely that there would be convergence in some areas of standards.

***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?*

Attempts to harmonise GFS reporting with GPFR continues the mindset of domination explicit in “if it is good enough for profit entities it is good enough for not-for-profits”. GFS reporting is specific to the needs of Government financial analysis and

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comparability at a national and trans-national level. But it does not need to be anchored to AASB requirements. In effect, it is special purpose reporting, where the users of the reporting - Governments - have agreed to a format that suits their needs. In that regard, GFS reporting was a leading example of multi-national agreement about financial reporting that has arguably not been matched as yet to the same extent in the for-profit sector.

IPSAS should be useful reference for standards for policy-delivery entities in Australia. But relevance and usefulness to the policy delivery sector could allow Australia to lead the international thinking in establishing standards in areas not yet addressed by the IPSASB.

***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 matrix approach should allow clearer intra-sector reporting and measurement rules to be available to assist preparers and users.

***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?***

To an extent, Kevin Simpkins' paper provides a good start to identifying the different user needs in the not-for-profit/policy delivery sector.

Because of the domination of for-profit thinking in standard setting in the last 10 or so years, it is probably useful to clear away the 'for-profit' mindset when addressing the needs of users in the not-for-profit/policy delivery sector, so a researched Statement of User Needs would appear attractive. Experiences of users from the not-for-profit/policy delivery sector, in attempting to work with financial reporting formats inspired by the dominant 'for-profit' mindset, should evoke some useful responses.

***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 strategic mindset needs to accept that the role of financial reporting in the for profit/profit delivery sector is quite different to the not-for-profit/policy delivery sector. It is only when that is accepted that domination by the for profit thinking will be removed from the not-for-profit/policy delivery financial reporting requirements, including the linking of cash flow to budgets, and to inputs/outputs relationships.

***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?***

Space and voice needs to be available to users and representatives from the not-for-profit/policy delivery sector. This could be achieved by a separate Board or by sub-committees, but representatives should be people familiar with the requirements of that sector. There is little that a for-profit mindset can contribute to the not-for-profit/policy delivery sector, and vice versa. Sign-offs by Boards for compliance with prescribed matters could discipline the process, but are an incidental issue which may not reflect the underlying substance of the process.

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

The Management Discussion and Analysis concept is also important to the not-for-profit/policy delivery sector, and encouragement for telling the story behind the numbers (however measured and reported) remains very important in that sector. The customers of the financial information are not professional investment fund analysts. They are, for example, Parliamentarians or members of associations who are not expected to be financially literate, and so they need accountants or others to provide the analysis that would otherwise be done by professionals within the for-profit sector.

Thank you for the opportunity to comment.

I would be happy to provide further comments on specific matters that I have raised in these responses.

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*Iain Summers B Comm FCA FCPA FAIM FAICD was Northern Territory Auditor-General from 1995 to 2002, after eleven years as a partner of Pannell Kerr Forster Chartered Accountants Since retiring as Auditor-General, he has been providing governance and management advice and assistance primarily to community and public sector entities.*

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