

Department of Treasury and Finance

“Public Sector Standard-Setting:
on the Yellow Brick Road?”*

address to the

National Institute of Accountants

Government Accounting Masterclass

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Introduction

The Yellow Brick Road is probably best known to today's audience from the title of the Elton John song "Goodbye Yellow Brick Road" but John's lyricist Bernie Taupin borrowed it from Frank Baum's childrens' story from 1900 "the Wonderful Wizard of Oz".

The central character in the story is 12-year-old Dorothy who is transported to Oz after her house is hit by a tornado. After various adventures, she discovers that she needs the help of the Wizard of Oz to get back home to Kansas, and to get to the Emerald City, where she will find the Wizard, she must follow the Yellow Brick Road.

Along the way, she is accompanied by her dog, a Straw Man lacking a brain (actually a Scarecrow but forgive me a little licence), a Tin Man lacking a heart and a Cowardly Lion.

The Yellow Brick Road is the path that leads to answers to some really important questions in the Wizard of Oz story, though the answers were not quite what Dorothy and her friends were expecting.

I imagine you are wondering what the Wizard of Oz story has got to do with public sector standard-setting. I will explain later but the answer is "not much"! It just shows what desperate measures people will stoop to in an effort to make entertaining an address on this dry subject!

We will get back to the Wizard of Oz later. In the meantime, I plan to focus on the following themes:

- the state of play with Australian public sector standard-setting;
- the emerging role of the international standard-setters;
- the Australian Accounting Standards Board's limited response to public sector priorities;
- who can make a difference, and why should they?; and
- my thoughts on the future – whether public sector standard-setting is on a Yellow Brick Road?

I want to emphasise that I am speaking today on my own behalf (and most definitely not as a member of the Financial Reporting Council) and that the opinions I will express are my personal views and should not be associated with either the Financial Reporting Council or my employer.

The Current State of Play

For the majority of the past two decades, Australia has been considered amongst the world's leaders in the development of accounting standards for the public sector.

During this period, there have been a number of key developments in public sector accounting, including:

- the introduction of accrual accounting and reporting within all jurisdictions (which occurred from the 1990s onwards);
- as a result of the Australian Government's CLERP reforms, the merger of the former Public Sector Accounting Standards Board and the former Australian Accounting Standards Board, to form (in 2000) a single statutory standard-setting Board, the current Australian Accounting Standards Board;
- the application of Australian Accounting Standards, based on International Financial Reporting Standards, to all levels of government (in 2005); and
- most recently, the part-completed harmonisation of Generally Accepted Accounting Principles with Government Finance Statistics reporting.

Since the commencement of Australia's new standard-setting arrangements, the AASB has adopted a sector-neutral approach to the setting of Australian Accounting Standards.

That approach is to base Australian Standards, Interpretations and Conceptual documents on those of the International Accounting Standards Board, but to make such modifications as the AASB considers necessary, so that (with a small number of exceptions) each Standard may apply to all entities.

In developing this single set of standards, the AASB also has regard to the standards of the International Public Sector Accounting Standards Board in respect of issues affecting public sector and not-for-profit entities, however the reliance placed on individual International Public Sector Accounting Standards varies widely. IPSASB, as you probably know, is a creation of the International Federation of Accountants, itself a federation of the professional bodies worldwide.

In 2006, the AASB agreed that, while sector-neutrality should remain as one of the Board's strategies, it should be re-expressed in terms of like transactions being treated in the same manner by all entities, whether in the for-profit sector; the not-for-profit private sector; or the public sector, unless there is a sound reason to be different in particular circumstances. This approach is described as "transaction-neutrality".

As part of the stakeholder consultation for the FRC's Review of Sector-Neutrality (the Simpkins Review), the Australian public sector generally agreed that transaction-neutrality is an appropriate fundamental principle for accounting standard-setting.

However, because IFRS is currently focused towards the for-profit sector, and does not deal comprehensively with public sector issues, there are a limited number of cases where so-called “Aus paragraphs” may be required. By way of example, such issues include non-exchange transactions, assets with no active market and non-cash generating assets, but there are many others.

The implementation of IFRS posed significant challenges for both the for-profit sector and the public sector. While many of these challenges were shared, there were also significant differences in the challenges faced by each sector.

It is clear that the vast bulk of Australia’s GAAP accounting framework easily applies to the public sector. However, the different objectives and constraints faced by the for-profit and public sectors necessitates some specific tailoring of the rules for presenting their respective financial positions.

It is crucial that the application of the AASB’s transaction-neutrality principle ensures that the differences between the public and for-profit sectors can continue to be accommodated, otherwise there is a serious risk that public sector financial reports may lose their relevance to users.

An issue that is central to this question is the conceptual framework that applies to public sector accounting and reporting.

Statement of Accounting Concepts SAC 3 *Qualitative Characteristics of Financial Information* notes that financial reports are to be presented in a manner which satisfies the concepts of comparability, understandability, relevance, reliability and timeliness. These criteria are interdependent and each is necessary for financial information to meet the needs of users and be clearly understood.

However, in my view, the key principle for public sector reporting is comparability. The users of public sector financial reports need confidence that information is consistent over time and is comparable with other similar entities (at a point in time and over time). When I say “similar”, I am referring to the comparison with other entities within the jurisdiction and across other jurisdictions.

This implies that financial reports should be consistently presented by a government (both consistent over time and with other key government reports, such as budgets), and that the reports are comparable with other similar entities.

The issue of comparability is the fundamental basis of why users want the public sector to produce financial reports. Comparable information enables valid comparisons to be made over time within each jurisdiction and between other jurisdictions. It requires the use of consistent accounting principles and methods.

In my view, it is essential for public sector accounting standards to be based on a sound conceptual model that is appropriate to the public sector context and which supports a set of standards that are relevant to both budget and outcomes reporting.

The Role of International Standard-Setters

Prior to the adoption of IFRS in 2005, standards for the for-profit and public sectors were developed in Australia by the AASB.

Since 2005, the Australian Accounting Standards are derived from IFRS and, subject to the AASB's transaction-neutrality policy, are amended for the public sector, if necessary.

The AASB has been actively participating in the development of new, or amended, IFRS by providing comments on IASB Exposure Drafts. The AASB also provides comments on IPSASB Exposure Drafts, and provides resources and support to both international standard-setters.

The Australian public sector, particularly the Australasian Council of Auditors-General and HoTARAC, strongly supported the adoption of Australian equivalents to IFRS and continue to support, to the maximum extent possible, the use of transaction-neutrality. However, there exist conceptual and technical issues in applying a for-profit framework to accounting and reporting for the public sector.

At an international level, it is important to note that the IASB's Conceptual Framework was developed primarily to accommodate the needs of the for-profit sector. As the AASB utilises a minimalist approach to adding material for the public sector and not-for-profit entities, the level of guidance may be inadequate for these sectors. This is likely to be exacerbated by the ongoing convergence of the IASB with the United States' Financial Accounting Standards Board, which may cause the current international standard-setting framework to lean towards a greater accommodation of for-profit sector needs at the expense of the needs of the public sector.

As I noted earlier, the AASB may refer to the standards of the IPSASB in respect of issues affecting public sector and not-for-profit entities, particularly in those cases where the IASB's guidance is inadequate.

Over the past decade, HoTARAC has supported the work of the IPSASB on public sector issues of common interest, including consultation with the IPSASB on its work program priorities, participation in its consultative groups and providing comment on relevant Exposure Drafts and IPSAS. Indeed, HoTARAC and IPSASB have two members in common.

While the IPSASB is currently the nearest thing to an international public sector standard-setter, its past track record shows limited progress on public sector issues of interest to Australian jurisdictions.

The Australian public sector is strongly supportive of the IASB and remains committed to the international harmonisation of accounting standards. It is disappointing that a similar model is not in place (internationally) for the public sector, however the IPSASB is currently some way behind the AASB in dealing with many public sector issues.

This is a significant ongoing concern for the Australian public sector and, until more focussed action is taken, this means that HoTARAC does not support harmonisation with IPSAS. Rather than considering widespread adoption of all IPSAS, HoTARAC's view is that the AASB should continue to consider the content of each IPSAS on its merits and decide whether the particular content of individual standards is in the best interests of the Australian public sector.

This raises a significant gap, in terms of identifying an international public sector standard-setter that is well positioned to address the issues of relevance to the Australian public sector.

The IASB has indicated that it is responsive to taking a role on public sector issues in the longer term, but is overwhelmed by other priorities at present.

HoTARAC is strongly of the view that a single world-wide standard-setter, covering all sectors and classes of entities, is an important goal. To this end, it sees great merit in developing a merger path between the IASB and the IPSASB, as a means of achieving a single international standard-setting body for the for-profit and public sectors. Over the past few years, HoTARAC has made a number of submissions to both Boards to this effect.

It is interesting to note that the question of having one international standard-setter is currently being considered by the IASB's parent body, the International Accounting Standards Committee Foundation, as part of its ongoing constitutional review. It is understood that the AASB and the FRC have both made submissions to the review, supporting a move towards one international standard-setter for all entities, while also acknowledging that each Board currently has many issues on its work program. The aim of having one international standard-setter and transaction-neutrality is considered desirable, by both bodies. This would ensure world-wide consistency and avoid duplication of very scarce standard-setting resources and expertise.

Public Sector Concerns

Since the Australian Equivalents to IFRS were introduced in 2005, the AASB has utilised a minimalist approach to adding material for the public sector and not-for-profit entities. In many cases, the level of guidance for these sectors has been significantly reduced, which has led to reporting that does not adequately meet the needs of the users of public sector financial reports.

The IASB's primary focus on the needs of for-profit entities means that generally it has applied a practice of firstly considering the for-profit sector's perspective, with the public sector's perspective only being considered if issues arise, which in some cases may be many years later (service concession arrangements is a topical example of this).

In the majority of cases, the same process and prioritisation of issues has also been adopted by the AASB. This can be counterproductive, particularly in the instance where there are specific public sector transactions (for example statutory receivables) or when transactions are between the public and for-profit sector such as for service concession arrangements or accounting for an emissions trading scheme.

In general, public sector issues fall into four categories:

- Issues that are specific to the public sector – These transactions are unique to the public sector and are rarely, if ever, encountered in the for-profit sector. Examples of such issues are appropriations; grants between governments; statutory rights and obligations; and administered items.
- Issues that have a different context than the for-profit sector – Such issues generally arise due to the different objectives of public sector reporting, the different activities that the public sector undertakes or the different environment in which it operates. For example, the concept of control, the difficulty of assessing market value, the scarcity of equity instruments, together with the non-profit oriented characteristics of the public sector environment, create difficulties in applying a for-profit focussed framework.
- Transactions between the public sector and the for-profit sector - In these instances, it is crucial that the standard-setter fully considers the perspectives of both counterparties. With regard to service concession arrangements, it is only very recently that the grantor's perspective, which is usually the Government, has been considered by standard-setters. More topically, the majority of literature on accounting for an emissions trading scheme only refers to the for-profit sector perspective.
- Information that is not relevant for the public sector – Due to the public sector's focus on accountability and stewardship rather than profit, together with its different risk profile, a number of current Accounting Standards result in the provision of information which is of limited use to users, such as many of the financial instruments disclosures or the use of point-in-time discount rates for valuing many long-term liabilities and assets. Other information of limited relevance for the public sector includes disclosures on related parties or key management personnel.

In 2006, ACAG and HoTARAC provided to the AASB a joint Paper titled "Gaps in GAAP". The Paper identified issues for Australian public sector preparers and auditors in the implementation of IFRS, although not all of the issues were exclusive to the public sector. The gaps in GAAP exercise was based on significant work by both ACAG and HoTARAC, as peak bodies representing significant groups of public sector stakeholders, and was a very thoughtful exercise that was designed to express to the AASB the key priorities for public sector standard-setting issues.

The Gaps in GAAP Paper was considered by the AASB in 2007, and was largely set aside, with the AASB finding reasons to progress very little, if anything, on the public sector's list of priorities. To date, a significant number of those issues are yet to be fully resolved, although some still remain on the current AASB work plan, albeit with a very low priority.

The scant regard paid to the Gaps in GAAP Paper brings into focus the AASB's current method of considering public sector issues as part of the standard-setting process.

In Wizard of Oz parlance, the fate of the Gaps in GAAP paper might be Dorothy's dog.

HoTARAC is seriously concerned about the way that the AASB is going about its business, where it is allocating its resources and what it sees as its function and priorities. I understand that ACAG shares similar concerns. The AASB's current Work Program devotes a very large proportion of the AASB's resources to for-profit activities, presumably on the basis that Australia should continue to try and exercise some influence over outcomes via the IASB. However, the reality is that Australia has little influence on international standards and the resources devoted to such issues are generally ineffective.

In contrast, the AASB Work Program devotes minimal resources to the public sector. Virtually all of the important public sector and not-for-profit projects are regarded as low priority (at best), meaning that issues of critical importance to these sectors are getting no AASB resources, and therefore that no progress is being made.

A notable exception from the past has been the AASB's work on GAAP-GFS harmonisation, where at the instigation of the FRC, a substantial effort resulted in a Standard that has achieved world-wide recognition.

But there are many examples of important standard-setting projects that have been languishing for years for want of resources. Of these, examples such as control in the public sector, measurement of long-term financial liabilities, Budget reporting and service concessions come to mind immediately.

Of separate, but related, concern is the fact that the AASB is increasingly devoting resources to its involvement with various other bodies that have an international focus, such as the national standard-setters group and the proposed new Asia-Pacific group. This also reduces the capacity of the AASB to devote intellectual effort and other resources to domestic public sector and not-for-profit issues - or to Trans Tasman Convergence which I see as very worthwhile. It is unfortunate that the AASB is committing to such broad-reaching activities in preference to getting on with the many important topics that remain on the domestic public sector and not-for-profit agenda.

The low priority being allocated to public sector issues by the AASB was discussed by HoTARAC at its June 2009 meeting. HoTARAC concluded that it was likely to be more effective to focus the AASB's attention on a small number of high priority issues rather than a larger list such as the Gaps in GAAP Paper. In view of the relatively scarce resources currently being devoted to public sector issues by the AASB, this appears to be the best way to ensure that progress is made on the most important matters.

The recent commencement of the new AASB Chair, Kevin Stevenson, makes it very timely for instigating discussions on increasing the priority and resources being allocated by the AASB to public sector issues. And, to be fair, while it is still early days, the attitude of the new Chair to public sector issues appears to be good and the future looks (somewhat more) promising.

Making a Difference

Despite these promising future prospects, the current public sector framework is symptomatic of a prolonged and unfortunate history of insufficient focus by Australia's standard-setters on the public sector.

At many levels, within the accounting profession and the standard-setting fraternity, there remains a lot of ignorance and apparent unwillingness to think about public sector accounting issues at a conceptual level. There is still a flawed but common attitude that for-profit GAAP is immutable and standards don't need any tailoring to suit the public sector context.

The level of attention given to public sector issues tends to reflect the profile of the AASB's membership. In the past, the majority of the AASB's membership was drawn from the for-profit sector and, consequently, the AASB appeared to have a lesser interest in, appreciation of, or understanding of public sector issues.

However, in more recent times, the composition of the AASB has changed to include more public sector representatives. This will increase the potential for Board members to become more heavily involved in the development of standards for the public sector.

While the AASB's capacity to address public sector issues appears to be improving, AASB members need to accept that they have been chosen for their potential contribution to standard-setting in general rather than for their expertise in a particular area or sector. All AASB members should be expected to apply their skills across the full range of issues before the Board. While this will require AASB members to quickly attain familiarity with issues that are unfamiliar to them, it is as much of a challenge for those members with public sector backgrounds to understand certain for-profit sector issues, as it is for members with for-profit backgrounds to get their heads around some public sector issues.

Notwithstanding the recent changes to Board representation, it is not acceptable for the public and not-for-profit sectors to wait for a long time for progress to be made on relevant standards. The AASB needs to develop strategies that enable it to better meet public sector needs. This requires appropriate consultation with users and preparers, and sufficient resources being devoted to developing standards for the public sector and the not-for-profit sector.

There is a range of issues that needs to be addressed in the public sector and the broader not-for-profit sector. Issues of concern with the AASB's Conceptual Framework include:

- the term "reporting entities", as defined in SAC 1, does not fully accommodate the needs of not-for-profit entities;
- discussion on the objectives of general purpose financial reports, and users of these reports, is restricted to for-profit entities;

- guidance on the qualitative characteristics of financial reports, materiality, equity, and the capital maintenance concept, is geared towards for-profit entities; and
- stewardship and accountability, rather than profit, are important issues for the public sector.

In addition to these conceptual issues, the Chair of Heads of Treasuries has recently written to the AASB and the FRC seeking a review of the Accounting Standards in relation to the fair value measurement and presentation of long-term financial liabilities and other long term provisions, particularly in respect of superannuation liabilities. This issue is a high priority for the Australian public sector.

Other public sector priority issues include:

- control in the public sector;
- non-exchange income and transactions;
- accounting for environmental initiatives;
- borrowing costs; and
- accounting for public private partnerships (service concession arrangements) from the grantor's perspective.

As noted earlier, there are fundamental differences in the operating environments of for-profit businesses and public sector entities. The consequence of these differences is that concepts and practices developed for the for-profit sector may not always be appropriate for the public sector.

Because the underlying business model for the public sector is different from that of for-profit businesses, the underlying conceptual framework is inadequate for the public sector. Current Australian GAAP does not adequately reflect the differing accountabilities and user needs of the public sector.

In order to inform the development of a replacement public sector conceptual framework, the needs of public sector users should be considered in detail by the AASB and the conceptual framework revised in accordance with those needs. Given that the AASB needs to keep its for-profit standards fully aligned with IFRS, meeting these public sector needs will be very challenging unless the IASB broadens its focus, which is not in prospect. I certainly do not underestimate the intellectual and practical challenge here. But we don't want the AASB looking like the Cowardly Lion of the Wizard of Oz. Courage is definitely needed!

A Public Sector Statement of User Needs for the Australian setting may be a useful tool for the AASB to reflect the specific needs of public sector stakeholders and to provide a context for its public sector standard-setting activities, within a fully IFRS harmonised context.

In addition, consistent with its Trans Tasman Convergence model, the AASB should consider closer liaison with New Zealand's FRSB, which appears to have a standard-setting model which is closely aligned to Australia's.

Greater clarity also needs to be provided by the AASB regarding the role of, and its interaction with, the IPSASB. The AASB should give due consideration to, but not be bound, by IPSASB requirements. To be fair, this is the AASB's track record to date but it would be good to have that approach more explicitly stated. Once its preferred approach is formally decided, the AASB needs to provide appropriate guidance to public sector stakeholders.

Australia's Heads of Treasury envisage a significant and enhanced role for the AASB in determining public sector accounting and reporting requirements for Australia in the future. Such a role should also involve the AASB taking a leadership role in public sector standard-setting internationally.

However, in order to achieve a level of transaction-neutrality suitable to the public sector, it is of critical importance for the AASB to ensure that adequate resourcing and priority is given to public sector issues, both those that are unique and those where the context is different between the public and the for-profit sectors.

Getting Back on the Yellow Brick Road

It could be perceived that, because this address focuses on "problems", Australia's public sector standard-setting system is fundamentally flawed. That is not in fact my view. Rather, my purpose today has been to identify issues that need to be considered in further enhancing a system that is generally recognised, both domestically and internationally, for its high quality.

I am strongly of the view that our "one Board" model is the right one and I would not support a shift from the current arrangement in which the AASB has responsibility for standard setting across all three sectors – for-profit, public sector and not-for-profit. Indeed, as I noted earlier, I would like to see us progress over time to a single standard setting body worldwide with responsibility for all three sectors.

And, I applaud the AASB for its excellent path-breaking work in developing AASB 1049, a standard which harmonises GAAP and GFS for the General Government and Whole-of-Government Sectors. AASB 1049 is a world first and has propelled the Australian public sector a long way forward in terms of reporting by Governments.

I am disappointed that the last stage of the GAAP-GFS harmonisation project, the extension to entities within the General Government Sector such as Government Departments, is not progressing quickly to completion. This is so notwithstanding the issue by the AASB in January 2009 of an excellent Exposure Draft, ED 174 which appears to be very close to an excellent standard. At recent meetings, the AASB appears to be having second thoughts about completing the project by issuing a standard based on ED 174. Hopefully, the AASB's second thoughts will pass and we will be able to look back on them with the same benign affection that we hold for the Straw Man of the Wizard of Oz!

The leadership of the AASB in setting public sector standards for Australia would have significant stature internationally. Given that the development of international public sector accounting standards currently lags behind that of the for-profit sector, there remains significant scope for the AASB to provide a lead to the rest of the world in relation to the eventual convergence of accounting standards for the public sector.

However, the AASB needs to come to the exercise with an open mind and be willing to adopt treatments which best meet the unique needs of the public sector. This will deliver Australian public sector accounting standards which fully satisfy the needs of users and will enable the AASB to play a leading role at an international level.

Our Australian standard-setting arrangements look to me like a Yellow Brick Road, though we do not seem to be moving very fast along that road at present. With some changes in perspective, and a better allocation of intellectual horsepower and resources to public sector issues, I see no reason why that road won't take us to the Emerald City of public sector standards.

Conclusion

In concluding my remarks today, I note that the future of public sector standard setting in Australia will be shaped by the outcome of the debate on priorities and resourcing. This has significant implications for public sector preparers, users and standard-setters depending on the AASB's response to the concerns of its public sector stakeholders.

If meeting the needs of public sector users requires a departure from the principle of transaction-neutrality, so be it. Where the public sector context requires a different treatment, the accounting standards should reflect that requirement.

Australia possesses a unique opportunity to lead the world in public sector standard-setting, but the AASB needs to act quickly and decisively, to get us travelling steadily on that Yellow Brick Road.

We all have a responsibility to actively participate in the AASB's processes, particularly by promoting the importance of public sector issues in the priorities of the AASB and persuading the Board to improve its focus on public sector issues.

Finally, to close the Wizard of Oz story, I should remind you that Dorothy woke up and discovered that everything that had happened in Oz had been a dream!

I hope that our public sector standard-setting journey ends as happily.

Thank you for your interest and attention.

End Notes

- The opinions expressed in this paper are those of the author and are not to be associated with the Financial Reporting Council or his employer.
- I am grateful to Craig Jeffery for his considerable assistance in the preparation of this paper.