

CPA AUSTRALIA

CFO PUBLIC SECTOR LUNCH

***Contributing to the Setting of
Accounting Standards
for the Public Sector***

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**Ian McPhee
Auditor-General for Australia
Member, Australian Accounting Standards Board**

Introduction

Global developments now influence Australian financial reporting far more than was the case when the Australian public sector first adopted accrual accounting. The machinery for setting Australian Accounting Standards has also changed, with responsibility moving from the accounting profession to the Australian Accounting Standards Board (AASB). The AASB is a government agency, but operates independently in its standard-setting role.

The members of the AASB come from diverse backgrounds and bring substantial experience to the task of standard-setting. It is supported by very able and hard-working staff. However, that is not enough to produce high-quality standards. The AASB needs input from those who use financial statements and from those who prepare and audit them. For this reason, the AASB welcomes contributions from public sector CFOs; indeed from all those interested in public sector financial reporting.

Not that long ago, the financial management function was not highly regarded in government agencies. It was rare to see any position of 'accountant' in the SES because the responsibilities were seen as mechanistic and confined to the 'back room'. Over time, the roles of accountants and CFOs in the public sector have grown, as agencies recognise the importance of high-quality financial management and strategic advice. Consequently, today accountants and CFOs are seen as influential participants in the management of their organisations. The knowledge and skills that they possess are precisely the attributes that qualify them to make a contribution to improving financial reporting in Australia.

My objective today is to encourage such contributions, particularly from CFOs. Knowing however, that CFOs are very busy, I will endeavour to set out how you can contribute in the most time-effective way.

I plan to start by outlining the role of the AASB, its key relationships and the broad influences on its work. I will then review some of the current public sector issues facing the AASB. Having set the scene, I will then outline ways in which CFOs can contribute most effectively to public sector accounting standard setting.

Role of the AASB

Like comparable overseas bodies, the AASB is charged with issuing accounting standards. However, the AASB is unusual in that it is charged with developing accounting standards for all sectors of the economy: private, public and not-for-profit. This is an important factor in the work of the AASB, requiring it not only to identify the different needs of each sector but also to consider the financial reporting issues they have in common. Central to this approach is the Board's view in relation to 'transaction neutrality': that the same transaction should be accounted for in the same way regardless of the sector in which it occurs; differences between sectors being limited to those arising from fundamentally different transactions or events, and differences in user needs or cost-benefit considerations. This view has also proved useful in analysing proposed changes to accounting standards: seeking to apply such changes to the three different sectors can be a useful test of the underlying logic.

The Board comprises 13 members, including a full-time Chairman, Mr Kevin Stevenson, appointed by the Minister for Financial Services. Although the majority of members have private sector backgrounds, five are from the public sector. In addition, there is a standing invitation for both the Australian member of the International Public Sector Accounting Standards Board (IPSASB) and Mr Warren McGregor (Australia's liaison International Accounting Standards Board [IASB] member) to attend Board meetings. Thus there is a good cross-section of experts at Board meetings.

When considering a new standard, the AASB is required by law to conduct a cost-benefit analysis. Information from users and preparers of financial statements is obviously a critical input to such an analysis. The costs of financial reporting are usually borne by preparers and the benefits typically accrue to users and the community as a whole.

Seeking to make Australia's voice heard in the development of global accounting standards is also a role of the AASB. Increasingly the world is moving towards a single set of accounting standards, at least in the private sector, driven by the increasing globalisation of world capital markets. There are strong arguments that this is in Australia's interest, but only if those standards are high-quality and address issues important to Australia. So the AASB and its staff invest significant time in monitoring, and seeking to influence, international developments in accounting standards.

Influences on the work of the AASB

As you would expect, the AASB does not work in a vacuum. While the AASB is an independent standard setter, it engages with a range of other organisations in pursuing its goals.

The Financial Reporting Council (FRC) is a special constituent¹. In addition to appointing the members of the AASB, other than the chair, it has the legislated power to set the broad strategic direction of the AASB. The current strategic directions set by the FRC require the AASB to:

- work towards the adoption in Australia of accounting standards that are the same as those issued by the IASB, to ensure their applicability to *Corporations Act 2001* entities for accounting periods beginning on or after 1 January 2005 (Direction of 5 September 2002); and
- pursue as an urgent priority the harmonisation of Government Finance Statistics (GFS) and Generally Accepted Accounting Principles (GAAP) reporting (Direction of 18 December 2002 as modified 11 April 2003).

¹ The FRC is responsible for providing broad oversight of the process for setting accounting and auditing standards as well as monitoring the effectiveness of auditor independence requirements in Australia and giving the Minister reports and advice on these matters. The eighteen members of the FRC are appointed by the Treasurer.

The AASB cannot be directed in relation to the making of a particular accounting standard. Nor can the FRC veto a particular standard – that is Parliament’s prerogative. But as you can imagine, the relationship between the FRC and the AASB needs to be close to ensure there is alignment on the direction and priorities for standard setting in Australia.

An ever-increasing influence over standard setting in Australia is the desire of the governments of Australia and New Zealand to accelerate harmonisation of regulatory arrangements that affect business between our two countries. One goal is to harmonise financial reporting between the two countries. So it makes sense that we act now to minimise differences between our respective standards. This is a particularly important relationship for the public sector, as both countries have been grappling with the special needs of that sector. The AASB and the NZ Financial Reporting Standards Board (FRSB) have a co-operation protocol providing for cross-membership, a joint work program, information exchange and joint meetings. At last year’s joint meeting, the AASB and the FRSB decide to remove as many differences between their respective sets of accounting standards as possible. In respect of the public sector, this would involve a joint exposure draft seeking to converge the not-for-profit paragraphs in current Australian and New Zealand standards.

Looking further afield, however, it is hard to overstate the influence of the International Accounting Standards Board (IASB) on Australian Accounting Standards. Increasingly, national standard setters are adopting IASB standards as an acceptable basis for financial reporting by large private sector entities. The IASB is well resourced and has an extensive program for further developing its suite of standards. Although the IASB has so far confined itself to producing standards for use by for-profit entities, most of these standards can be readily applied to the other sectors.

Because the FRC has given the AASB a broad direction to harmonise Australian Accounting Standards for the for-profit sector with those issued by the IASB, Australian Accounting Standards for the for-profit sector are based on IASB standards, so that a for-profit entity complying with Australian Accounting Standards would automatically be in compliance with IASB standards. Consequently changes in IASB standards have direct implications for Australian financial reporting, and the AASB works very hard to influence new IASB standards during their development phase.

Another key standard setter is the International Public Sector Accounting Standards Board (IPSASB), an arm of the International Federation of Accountants. As its name suggests, the IPSASB issues accounting standards designed specifically for the public sector. Like the AASB, however, it relies heavily on the body of standards issued by the IASB; thus there are many similarities between Australian Accounting Standards and those of the IPSASB. A key difference between the IASB and the IPSASB is that the latter has fewer resources and hence relies more on input from national standard setters, including the AASB.

The IPSASB is developing a conceptual framework and increasing its suite of pronouncements to cover a growing range of financial reporting issues. As this occurs, IPSASB pronouncements become more attractive to governments as a basis for public sector financial reporting. For example, the UK public sector uses IPSASB pronouncements as a source of secondary guidance. While there is no plan at this time to adopt IPSASB standards for the Australian public sector, the AASB contributes to the work of the IPSASB

and looks closely at this work when setting standards for public sector reporting in Australia. Longer term, it is conceivable that IPSASB pronouncements could provide a platform for public sector standards in Australia, if governance and funding issues were addressed. Desirably, this would involve a close relationship between the IPSASB and the IASB.

In the course of its work, the AASB not only deals with specific changes to accounting standards, but also monitors and seeks to influence strategic changes in financial reporting. In the latter category is the development by the IASB and the United States Financial Accounting Standards Board (FASB) of a new conceptual framework to underpin financial reporting.

The joint IASB/FASB project aims to harmonise the conceptual frameworks of the two standard setters. This is an important exercise, because the conceptual framework is intended to guide the development of new accounting standards. Also, the AASB's framework is based on (and incorporates) the IASB framework. Although the project is primarily addressing the needs of the private sector, there may well be flow-on effects for the public sector. Hence, in addition to its general interest in such an important development, the AASB is monitoring this project with an eye to the possible implications for Australian not-for-profit and public sector entities.

The AASB is not solely influenced by overseas standard setters, however. It pays close attention to the views of its Australian constituents, which is to say anyone in Australia who has an interest in financial reporting, whether they are preparers, users, auditors, academics or private citizens. Because the mandate of the AASB extends to the for-profit, not-for-profit private and public sectors, the AASB receives comments from a very broad range of entities and individuals. The AASB invests considerable effort in seeking comments on proposed accounting standards, and takes constituents views seriously.

The AASB takes particular note of the contributions of submissions from peak bodies. In the public sector, this means the Heads of Treasuries Accounting and Reporting Advisory Committee (HOTARAC) representing Commonwealth, State and Territory treasuries and finance departments, and the Australasian Council of Auditors-General (ACAG) representing Australian and New Zealand Auditors-General. Because these bodies reflect a considered consensus across jurisdictions, their submissions are particularly valuable for issues with impacts across the Australian public sector. The Board is also very keen to hear from users of public sector financial statements, given the strength of representations from HOTARAC and ACAG.

The AASB's public sector agenda

On those occasions when changes in accounting standards appear in the Australian press, it is usually the impact on companies that grabs the headlines. So some might be surprised to hear that, in addition to projects that may affect both the public and private sectors, the AASB is working on several projects specifically addressing public sector financial reporting.

Reduced Disclosure Regime

As you may be aware, the AASB is proposing to introduce a reduced disclosure regime (RDR) that would reduce disclosure requirements for many entities in the public and private sectors. This project originated in an IASB project to simplify accounting standards for small

to medium entities. Most recently, the AASB has released an exposure draft of proposed changes under the RDR.

The existing IFRS requirements would continue to apply to publicly accountable for-profit entities, federal, state, territory and local governments, and universities. Subject to feedback on the exposure draft, all other entities would have the option of reporting under the RDR, with the approval of their regulators. For these entities, recognition and measurement rules would be unchanged, but many disclosure requirements would be removed. For example, most of the detailed disclosures of the fair value of financial instruments would not be required. Also, the requirement to disclose the amount expected to be received or settled after 12 months, for each line item in the balance sheet, would be removed.

The AASB has considered the public sector in this RDR process. The proposals would not change whole of government or general government sector (GGS) reporting, but governments could adopt the new regime for some, or even all, of their controlled entities. This would be an opportunity for some parts of the public sector to reduce the volume of disclosure and still provide meaningful general purpose financial reports to Parliament and the public. I would emphasise, however, that these are only proposals. Some will no doubt argue that no government entity should be allowed to reduce its disclosures. Public sector CFOs should take an active interest in this project, particularly if they have strong views on whether or not public sector disclosures could be reduced without impairing accountability.

GFS-GAAP harmonisation

In 2002, the FRC gave the AASB a direction to undertake GFS-GAAP harmonisation. In practice, this means incorporating elements of the Government Finance Statistics framework of the Australian Bureau of Statistics into public sector accounting standards. Progress has been substantial. The AASB has already issued a standard for reporting at the whole-of-government and GGS levels. Recently, the AASB has been considering whether GFS principles and methods should be incorporated in reporting by entities within the GGS. There has been considerable debate on this latter issue, with comments from constituents both for and against such a change. The AASB has spent considerable time weighing up these comments.

At this stage, the AASB has requested further work be undertaken to address the issue of reporting by entities within the GGS, including looking broadly at disaggregated reporting, administered items and the inclusion of budgetary information in financial statements. If this progresses, after Board consideration, a further exposure draft is most likely. This has the potential for significant changes to public sector reporting, and I suggest that every CFO of an entity within the GGS would be interested in the outcome.

Related parties

Australian standards currently do not require not-for-profit public sector entities to disclose executive remuneration, although departments of finance and treasuries typically fill this gap with their own requirements. The AASB intends to review current disclosure practice and consider whether Australian Accounting Standards should mandate standards for related party transactions, including executive remuneration disclosures, for not-for-profit public sector entities.

Income from Non-Exchange Transactions

In conjunction with the NZ FRSB, the AASB is undertaking a project on income from non-exchange transactions. This encompasses reporting of grants and taxes, items which constitute the vast majority of Australian governments' income. The issue of when to recognise income from grants has been a particular focus of the debate. At the moment, the AASB is exploring an approach that would defer recognising income from grants (that is, recognise liabilities) until the grant recipient met enforceable obligations in the grant agreement.

Control in the public sector

The concept of control is an important one for both the private and public sectors. It determines which assets and liabilities are included in entity financial statements (including the treatment of administered items), and which entities are included in consolidated financial statements. Applying this concept to the public sector raises specific issues, which the AASB has commenced a project to address.

Long term fiscal sustainability

Long-term fiscal sustainability reporting is of particular relevance to Australia, where Intergenerational Reports are issued every five years by the Treasury to assess the fiscal sustainability of Australian Government policies over a 40 year time horizon. The IPSASB is seeking comments on how information on long-term fiscal sustainability could be incorporated into general purpose financial reports.

The preliminary view of the IPSASB is that information about long-term fiscal sustainability should be included in general purpose financial reports, either in the form of additional statements or summarised projections in narrative reporting, and that the key assumptions underlying projections should be disclosed. At this stage, the IPSASB takes the view that long-term fiscal sustainability reporting should be limited to whole-of-government reporting and not required at the individual entity level.

If fiscal sustainability information were to become a permanent feature of annual financial statements, there would be added demands on preparers and auditors to ensure the information was relevant and reliable. Furthermore, an investigation into the concept of sustainability may also be beneficial, by challenging current concepts of financial position, not only in the public sector, but in the private sector as well.

Performance reporting

As an example of how the public sector may be indirectly affected by changes in standards for other sectors, consider the issue of performance reporting for private sector not-for-profit entities. The AASB has a project on this topic, investigating what financial and non-financial information should be included in general purpose financial statements to enable users to assess the performance of entities. Although the public sector is not in scope, as the expectation is this project will be completed in a reasonably tight timeframe, it is likely that the final result of the project would influence the AASB when it goes on to examine the same issue for the public sector.

How to influence the process

Having explained some of the influences and topics on the AASB's agenda, I turn now to some specific suggestions for CFOs seeking to influence the AASB.

The first point to make is an obvious one: be informed and up to date on the key issues that are likely to affect the public sector generally and your portfolio and agency specifically. If you don't know what the current issues are, then you will not be well placed to influence the debate or the outcome.

There are many available sources of information on upcoming changes to accounting standards from a range of sources, including standard setters, the major accounting firms, and the ANAO. The AASB has alerts, updates and e-newsletters available free of charge through on-line subscription. There is also an AASB work program on the AASB web site, listing each project and the expected timing of any exposure draft or final standard.

In fact, there is so much information available that it is necessary to be selective. When the IASB upgraded its suite of standards five years ago, it undertook to make minimal changes in the following five years to ease the transition burden for countries wishing to adopt its standards. This period is now over and we are seeing increased activity by the IASB, which translates into more material to read about proposed changes. Few CFOs would have the time to read all this material.

However, there are ways of dealing with the volume of information on changes to accounting standards. Some of what is produced will only, or primarily, relate to the private sector. Often reading a summary of a document will indicate whether it is likely to substantially affect the public sector. For example, changes in the standards relating to entities buying goods and services with their own shares are irrelevant to any entity without share capital. If your time is too limited even for this, you may nevertheless be able to review the AASB work program from time to time and follow progress on projects relevant to your entity.

Another important factor in influencing the process is choosing the right time to intervene. Because Australian Accounting Standards are largely based on IASB standards, it is difficult to make changes once the IASB has put a standard in place. Any efforts to influence IASB standards need to be made before the IASB finalises its standard. The IASB is unlikely to revise its standards because of late comment from the Australian public sector, especially since the IASB openly states that its standards are designed for use by for-profit entities.

The for-profit focus of the IASB does not prevent the AASB from amending Australian standards to meet the needs of the public sector. So it is possible to approach the AASB at any time and request a modification of Australian Accounting Standards. However, this does not mean that the AASB will overturn accounting standards simply because the public sector, or even the AASB, would have preferred the IASB to have come to a different outcome. To ensure rigour in the process of modifying Australian Accounting Standards, the AASB and the NZ FRSB have developed a policy for deciding on when to modify standards, or create new standards, for not-for-profit entities.

Under this policy, modifications to IFRSs for not-for-profit entities may be required when the IASB's for-profit focus means an IFRS does not appropriately address not-for-profit issues. In deciding this, the AASB would take into account: the nature of transactions, events and

circumstances and their impact on not-for-profit entities; benefits to users of complying with the IFRS; costs of complying with the IFRS; and whether the differences are sufficiently significant as to warrant a modification to IFRSs for not-for-profit entities.

The AASB holds the view that there are few transactions, events and circumstances that apply uniquely to not-for-profit entities. However, some transactions, events and circumstances are much more common amongst not-for-profit entities and therefore may warrant a separate standard or guidance. For example, non-cash-generating assets, and non-reciprocal transactions such as taxes and grants, are much more common in the not-for-profit sector. Also users' information needs may be different, with a lesser focus on profit and a greater focus on service delivery, efficiency and fiscal sustainability.

The mere fact that a difference exists between the for-profit and not-for-profit sectors does not mean that the AASB will modify its accounting standards. Modification is more likely where the difference is significant, will have a significant impact on financial statements, and where the benefits of the modification exceed the costs.

In deciding what modification to make, the AASB would firstly consider the requirements of its conceptual framework, the *Framework for the Preparation and Presentation of Financial Statements*. The AASB would then consider other relevant authoritative material, including: departures from IASB standards adopted in IPSASB standards; the IPSASB conceptual framework, when this is completed; pronouncements issued by another national standard setter using a conceptual framework similar to the AASB; and the Government Finance Statistics Manual. Consequently, CFOs seeking a modification to Australian Accounting Standards are more likely to be successful when their arguments are consistent with those documents.

The full text of the AASB policy *Process for Modifying IFRS for PBE/NFP* is available from the AASB website.

As can be seen from the above, the AASB takes into account the costs to preparers as well as the benefits to users in making decisions about modifying standards. Since, however, the purpose of financial reports is to provide information benefits to users, submissions that focus entirely on the costs to preparers are less likely to succeed than those that also identify benefits to users.

Avenues for influencing the AASB

There are several avenues for influencing the work of the AASB.

The simplest approach is to write directly to the AASB, setting out the issue and proposing a solution. This might be appropriate where the issue only affects a single entity. Typically, however, the issue is common to a number of entities, either within your jurisdiction or outside it. In such cases a better approach might be to seek a joint submission with other parties.

Alternatively, you may approach the AASB through your department of finance or treasury. These entities are experienced in making submissions to the AASB through HOTARAC, and can provide a whole-of-government perspective. Representations from HOTARAC and ACAG have had a significant influence on the AASB's work program for the public sector.

For example, ACAG wrote last year to the AASB indicating Auditor-Generals' priorities for improving accounting standards for the public sector. The letter identified five areas as high priority:

- Grants*
- Public-private partnerships, specifically accounting by the public partner*
- Infrastructure, heritage and cultural assets
- Intangible assets created by government
- The concept of control and significant influence as it relates to the public sector*

Three of these items (marked with an *) are now active projects on the AASB work program.

You may be able to raise the issue through your professional body. The professional bodies in Australia regularly make submissions to the AASB and the rigour and professionalism of their work is well recognised.

On some issues, the AASB will hold roundtables, where interested parties can participate with AASB members and staff in a discussion about a proposed standard. The AASB has found this a helpful method of receiving input. In 2009 there was a very useful roundtable discussion in Canberra on GFS/GAAP harmonisation, attended by CFOs and financial reporting staff from several public sector entities. I hope we see more roundtables on public sector issues, and that more staff of public sector entities attend.

The AASB may also appoint stakeholders to a project advisory panel: a group of people with expertise in a particular topic. Panel members may be asked to provide advice and comments to staff and/or the AASB members as agenda papers are developed to address an issue.

Of course, you can and should raise issues of financial reporting with your auditors. Speaking for the ANAO, we would much rather be consulted up front than be drawing attention to problems at the eleventh hour or after the event.

Submissions to the AASB need not be lengthy. If there is only a single issue you wish to raise and it can be dealt with in two paragraphs, that is fine.

Successful examples of influencing AASB

To demonstrate that influencing the AASB is not just a theoretical possibility, I would like to give two examples of public sector stakeholders influencing the AASB. The first relates to an approach by a single government department with a very specific problem. The second relates to a broader approach from the public sector as a whole, which fundamentally changed whole-of-government reporting in Australia.

When Australia adopted IASB standards in 2005-06, the Department of Defence was faced with a problem. The transitional provisions developed by the IASB could only be used by entities that made an explicit and unreserved statement of compliance with Australian Accounting standards. Defence needed to use those transitional provisions, but because of long-standing problems in accounting for inventories and related items, could not make an explicit and unreserved statement of compliance.

Defence approached the AASB, who issued an amendment to the relevant standard. That amendment allowed not-for-profit public sector entities to access the transitional provisions, where there were extreme difficulties in complying with Australian Accounting Standards due to information deficiencies. As a result, Defence's problem was overcome.

In 2002, representatives of the heads of treasuries and departments of finance approached the Financial Reporting Council with a view to bring together Australian Accounting Standards and the GFS framework of the Australian Bureau of Statistics. The FRC issued a direction in December 2002 (modified in April 2003) and the AASB responded. In September 2006, after much debate, the AASB issued AASB 1049, addressing reporting by the GGS. In October 2007, the AASB extended that standard to include whole-of-government financial reporting.

As previously mentioned, the AASB is currently involved in a further phase of the GFS/GAAP harmonisation project, looking at the possible extension of GFS/GAAP principles to financial reporting by entities within the GGS. As part of its consultations on this project, the AASB held a roundtable in Canberra in 2009. It was pleasing to see several CFOs and other representatives from line agencies, and I know that the AASB took their comments very seriously in its deliberations. We are still waiting to see what the final outcome of this phase of the GFS/GAAP harmonisation process will be.

Summary and Conclusion

The pace of change in public sector accounting may have slowed from the hectic days of the introduction of accrual accounting. Strategic issues are now receiving more attention, including the platform for public sector standards going forward, harmonisation with New Zealand, harmonisation with GFS and the nature of the public sector reporting entity. There is still a range of public sector issues to be resolved, including accounting by grantors and the concept of control in the public sector. Change will continue and will keep demanding responses from standard setters and preparers of financial statements. The Australian public sector, with the experience accumulated over the past 15 years, is well placed to deal with that change. The knowledge and skills of CFOs and their staff are not just a vital resource for their own agencies, but also for the AASB as it seeks to further refine public sector reporting.

The examples I have given show that it is possible for public sector stakeholders to influence the development of Australian Accounting Standards. The AASB, which is rejuvenating its public sector work program, is a willing partner in this exercise. The Australian Government public sector has had a long history of contributing to the public sector standards in question. I would encourage you to continue to work to improve financial reporting, not just for your own entity, but for the public sector, and the community, as a whole.