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

E-mail: [jdelbusto@treasury.gov.au](mailto:jdelbusto@treasury.gov.au)

Dear Mr del Busto

### **Review of the Policy of Sector Neutral Accounting Standards Setting in Australia**

We appreciate the opportunity to comment on the FRC Review of the Policy of Sector Neutral Accounting Standards Setting in Australia.

New Zealand and Australia have adopted similar “sector-neutral” approaches to setting financial reporting standards, operate in similar environments and face similar challenges. The “sector-neutral” standard setting approaches adopted in Australia and New Zealand have, in our view, contributed significantly to the ability of the Australian Accounting Standards Board (AASB) and the Financial Reporting Standards Board (FRSB) to participate in and influence international standard setting. Decisions on the standard setting approach adopted in Australia are likely to impact on the standard setting approach in New Zealand and possibly on the contribution and influence of the AASB and FRSB to international standard setting.

The FRSB believes that there is a significant commonality in terms of accounting requirements for profit-oriented entities, public sector entities and not-for-profit entities and that overall a single set of financial reporting standards applicable to all entities remains the most effective and efficient approach to setting financial reporting standards. However, it is also essential that the standards are appropriate to all entities required to apply them and that user needs drive development of such standards. In relation to public and not-for-profit sector entities the FRSB also believes that development of a conceptual framework is essential to guide the development of a consistent and coherent suite of standards. The International Public Sector Accounting Standards Board (IPSASB) project to develop a conceptual framework applicable to public sector entities provides an opportunity for the AASB and the FRSB to consider information needs of users of financial information of not-for-profit and public sector entities and contribute to the improvement of conceptual frameworks and reporting requirements relevant to these entities.

It is with above perspective in mind that the FRSB provides its views on the specific matters for consideration. If you have any queries, or require clarification on any matters in the submission, please contact me (joannaperry@xtra.co.nz) or Simon Lee (simon.lee@nzica.com).

Yours sincerely

A handwritten signature in black ink that reads "Joanna Perry". The signature is written in a cursive style with a long, sweeping underline.

Joanna Perry  
**Chairman – Financial Reporting Standards Board**  
Email: joannaperry@xtra.co.nz

## **FRC Matters for consideration**

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?*

We are not able to answer this question directly as we do not have adequate information on how well the needs of all users of general purpose financial reports in Australia are being met. However, New Zealand operates in a similar environment to Australia and adopts a similar approach to standard setting. Our response reflects observations from the environment in New Zealand and we hope this is useful.

In New Zealand we believe that the needs of users of general purpose financial reports of large profit-oriented entities are well served in both the private and public sectors. That is the standards are developed specifically with the users of these entities in mind and the work plan of the IASB (and hence the AASB and FRSB) is developed to address issues facing large profit-oriented entities.

While much of the material in the IFRSs will meet many of the needs of users of public benefit entities (PBEs)<sup>1</sup>, the IFRSs are not developed specifically to address PBE user information needs, nor is the work plan of the IASB focussed on addressing the issues facing these entities. We agree that the needs of users of PBE general purpose financial reports are not being addressed to the same extent as the needs of users of general purpose financial reports of large profit-oriented entities.

This is not surprising. However, it does mean that additional efforts are necessary at the domestic standard setting level to ensure that the user needs of PBEs are addressed. Alternative and additional requirements and guidance relevant to PBEs are likely to be required in order to ensure the standards can be applied by these entities. We note that in concept there is a similar issue regarding users of financial reports of small and medium sized entities (SMEs). That is users of SME financial reports have different information needs and a different cost-benefit equation in terms of preparing financial information compared to larger entities. We note that the IASB has been considering this issue and will be proposing an IFRS for SMEs.

Australia and New Zealand have had a common conceptual framework and suite of standards applicable to all entities. We believe that this approach has served the needs of users well in the past and has given us a richer and more robust set of financial reporting standards. We do not believe that now is the time to fundamentally change the approach to setting standards for all entities.

Over the past few years the focus of the FRSB has been on developing the New Zealand equivalents to the IFRSs. In doing so a lot of work was done to ensure that the NZ IFRSs could be applied by public benefit entities. The FRSB is now beginning to address some of the more difficult and complex issues affecting PBEs. These issues require consideration of user information needs and conceptual issues. The development of a conceptual framework applicable to PBEs is critical to ensuring that the needs of all users of general purpose financial reports are met.

The International Public Sector Accounting Standards Board (IPSASB) is commencing a project to develop a conceptual framework relevant to public sector entities. This project has the potential to assist standard setters to address these difficult conceptual issues and is an area where the AASB and the FRSB have a significant contribution to make. Both the AASB and the FRSB are contributing to the IPSASB project.

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 standard setting approach adopted by the AASB is similar to that adopted by the FRSB in New Zealand. In New Zealand the adoption of IFRS required a new approach to standard setting. This new approach is still evolving. The process is necessarily flexible and needs to be regularly reviewed.

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<sup>1</sup> The term "public benefit entities" is used in this submission to refer to private not-for-profit entities (such as charities, sports clubs etc) and service oriented public sector entities (such as central government, government departments, local authorities etc).

Overall we believe that a sector-neutral<sup>2</sup> approach to standard setting remains the most effective and efficient approach to developing financial reporting standards. However, we agree that with the adoption of IFRS the standard setting environment is more challenging in a number of respects. These challenges are amplified when adopting a sector neutral approach to standard setting.

Some of the challenges are simply a result of adopting IFRS. For example, the externally driven work plan, the volume of new and amended standards etc, the related resourcing implications, and the limited ability to influence and develop standards.

In our view the main issues in a sector-neutral IFRS environment are:

- ensuring the standards provide relevant information to users of general purpose financial reports of PBEs;
- integrating requirements and guidance for PBEs into standards developed for profit oriented entities from a broad range of international and domestically developed material;
- ensuring adequate attention is given to addressing financial reporting issues facing PBEs;
- ensuring that PBE constituents understand the potential implications of proposed domestic equivalents of IFRS and have the opportunity to comment on them from an informed perspective;
- implementing a credible and reliable process to achieve the above.

At this stage we have not identified anything in the current standard setting approach that would prevent the AASB (or FRSB) from responding to these or future challenges or to ensuring the needs of public sector and not-for-profit users are appropriately met. However, we believe that the current process needs to continue to evolve to address these challenges. In particular:

- More extensive and targeted consultation is required, both in relation to proposed and revised IFRS and also in relation to public and not-for-profit sector issues.
- Greater efforts toward developing international standards relevant to the not-for-profit and public sectors. In particular the work of the IPSASB is an area where standard setters in Australia and New Zealand are able to make a significant contribution and one which is likely to yield significant benefits at the domestic level.
- There is a need to ensure an appropriate balance of resources is achieved in addressing PBE issues.

There would be benefit to PBEs in Australia and New Zealand if the AASB and the FRSB worked together to address these challenges.

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?*

We believe that a conceptual framework(s) (however structured), applicable and appropriate to all entities is an essential element in Australian (and New Zealand) standard-setting. Our preference is at this time to work towards developing a single conceptual framework applicable to all entities in Australia (and New Zealand). However, until the IASB and the IPSASB frameworks are more fully developed it is unclear whether a single framework applicable to all entities will be feasible. There are a number of possible approaches to developing a conceptual framework(s) that could be considered, including:

- Separate conceptual frameworks for profit-oriented entities (IASB Conceptual Framework) and for public benefit entities.
- A single conceptual framework applicable to all entities, based on the IASB Conceptual Framework, with additional and alternative principles and other material as necessary to ensure it is relevant to PBEs; and
- A single framework identifying higher level concepts applicable to all entities, supported by conceptual frameworks applicable to specific types of entities (for example the IASB Conceptual Framework for profit oriented entities and a specific framework tailored to public benefit entities).

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<sup>2</sup> Since the adoption of IFRS in New Zealand the notion of sector neutrality has changed and now represents an approach to setting standards where there is a single set of standards applicable to both for profit and not-for-profit entities, including public sector entities.

The IASB is currently revising its Conceptual Framework in conjunction with the FASB. This project focuses on profit-oriented entities. The IPSASB has recently commenced a project to develop its own conceptual framework relevant to public sector entities, using the work of the IASB as a starting point.

We note that a group of National Standard Setters<sup>3</sup>, recently wrote to the Chairmen of the IASB, the FASB, and the IPSASB welcoming their respective conceptual framework projects. The NSS Group also acknowledged in the letter that the IASB, the FASB and the IPSASB have different remits regarding the types of entities for which they are responsible, but encouraged the three boards to maintain close contact during the development of their projects in order to avoid unnecessary divergence between their frameworks.

We suggest that the AASB and the FRSB work together and contribute to the IASB and IPSASB projects. In addition, once the IASB and IPSASB conceptual frameworks are more fully developed, it may be useful for the AASB and the FRSB to co-operate in developing a conceptual framework(s) relevant to all entities in Australia and New Zealand, with a view to developing a common conceptual framework(s).

Whatever approach to developing a Conceptual Framework, and more generally to setting standards, is adopted in Australia and New Zealand, it is essential that user information needs and the underlying concepts are clearly articulated for all sectors. Given the responsibilities of standard setters in Australia and New Zealand to develop standards applicable to all entities, it is essential that any Conceptual Framework include a clear set of concepts to guide development of consistent, appropriate, and coherent alternative and additional reporting requirements relevant to PBEs. These concepts are also vital to ensure the credibility of the standard setting process.

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)*

In our view, the process for developing standards applicable and relevant to all entities is still evolving in Australia and in New Zealand. We believe that it would be premature to introduce a fundamental change to this process at this time. Each of the above approaches has their own advantages and disadvantages. However, it is not apparent to us at this time that the current approach is fundamentally flawed so as to justify the cost and risks involved in developing and introducing a totally new approach to developing standards. It is however, an issue that justifies regular review to ensure the process is meeting user needs.

Overall we believe that a single set of standards appropriate to all entities required to apply them, remains the most efficient and effective approach to setting financial reporting standards.

While users require some different information about different entities, a large proportion of the information needed is and should be the same. That is similar transactions with similar user information needs should be accounted for in a similar manner regardless of the sector in which an entity operates. Adopting multiple sets of standards runs the risk that similar transactions will be accounted for differently in different sectors. In addition the costs involved in developing and maintaining two sets of standards is in our view prohibitive and would be

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<sup>3</sup>. The NSS Group comprises standard setting bodies from Australia, Canada, France, Germany, India, Japan, Malaysia, New Zealand, Russia, South Africa, UK, USA. The responsibilities of these boards vary. Some are responsible only for setting standards for profit oriented entities in the private sector, while others are responsible for setting standards applicable to all entities including not-for-profit entities and/or public sector entities.

likely, at least in the short term, to create a great deal of uncertainty for the public and not-for-profit sectors and may adversely affect the quality of financial reporting in these sectors.

Multiple sets of standards will, in our view, increase compliance costs and possibly create barriers to movement of accountants between sectors. Where multiple sets of standards exist accountants will need to understand each set in order to work with entities in different sectors. Multiple sets of standards may also effectively narrow the pool of accountants available to work across all sectors, and in particular the not-for-profit sector. In New Zealand the not-for-profit sector is already finding it particularly difficult to attract qualified accountants and auditors, and any additional barriers to movement of accountants between sectors is likely to exacerbate this.

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?*

While we believe that a single set of standards should be retained, we consider that alternative and additional guidance and requirements will be necessary to ensure that financial reporting standards based on IFRS will meet PBE user needs. Such alternative and additional guidance and requirements will need to be based on a variety of sources. In New Zealand these sources are likely to be IPSASs and standards developed by standard setters with a similar conceptual frameworks. Converging with GFS requirements has not been an issue in New Zealand to date and is, therefore, at this point in time unlikely to be a major influence on financial reporting standard setting in New Zealand. However, we note that the International Monetary Fund has stated that it is basing its standards for preparation of GFS more closely on IASB standards. A certain amount of convergence is therefore likely to occur through this process.

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?*

Overall we believe that the current standard setting approach is still evolving. In New Zealand our preference is to continue with the existing approach, enhanced as appropriate to address the needs of users of PBE financial statements. In our view the geography of alternative and additional requirements and guidance for PBEs is a secondary issue. The primary issue is whether or not the needs of users of the financial information are being met.

We do not consider that the three approaches outlined above are necessarily mutually exclusive. That is, enhancing the current approach to standard setting could involve adopting a matrix approach and/or development of non-standard level guidance. However, we do have some concerns and some observations.

Whatever approach is adopted it is essential that the ability of profit-oriented entities to assert compliance with IFRS is not compromised. Application of domestically developed (transaction-based) standards or

requirements that establish recognition, measurement and in some cases presentation requirements therefore need to be limited to PBEs.

We would support the provision of other non-standard level guidance to assist PBEs to implement the standards. We would envisage non-standard level guidance developed by domestic standard setters would be similar in nature to the basis for conclusions, application guidance and illustrative examples attached to the IFRSs.

Certain other non-standard level guidance, for example educational material, may more appropriately be developed and issued by entities other than the standard setter. For example, in New Zealand guidance is being developed to assist small not-for-profit entities apply the NZ IFRSs. The guidance is being prepared by the PBE Working Group and will be reviewed by the FRSB from a quality assurance perspective. However, it is proposed that the guidance will be issued by the Institute (not the FRSB) as non-authoritative guidance.

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?*

We believe that general research on user needs would be useful, particularly in respect of PBE user needs. Internationally there appears to be little agreement on what information users of PBE financial statements need. We therefore expect that consideration of user needs will be central to the development of the IPSASB conceptual framework project. Our preference would be that PBE user needs be incorporated into the Conceptual Framework. This would not, however, preclude the development of application guidance or basis for conclusions supporting and explaining PBE user needs and the implications of the needs on financial reporting.

Research into PBE user needs would also assist the AASB and the FRSB to contribute to the IPSASB Conceptual framework project and at the domestic level help ensure development of a sound conceptual basis for the development of alternative and additional PBE reporting requirements and guidance. Unless PBE user needs are clarified and the implications for financial reporting understood there is a risk that financial statements of PBEs will become increasingly difficult to understand and lose credibility. At the conceptual level we would not expect that PBE user needs would change significantly year to year, but we agree that they should be monitored.

At the individual standard level we believe that consideration of PBE user needs must be included as an integral part of the due process in developing A-IFRS (and NZ IFRS). This is already happening to a certain extent in Australia and New Zealand. For example when IASB issues an exposure draft constituent views are sought regarding implications for PBEs.

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?*

No comment.

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?*

As noted in the report, the FRSB has established a PBE Working Group to advise it on financial reporting issues relating to PBEs. This working group is proving effective in considering not-for-profit and public sector

issues. Specifically the PBE Working Group has enabled the FRSB to access the expertise and views of a range of people working in the public and not-for-profit sectors. This group also ensures that there is a process in place to consider and address PBE issues and adds to the credibility of the FRSB.

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

No comments.