The School of Accounting Public Sector Research Agenda

REPORT TWO:

The Second of Two Reports to the Heads of Treasuries Accounting and Reporting Advisory Committee into the Reduced Disclosure Regime and Other Elements of Public Sector Financial Reporting

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Introduction – This report series

The School of Accounting at Curtin University is very pleased to lead this project with the Heads of Treasury Accounting and Reporting Advisory Committee and we consider that it is an important and useful body of work. The public sector in Australia is central to the development and maintenance of our Civil Society and the work it does is critical to our economy, our society and our future. The use of financial and other resources is necessary of course for the successful achievement of government policy in all jurisdictions. However, the transparent and effective reporting to Users\(^1\) of outcomes relating to resource allocation (whether in terms of money, asset deployment or other allocations) and the financial position and performance of government agencies, business enterprises and Whole-of-Government reports at the jurisdiction level is exceptionally important in our Westminster-based federated democracies.

In June 2011, Professor David Gilchrist and Associate Professor Robyn Pilcher (Gilchrist & Pilcher) presented a report to the Western Australian Treasury reviewing the Australian Accounting Standards Board’s (AASB) then newly promulgated (for introduction in 2013) Reduced Disclosure Regime (RDR). In essence, the report reviewed the applicability of the RDR in the Western Australian context and specifically considered the appropriateness or otherwise of adopting the regime.

The report was reviewed by the Western Australian Treasury and, after some deliberation, it was thought useful to discuss the report with the Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC) with a view to that body considering whether or not such a project should be replicated at the national level. At the end of August 2011, Gilchrist & Pilcher forwarded a proposed research plan and other relevant information to the Chair of HoTARAC with a view to gaining HoTARAC’s agreement that a national project was acceptable and outlining the parameters that such a project might take. Subsequently, toward the end of October 2011, HoTARAC confirmed its agreement to undertake the research program.

Professor David Gilchrist attended part of the HoTARAC meeting of 11 November 2011 in order to discuss the project and set out a way-forward. The participants in that meeting made a number of observations regarding the project generally and it was agreed that the project would proceed as soon as possible. Due to Christmas and other timing issues and participant availability, the project proper was not commenced until the end of February 2012. Initial interviews were completed by 30 March 2012. Gilchrist attended the 30 March 2012 HoTARAC meeting and made a presentation regarding initial findings with a view to obtaining comments and discussing outcomes prior to completing the first draft of the report.

\(^1\) As readers will understand, the term User is specific and important in the discussion surrounding the concepts of financial reporting in the Australian sector neutral regime. Here we use the term in its accounting meaning being that a User is a reader of an entity’s financial report that needs that financial information for decision making purposes but does not have the power to command the production of specific financial information. As such, we delineate the term by incorporating the capital “U” when we wish to express the accounting meaning.
It was envisaged that the final draft report would be available by 31 May 2012. However, the date was subsequently moved to 6 July 2012 in time for review at the August 2012 HoTARAC meeting.

This document constitutes the final report for HoTARAC’s review and it is available to HoTARAC for their use and dissemination as they see fit.

This has been an interesting and important project in the context of standards setting for public sector financial reporting in Australia. The initial intention of the project as agreed between Curtin and HoTARAC was to:

1. Examine the extent to which the adoption of RDR in its current form would be of benefit in terms of efficiency and effectiveness in public sector financial reporting.

2. To determine which aspects of RDR are of value and which aspects may not improve the efficiency of preparation and audit.

3. To provide additional recommendations and / or observations to HOTARAC as to the prospects for the adoption of RDR or for any other prospective improvements or enhancements that are identified out of the research.

4. The above three elements would require a review of RDR against full A-IFRS in the context of jurisdictional law and practice to the extent possible.

5. To make the above examinations in the context of the current work of the AASB, IASB and IPSASB regarding such elements as a prospective public sector accounting framework and the like. This element will likely inform the recommendations and comments regarding the RDR as well as inform HOTARAC regarding the effect prospective changes may have on future reporting arrangements.

Subsequent to the initial exchange of letters between Curtin and HoTARAC, there was discussion around extending the practical elements of the project in order to more fully examine:

1. The practical utility that might be found in the application of RDR by jurisdictions; and

2. What other changes might be suggested that would likely reduce the compliance burden, increase utility and make audit more efficient.

Therefore, the primary focus throughout this study has been around efficiency and utility in financial reporting. As a result, the interview process and documentation reviews focused primarily on these issues.
Additional to these foci, the March 2012 meeting of HoTARAC indicated that at least some representatives involved in the meeting were keen to establish very precise recommendations regarding reporting processes and standards with a particular emphasis on what might be changed in terms of the current reporting regime. This second report is intended to fulfil this objective. Additional HoTARAC input will be sought for this current report and it may be reprised as a second edition at some future point depending on the direction that HoTARAC or individual members of that group choose to head in.

As such, the reporting arrangements for this project are:

<table>
<thead>
<tr>
<th>Report Title</th>
<th>Topics / Content</th>
<th>Date Presented or Due</th>
</tr>
</thead>
</table>

The highlighted report above is this report. The balance of this document constitutes Report Two of the School of Accounting’s response to this research program and the findings resulting from a document review process developed out of the research process undertaken in order to complete Report One.

Once again, the researchers would like to express their gratitude with regard to the time and effort taken by the initial interviewees and subsequent responses from members of HoTARAC following the tabling of Report One. We appreciate the candour shown and the importance placed on this process by those involved.
Reprise of Report One – The context, limitations and findings

This section is designed to ensure the context and limitations identified in Report One are considered by readers of this document and that the recommendations and findings included in that report are not neglected in developing an understanding of the issues raised herein. The key elements discussed in this section are:

1. Contextual Limitations and Issues;
2. Findings Reported
3. Recommendations For Further Research

It should be noted that the content of this section is very much truncated in order not to simply repeat content formerly included but in a way such that it provides the reader with sufficient understanding to be able to review this document without necessarily reading the first. However, it is strongly recommended that readers do review Report One prior to undertaking a review of this document as the two reports are intended to be read jointly and we consider that readers should have a full understanding of Report One prior to reviewing Report Two.

1. Contextual Limitations and Issues Identified in Report One:
The contextual limitations cited in Report One are reprised here in order to briefly overview the context of the evaluation of accounting standards as they apply to public sector financial reporting. The key contextual limitations established in Report One are:

a. Relative Homogeneity: The level of homogeneity between jurisdictions across Australia in relation to public sector financial reporting is relatively high predominantly as a result of each jurisdiction’s application of the majority of the Australian Accounting Standards and AUS Paragraphs as they apply to public sector reporting. Similarly, public sector audit is relatively homogenous for the same reasons.

b. Potential Loss of Specificity: The homogeneity discussed in point (a) above may be achieved to some degree by reducing the willingness of jurisdictions to consider reporting frameworks outside of the formal standards arrangements which may mean that, to some degree, informational specificity may be lost in order to achieve compliance. In other words, reporting nuances may be relevant but lost to conformity.

c. Homogeneity Limited: There is a clear limit to the extent that there is full homogeneity within the Australian jurisdictions as far as financial report preparation, presentation and audit are concerned.
d. **Cultural and Historical Differences**: Further complexities relate to the historical place of financial reporting from jurisdiction to jurisdiction, the relationship between public sector entities and central government agencies, the relative capacity of agency finance personnel and the relative size of jurisdictions and reporting entities within those jurisdictions (usually measured by turnover).

e. **Differential Structures and Resourcing of Jurisdictions**: An additional complexity has been identified when considering the relativities of size (by turnover and resource base) of each participating jurisdiction and their capacity for developing policy and practice with regard to financial reporting arrangements.

f. **Resourcing & Capacity for Responding to Prospective Changes in Standards and Methodology**: Together with item (e) above, it was clear that there are very little resources applied to this important area of transparency and accountability within most jurisdictions. There is a reliance placed on larger jurisdictions by smaller jurisdictions to assist in developing responses to proposed changes etc.

g. **Inherent Limitations of Homogeneity**: Extending the comments in (a) above, there were found to be a number of significant differences which tended to result from historical, legislative and cultural frameworks. Indeed, there are reasons why differences exist and, in the broader reporting and accountability framework of each jurisdiction as it applies the Westminster doctrines, it was found that financial reporting homogeneity is not necessarily of universal benefit.

2. **Findings Included in Report One**

The key findings reported in Report One are reprised in this section. This review is necessary as the findings originally reported form the basis for the work done to develop this document. It is important though, that readers appreciate that the best way to understand these findings is to review Report One prior to considering the summarised findings here. Such a review of Report One will assist readers to understand the purpose for the subsequent work that resulted in the major elements of this report. Additionally, readers need to be aware that, as this is a very truncated, summarised version of the original discussion, nuances raised by them if they were participants in the original study may not be reflected here. This is not a reflection on the status of those findings but a reflection on the amount of space able to be allocated to this aspect of the discussion.

The findings are reprised by theme in the same order, and using the same headings, that they were raised in the first report below in the same order as that in which they were raised in the original report. However, high level findings to be noted here include:
i. The jurisdictions interviewed were all deeply interested in improving and making more efficient their financial reporting processes and were supportive of this research program and interested in the findings.

ii. Most jurisdictions reported limited resource capacity for considering the issues and a need to prioritise their work such that practical and immediate considerations often overtake conceptual and policy issues at a standard setting level.

iii. All jurisdictions interviewed confirmed that they provide model financial reports to the reporting entities within their jurisdictions. The number of models provided depended on the jurisdiction’s perception of what was needed and the relative importance of differentiating between organisational types. Depending upon the local usage, these models either constituted recommended or mandatory practice. Some concerns were raised as to the effect of this process and the extent to which CFOs within jurisdictions’ entities were engaged with the standards when considering their reporting processes and whether or not they simply relied upon the regulator.

iv. The place of the Westminster System was not considered to be well understood outside of the public sector and therefore sector neutral pronouncements may not be nuanced to take into account the key elements within constitutional arrangements of jurisdictions. For instance, the separation between parliament, government and the public sector was considered to be not well understood within the standard setting fraternity.

Key findings by theme:

A. Does the RDR provide an opportunity for efficient and effective financial reporting within your jurisdiction?

The majority of interviewees saw minimal opportunity for efficiencies in applying the RDR as it stood at the time of the interviews.\(^2\) The central issues identified were:

- There seems to be an intractable problem regarding the need to consolidate a significant proportion of public sector entities’ financial reports in any one jurisdiction into a set of Whole-of-Government reports.

- Most interviewees felt that the principal reductions allowed to Tier 2 entities did not apply to the types of public sector organisations that might fall into the Tier 2 category.

- The relative size of entities within the GGS of many jurisdictions meant that the RDR may apply but was still considered to be too onerous in the case of micro-entities. Some interviewees reported that they felt there needed to be an

\(^2\) It should be noted that since the interviews were carried out a number of changes have been adopted by the AASB in relation to its RDR. The researchers do not consider that these changes make a material difference to the suitability of the RDR for the public sector as discussed in this section.
additional element to the regime (say a Tier 3) where cash accounting and very simple reporting is allowed.

- It was found that some elements of the RDR were of value to the sector including those reporting reductions pertaining to superannuation and financial instruments.

- Some RDR exclusions were also found to be relevant to some entities within jurisdictions. However, the need to consolidate and the resource intensity of the regulator’s role in providing models for reporting entities meant that these exclusions were unlikely to be able to be implemented where they could be.

- It was identified by a number of interviewees that GTEs / PBEs (government enterprise organisations and public companies wholly owned by governments) also needed to be Tier 1.

- All jurisdictional regulators (i.e. Treasury and Finance Departments) uniformly acknowledged that the implementation of the RDR within their jurisdiction would necessitate their developing additional model accounts for use by the affected entities.

- The RDR pronouncements were not adequate for a number of interviewees who reported that they were concerned that the regime does not address the core concerns of the sector in terms of efficiency and necessity of reporting.

Overall, while it was found that the RDR arrangements were lacking significantly, there was general agreement that the RDR pronouncement does open the door for a fresh consideration of issues associated with public sector reporting and for the development of an alternative reduced disclosure regime pertinent to the GGS.

B. What elements of the current standards regime are major inhibitors to transparency and efficiency of reporting and auditing?

It was unanimously agreed that a major purpose of financial reporting within the public sector is to ensure transparency and accountability. Clearly, in order to achieve such an outcome, the reports created should be as simple as possible and incorporated into a financial management and reporting system that is also simple and clearly understood. Transparency and efficiency of reporting and auditing were found to be effected by the following issues:

- Some felt that reports were too large and intricate for uninitiated Users (such as parliamentarians and the general community) to be able to understand them and utilise them.

- While not directly part of the current standards regime, there is limited resource allocation toward standard application in jurisdictions and toward responding to
AASB and other proposed changes. This has the effect of reducing the capacity for regulators to consider the reporting requirements of their jurisdiction in the context of the priority of transparency and to consider what might be useful and effective changes.

- Differences between jurisdictions’ public sector reporting arrangements were also identified as an issue reducing the capacity of Users to understand reports as there is not a national uniform reporting arrangement.

- The existence of several financial reporting regimes serve to increase complexity and potentially reduce transparency. Each jurisdiction not only implements the AASB pronouncements for financial reporting purposes, but they also have a Budget process outside of the financial reporting process and have to respond to the Government Financial Statistics (GFS). Additionally, some jurisdictions also have local unique reporting requirements related to performance.

C. Who are the Users of your jurisdiction’s financial reports?
The transaction neutral arrangements in Australia mean that the concept of User is considered to be uniform regardless of the sector. The information needs of the User are based on a predominant expectation that Users are those seeking to make financial decisions regarding the reporting entity. Therefore, the current transaction neutral view of the User impacts the development and implementation of financial reports within the public sector. In order to consider the question as to whether or not such a position is warranted in the context of the public sector, it is necessary to identify who those Users are. There was some difficulty experienced by a number of interviewees when asked who they considered to be Users of the financial reports produced by entities within their jurisdiction. Importantly, a number of jurisdictions included central government agencies (such as Treasury) as Users and considered the discipline of applying standards and audit at the sub-government level introduced a level of comfort for those in central agencies seeking to utilise information provided by line agencies and other entities. Interestingly, of those Users enumerated by respondents, the general public was typically identified as an important User but users of a “second order” to other Users. Some respondents included Ministers as Users.

D. Is there a place in public sector reporting for the decision-making focus currently used in the development of accounting standards?
The difficulty experienced in identifying Users was extended when the issue of decision usefulness was raised. The decision essentially being whether or not to provide, withdraw and/or maintain financial resources. However there were a number of findings that led us to question the ongoing relevance of this precept in the context of public sector reporting.
The financial management and reporting framework within the Westminster System as it is generally applied in Australia includes the following macro elements:

i. The Budget Process;
ii. The Half Yearly Budget Review Process (an administrative process but important in this discussion);
iii. The Financial Reporting Process;
iv. The Auditing Process; and

A majority of interviewees agreed that the budget process is the primary decision-making process within their jurisdiction.

Indeed, a majority of participants agreed that the financial reporting process is not used to any great degree in the resource allocation decision making process. Rather, they considered that the financial reporting process itself was extremely important as it:

- Provides a basis for Auditors-General to undertake an assurance process over the accounts;\(^3\)
- Allows for accountable and transparent reporting of actual financial position and performance of each entity and of the Whole-of-Government; and
- Allows for entities to acquit their obligations in relation to the appropriation made available to them by the parliament.

E. What major elements of the current reporting regime are inappropriate for public sector application?

It was considered that community asset recognition and valuation constituted an area of considerable concern and where prospective efficiencies could be gained and simplification made. The discussion around these issues developed out of specific questions regarding perennial issues within the public sector financial reporting framework such as the valuation and reporting of Land Under Roads (LUR) and Community Assets (CAs) which are assets held in trust for the community and are not available for sale nor likely to be sold.

The inclusion of the above types of assets and valuation movements in the financial reports has a tendency to have resource and utility costs as valuation is costly, ineffective\(^4\) and results in the production of information of limited acquittal or, indeed, decision making

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\(^3\) Indeed, one participant indicated that they felt the financial reporting process within the public sector ensured that “[r]eports allow for assurance and examination.”

\(^4\) Most interviewees agreed that the valuation process used for LUR and other CAs was too difficult. Indeed, Valuers General in Australia have not agreed a uniform valuation technique and so values for LUA and CAs comprising land may well be undertaken differently from jurisdiction to jurisdiction.
value. In other words, a number of respondents were querying the purpose of continuing with this practice.

F. What miscellaneous elements are important in this discussion?
There were a number of issues considered beyond those directly related to RDR and financial reporting practices in the context of the AASB pronouncements. These elements were:

i) Jurisdictional resourcing for considering these issues and setting reporting policy and practice – limited people to fulfil the review, analysis and policy making function.

ii) Place of the Westminster System – a lack of understanding outside of the public sector about the role of Parliament, the place of the government and so on.

iii) Broad Capacity within the Sector – the extent to which the sector itself has capacity in terms of people and experience to fulfil its reporting obligations in a more efficient and effective manner.

iv) Transaction Neutrality – extent to which this policy allows for the public sector to acquits its reporting responsibilities.

G. What should HoTARAC consider in terms of strategic ways forward for standard setting for the public sector?
Key thoughts raised during the interview process included:

i) Most interviewees agreed that the current “one-size-fits-all” regime is not adequate to public sector requirements.

ii) Most interviewees did not consider it necessary or practical to establish a public sector standard setter.

iii) Similarly, most interviewees considered that it is not necessary to establish a separate set of accounting standards relevant to the public sector.

iv) Where additional AUS paragraphs or sector specific standards were to be developed and adopted.

v) The AASB’s foundation documents (i.e. the Framework and the Statements of Accounting Practice) could be nuanced to take into account the needs of the public sector.

vi) There is a need to emphasise the cost/benefit decision when considering the content of public sector financial reports.
vii) Financial reporting should have an outcomes emphasis rather than a performance emphasis in the case of performance measurement.

3. Methodology
The purpose of this section of the report is to provide the reader with an overview of the structure and processes adopted in the development and implementation of this report. Readers are referred to Report One in order to gain an understanding of the methodology used to arrive at the findings above and to gain a fuller perspective of the overall research program.

In the development of this report, the research team undertook an extended document review paying particular attention to:

i) A review of the evidence gained in the development of Report One;

ii) The Australian Accounting Standards (AASBs);

iii) The financial reports of each sovereign jurisdiction in the Australian Federation;

iv) A limited literature review; and

v) The Australian Auditing Standards (AuASBs).

Additionally, we have tried to reflect the comments and concerns of the interviewees and the HoTARAC meeting of 30 March 2012 where the first report was discussed. Overall, this report looks to develop the themes identified out of previous work and develop the thinking.

4. Aims of Report Two
Having reprised the first report in this series and reviewed the findings relevant to that report, this section is designed to provide the reader with an overview of the purpose of this report.

In essence, the purpose of this report is to develop the thinking of the previous report by identifying a number of practical elements that can be considered, nuanced and – should HoTARAC deem it appropriate – developed for implementation / wider consultation. The issues reviewed are not intended to be an exhaustive set of prospective changes and strategies but, rather, to be a set of practical, implementable strategies that can be further examined. Overall, the aims of Report Two are to find key strategies that can assist HoTARAC in their pursuit of:

i) A reduction in complexity of financial reports such that Users’ understanding is increased;

ii) An increase in efficiency in the context of financial report production;
iii) A decrease in regulator intervention, including the creation of models;

iv) An increase in external audit efficiency; and

v) The identification of further research / exploration areas that are likely strategically viable.

It is acknowledged that this is an iterative process and that future reports / research pieces may be required to build a better understanding and to build capacity in terms of strategic options. We have provided suggestions for further research below.

5. Findings & Discussion

In this section, we seek to provide HoTARAC with the findings of the study and have discussed them in the context of the aims of the report discussed in the previous section. We have reviewed the issues and ideas that were identified within the original report and considered them in accordance with feedback received. The overall position we take is that there is opportunity for change and individual jurisdictions are keen to explore opportunities in this regard with a view to identifying efficiencies and increased transparency.

In short, we consider that HoTARAC should review options for:

A. The development of a nuanced Framework including elements focused upon Public Sector reporting which will allow for the establishment of a Third Tier (see point C below) and incorporate accounting for “Community Assets” (see point F below);

B. The development of a Reduced Disclosure Regime for the Public Sector (PS-RDR);

C. The development of a third tier for reporting for application in the case of small entities;

D. Liaison with the Australasian Council of Auditors General regarding entering discussions regarding the prospects for change as outlined in this document and the extent to which the changes will affect the external audit requirements. This will assist in the identification of audit efficiencies gained out of reporting format and preparation changes; and

E. The development of a resource(s) base that would be deployed to increase the Australian public sector’s understanding of the place of the Westminster System in the Australian political settlement including the role of Parliaments in the context of financial and performance reporting.

As described above, the options identified would, we believe work toward the broad goals of increased efficiency in reporting and auditing, increased understandability from the Users’ perspective and increased focus in the areas of greatest materiality. However, there
are significant limitations in relation to the achievement of these outcomes and these include:

i) The measurement of efficiency and effectiveness in the context of financial reporting and external audit in the public sector is very difficult and time consuming. Broadly, it is expected that, if these measure were successful, relative costs would reduce over time for reporting activities and assurance activities leaving more resource for other elements of control.

ii) The difficulty of reducing complexity within financial reporting for public sector organisations individually and collectively - in terms of jurisdictions – is substantial. The modern Australian public sector is a complex environment exacerbated by the federal structure. In Australia, generally, understanding of financial reporting is relatively low and the reduction in complexity in order to build understanding in those who may not be fully conversant with financial reporting arrangements will per force see a reduction in the value of information.

iii) The above two problems are exacerbated by the fact that we do not really have an understanding as to who the principal Users are of public sector financial reports and, therefore, what their requirements are. There is a growing anecdotal acceptance that central agencies and Parliamentary Committees (if not Parliaments) use these reports and others including Members of Parliament and the broader community use them – and the attendant audit report - almost on an exceptions basis.

iv) The federal system has also, over time, introduced nuances in the way jurisdictions operate such that there are important, valid reasons for differences in reporting between jurisdictions. While we suggest here that the Framework should be modified to include nuanced arrangements for the public sector, that a PS-RDR should be contemplated and that a third tier should also be developed, the introduction of these arrangements would necessitate the introduction of change in terms of certain jurisdictions in order to achieve uniformity or the ongoing acceptance of jurisdictional nuances that mean uniformity cannot be achieved. However, the higher the similarity across the sector, the less nuanced reporting in relation to particular jurisdictions and the less control each regulator will have over reporting arrangements.

In considering the options, HoTARAC should review closely the restrictions identified above and make a determination based on their joint acceptance of those elements.

Further to the above, table one below provides a breakdown of public sector entities (Departments and Statutory Authority) for each jurisdiction in Australia according to each jurisdiction’s published annual financial statements for financial year 2012. Table two below provides the same data but as a percentage of the total number of entities in each jurisdiction. Table one is an important table in the context of the discussion because it tries
to show the relative financial size of entities by turnover in discrete bands. This table assists – although it is not comprehensive – to support the logic of some of the options outlined in this paper and also to highlight which jurisdictions might consider those options more fully than others.

Table two is provided to assist in gaining an understanding as to the proportion of entities falling into each turnover band. When reviewing this table, it becomes clearer as to those jurisdictions where, for instance, the introduction of a third tier might be less helpful. This is discussed further below but table two provides a general overview of the effects of materiality on the Whole of Government report in each jurisdiction. As an aside, it reinforces the difficulty of prescribing a “one-size-fits-all” financial reporting regime.

The balance of this section deals with each review option (i.e. options A to H) introduced above.

Table One - Turnover of Entities by Jurisdiction

<table>
<thead>
<tr>
<th>Jurisdiction</th>
<th>$0 - $10m</th>
<th>$11m - $100m</th>
<th>$100m - $250m</th>
<th>$250m - $500m</th>
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<td><strong>80</strong></td>
<td><strong>311</strong></td>
</tr>
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</table>

5 Including entities’ own revenue and government appropriation. Other Comprehensive Income is excluded.

6 Source: Entity Financial Reports 30 June 2012. It is important to note that the numbers of agencies / entities included in each turnover band are derived from publicly available data and, as a result, the nuances of the numbers of entities in each band are not available for each jurisdiction as some entities are consolidated up into larger agencies. While the numbers of agencies / entities and their identity are available via publicly available information, the source of turnover and net assets is not necessarily available without review of non-published data.
Table Two – Proportion of Entities by Jurisdiction in Each Turnover Category

<table>
<thead>
<tr>
<th>Jurisdiction</th>
<th>$0 - $10m</th>
<th>$11m - $100m</th>
<th>$100m - $250m</th>
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A. The development of a nuanced Framework

In interviews used to develop Report One, it was considered by some respondents that the current Australian Accounting Standards Board (AASB) Framework is said to be sector neutral but is, in fact, commercially focused. Rather than establish a separate Public Sector Accounting Standards Board and/or separate Public Sector Accounting Standards, the majority of respondents felt that the major adjustments required to make the standards more effective in terms of public sector reporting could be undertaken via a nuanced Framework and the use of Aus Paragraphs.

In amending the Framework, the following elements need to be considered:

i) The refocusing of the purpose of financial reports away from decision making toward acquittal, accountability and transparency:

It was acknowledged in Report One that the primary decision making process in the context of the public sector is the budget process. It was further posited that the key purpose of financial reporting in the public sector was to allow for the development of a consolidated report, the external audit of the finances and for regulators (i.e. Treasuries) to collate data in a formal, uniform way in support of central reporting and internal government control. Therefore, financial reporting in the public sector should properly have an acquittal, accountability and transparency focus rather than a decision making focus – paragraph 9(f) of the Framework is referenced here. This refocusing would be pertinent only to the public sector and would be supported by the use of Aus Paragraphs within the standards proper.

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7 This table is prepared based on the proportion of each entity turnover size as a proportion of the total number of entities in the jurisdiction. We have, naturally, treated each jurisdiction as unrelated to all others.
ii) The incorporation of a definition of “Community Asset” allowing for a new class to be identified and implemented that would only be available to public sector entities and Whole of Government Reporting. Currently, the recognition and valuation of assets requirements of the standards generally and AASB 1049 specifically has seen the application of the recognition and valuation requirements applied to assets that are held by government but are not able to be traded or used as a source of income other than immaterially. Such assets include major inner-city parklands, collections of assets of historical significance to the jurisdiction and Land Under Roads (LUR). Currently, these assets are recognised, valued and reported notwithstanding the following issues:

a) They are unable to be valued using a universally agreed methodology;\(^8\)

b) Notwithstanding this lack of an agreed valuation methodology, these assets are valued and recognised on the balance sheet of each jurisdiction and can represent a considerable proportion of the value of the net assets of an entity or Government;

c) The assets cannot be realised as they are either supporting infrastructure of significance (e.g. roads – AASB1051) or there are considerable community expectations as to how they are deployed by governments (e.g. the Domain in Melbourne, Hyde Park in Sydney or Kings Park in Perth, key historical elements of jurisdictional art collections, museum collections). In other words, such assets could not be realised or repurposed without considerable political difficulty;

d) Valuers General charge governments and entities for the provision of a valuation service as do other specialist valuers while auditors general must audit the valuations placed on these Community Assets, all adding to the cost of preparation and assurance while adding little, if anything, to the utility of the reports; and

e) An element of the difficulty of valuing such assets is the fact that they cannot be deployed in pursuit of revenue in a commercial manner. Some such assets can be used to raise revenue to the extent that a proportion of costs are recovered. However, generally, such assets would be held in trust for the community by the government. These assets are unlikely to represent a future economic benefit but may represent cultural benefits.

Therefore, principles to be used in identifying a Community Asset would likely include:

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\(^8\) Valuers General in Australia are yet to agree a universal valuation methodology for such assets as Land Under Roads.
I. Are difficult to value in a meaningful and universally acceptable way. Generally, it is accepted that the asset cannot be measured reliably;

II. They have considerable connection to the community or are assets that are extremely difficult to realise either separately or as a class;

III. As such, they are unlikely to be an asset or asset class that is of financial benefit or able to be used as collateral or represent a true contribution to the net assets of a public sector entity or government;

IV. Further, the fact that they may lack economic value in the strict sense meant by paragraph Aus 54.2 does not mean they are not of community value – that is non-monetary value.

V. They are likely to be assets that, if included in the balance sheet, would need to be separated from the asset base in order to arrive at a true view of the net assets of a public sector entity or government.

In reporting Community Assets, the balance sheet of public sector entities and Governments would separate such assets and value them on an intermittent basis in order to apply a value for presentation purposes. Jurisdictions might also choose to list such assets separately within the notes to the accounts but not as financial information but for notation purposes. That way, under either arrangement, the general consensus for continuing to report on such assets in order the engender the discipline of such reporting would be retained while the opportunity for creating efficiencies would be realised along with the preparation of a truer balance sheet.

iii) Materiality needs to be considered in the light of the collection, management and use of public money and its reporting. Paragraphs 29 and 30 of the Framework consider materiality to be a predominantly financial value. In considering the position of materiality in the context of the public sector, Report One found that qualitative materiality should also be considered when arriving at disclosures in a set of financial statements. In the public arena, the use of public funds attracts considerable attention regardless of the quantum and it is behaviours in the use of public funds that Users are likely to be interested in as much as the quantum.

iv) The context of financial reporting within the broader financial management arrangements within the jurisdiction (e.g. the budget process, half year reviews etc) should also be considered in an Aus Paragraph relevant to the public sector only. There needs to be a strong relationship between what is reported in the
budget papers and other formal reporting processes and that which is reported in the financial statements.

v) The identification of Users and the place of the Westminster System of constitutional government should also be considered in the context of the preparation and presentation of a set of financial reports. There should be an Aus Paragraph that describes the place of government, the supremacy of Parliament as the principal audience for the reports and the role of ministers and others in the responsibility chain. This is especially necessary as some identify ministers and government members as the principal audience for public sector entities’ financial reports. The place of the Public Accounts Committee and Estimates Committee (or similar) would also need to be considered here.

Overall, readers will immediately recognise that there are a considerable number of paragraphs within the Framework that would also need amendment in order to redevelop this foundation document such that it recognises the nuances relevant to public sector reporting and reduces the elements of valuation and recognition that increase preparation costs, increase complexity to the detriment of understandability and thereby increase external audit costs.

B. A Need to Develop an Alternative, Fit-for-purpose Reduced Disclosure Regime for the Public Sector - PS-RDR

The public sector application of RDR as it currently stands was found to be unpromising for Regulators as the reporting requirements removed under the RDR regime are generally not applicable to public sector reporting (they were generally found to relate to private sector, for-profit transactions and reporting) and, at the end of the day, the public sector entities are required to be consolidated up to the Whole of Government report. Given Governments must report as Tier 1 entities, information that might not be required at the entity level was likely to be required at the Whole of Government level and so is necessary to produce in any case.

It is reaffirmed in this report that, having compared the RDR reporting requirements with the current view of reporting requirements at an entity and government level (see appendix one, Report One), there is a requirement for the development of a Public Sector version of RDR (PS-RDR) that can be applied at the entity and Whole of Government levels.

In reviewing the application of the current RDR arrangements to public sector entities, the following issues have been noted:

i) The definition of Public Accountability creates confusion in the context of Public Sector Entities. AASB1053 (Paragraphs B1 and B2) use the concept of public accountability to identify for-profit entities that are required to report as Tier 1 entities. Governments are required to report as Tier 1 entities and apply the standards fully while sub-government entities are able to apply Tier 2 requirements. This is somewhat arbitrary.
ii) As described above, the opportunity for applying Tier 2 requirements at sub-government level does not necessarily reduce preparation requirements as the need to consolidate into Whole of Government reports means information is still required to allow such a consolidation at least for material amounts.

iii) The prospect of applying Tier 2 to some entities within a government means that regulators are required to undertake additional work in developing models to facilitate the implementation of RDR in some agencies thus creating additional work centrally for prospectively limited reductions in the entities.

iv) A number of RDR reporting reductions that were initially reported as concerning in Report One have subsequently been amended such that some of the concerns raised in that report are defunct. An example here is the application of RDR in AASB7 wherein defaults and breaches on loans payable are now reportable by entities applying RDR (see paragraph RDR18.1). However, it is interesting to note that the application of RDR18.1 does not reduce the reporting requirements in any material way.

v) The RDR regime does not consider the relationship between the budget process, Government Finance Statistics Reporting (GFS) and financial reports.

vi) In terms of GFS, the harmonisation process has gone some way to ameliorating the differences between financial reporting arrangements and GFS. However, there is still considerable variation in how information is derived and reported. This builds inefficiency and cost into the process.

vii) It is difficult to determine what elements within the requirements set for Tier 1 and Tier 2 reporting as we have a very limited understanding of the needs of Users. This makes the identification of Users and their requirements as provided by SAC 2 and the Framework somewhat arbitrary. Further, making prescriptions of alternate ways of fulfilling reporting requirements and meeting the needs of Users is difficult without knowledge of who they are and what they need.

viii) Importantly, without such knowledge, the identification of those elements of the standards regime suitable for retention, amendment or removal from a public sector perspective is also arbitrary.

As such, in developing a PS-RDR, the following need to be considered:

i) The development of a PS-RDR is consistent with the consensus that a reworked Framework combined with the use of Aus Paragraphs is the most appropriate way forward in terms of the establishment of more appropriate accounting standards for application in the Australian public sector.
ii) The preparation and presentation requirements encompassed in the PS-RDR should be developed with reference to the Parliament as the principal audience and so should seek to meet the information needs of that sovereign body. The requirements of Public Accounts Committees and other economics committees would be an important reference here.

iii) The financial reports should encompass sufficient information such that the budget documents, GFS and the position and performance of entities and governments can be reviewed holistically. This is especially important given the centrality of the budget process in the polity and the need to reduce complexity.

iv) PS-RDR would likely be able to be applied to Whole of Government reports as well as to sub-government entities on the basis that PS-RDR would be more reflective of the information needs of Users and that the financial statements are presented as discussed in point (iii) above.

v) Alternatively, should HoTARAC and/or jurisdictions consider that full Accounting Standards should be applied to Whole of Government reports, given the information provided in Table One and Table Two, there is opportunity for implementing the PS-RDR for smaller organisations that may also be immaterial and thus not needed to be consolidated into the Whole of Government financial reports.

vi) The preparation and reporting requirements of GFS should be harmonised with PS-RDR such that differences are minimised in the interests of efficiency and understandability. This may mean the PS-RDR is subordinated to GFS as the former is changeable at the national level while the later is not.

vii) The terminology within the PS-RDR Aus Paragraphs should be developed such that the nomenclature and other descriptions used conform to public sector language and usages. The current standards are written with a commercial focus and the application of the standards is made harder in a public sector environment as a translation needs to occur in order to apply the standards as intended.

viii) A third tier, as discussed at C below, should be developed and incorporated into the PS-RDR.

ix) Given the need for the development of outcomes based reporting within government, the PS-RDR also needs to consider the work undertaken by the Australian Accounting Standards Board in terms of arrangements for reporting performance.

x) Given the importance of precedence within the Westminster System variants in each jurisdiction in Australia, the PS-RDR also needs to recognise the need for each jurisdiction to be able to report differently in some areas.
In undertaking this process, initial steps may include the development of a model financial statement which could be used as a starting point for considering the requirements of the PS-RDR.

**C. Development of a Third Tier – PS-RDR3**

In the context of the discussion at points A and B above, consideration should be given to the development of a third reporting tier (PS-RDR3). While the suggestions regarding the Framework would need to be undertaken in order to support the establishment of a third tier of reporting, such a tier could be established over and above the current reduced reporting arrangements in place regardless of whether HoTARAC considers that the development of a PS-RDR is appropriate or not.

The introduction of a third tier of financial reporting requirements would be undertaken if HoTARAC or individual jurisdictions consider that there would be savings made as a result of the establishment of a considerably reduced reporting regime for public sector entities that fall into a particular defined category. Such reports would not be consolidated into the Whole of Government financial reports nor would the reduced reporting arrangement be available where qualitatively material transactions or assets were other not reported as part of the Whole of Government reporting process.

Entities for which such a reporting framework would be applied would need to have the following attributes:

i) The only transactions that occurred during the financial year were of a quantitatively immaterial nature; and

ii) The only transactions that occurred during the financial year were of a qualitatively immaterial nature; and

iii) No assets are held that are qualitatively material in nature; and

iv) No assets are held that are quantitatively material in nature; and

v) The entity(ies) are not reasonably likely to fall outside of these attributes in the future. That is, entities that adopt are able to adopt the PS-RDR3 arrangements would not be able to move between tiers in the case that their circumstances change as the valuation, preparation and presentation requirements of Tier 1 and Tier 2 are not intended to be carried into Tier 3. As such, it is intended that entities that otherwise carry the full set of attributes described above but are start-up entities or entities that are being reorganised or in some other way repurposed will not be able to be considered Tier 3 reporting entities as the expected movement to Tier 2 or Tier 1 will preclude this.

In terms of the above tests, materiality is to be evaluated in the context of the Whole of Government reports not in the context of entities that might be candidates for the...
application of PS-RDR3. For instance, what constitutes a small organisation for one jurisdiction may be a medium sized organisation for another.

By way of example, the types of organisations that might fall into this category are:

i) Ongoing entities that are small in the context of the size of the government in question in terms of quantum of total cash flow, income or expenditure;

ii) Redundant entities that are awaiting repealing legislation;

iii) Entities that are redundant but that are not intended to be disestablished (e.g. the entity that operates a regional cemetery that has no further capacity); and

iv) Entities that are established in order to undertake a particular purpose that is orientated to service within government. That is, small entities that are established solely to provide services to other government entities.

The reporting requirements of entities able to adopt PS-RDR3 would include:

i) An Income Statement;

ii) A Balance Sheet;

iii) A cash flow statement; and

iv) Notes to the accounts relative to material information or contingent issues including a note explaining the rationale for the adoption of the third tier of reporting relative to that entity.

Where appropriate, it may be that an entity simply reports on a cash basis where the presentation of an income statement and/or balance sheet does not serve to inform Users.

It is suggested that the PS-RDR3 reporting requirements would also include the prerogative of application to the jurisdiction (which it is in any case) such that individual jurisdictions may decide whether to apply the third tier or not.

D. Australasian Council of Auditors General and Prospects for Audit Efficiencies

The involvement of the Australasian Council of Auditors General (ACAG) is fundamental to the development and implementation of the suggestions embodied in this document. This involvement of ACAG would, principally, relate to the Australian members only. A major rationale for considering the issues raised in this paper is, of course, the identification of opportunities for making efficiencies in terms of time and money spent fulfilling the reporting role. Of course, another considerable cost associated with financial reporting arrangements is the costs associated with external audit. The cost of external audit is significant and continuing to rise as:

i) Users of financial statements and the external auditors’ reports are demanding increased levels of assurance;
The value of financial reports and the numbers of transactions summarised in those reports are effectively increasing the risk associated with undertaking external audit;

The assurance process is carried out over increasingly complex financial reports and carried out against increasingly complex financial reporting arrangements in terms of the Accounting Standards;

Additionally, Auditors General are under pressure to provide alternative forms of assurance as well as other independent reports to Parliaments and their committees including the provision of performance reports, the undertaking of specific investigations and the provision of assurance over outcomes reporting arrangements in place in some jurisdictions; and

The human resources employed and the call on the capacity of private firms is increasing in cost and volume such that the overall cost of audits is rising regardless of the efficiency of audit offices.

Therefore, a major possibility for efficiencies arising out of this process includes the engagement of ACAG and the joint identification of external audit efficiencies to be aligned with the adoption of PS-RDR and PS-RDR3. Savings could be identified out of:

The identification of reduced disclosure arrangements as identified in this document and which will result in less audit work to be undertaken;

The use of review techniques rather than audits when developing an assurance response for entities reporting under PS-RDR3. The application of reviews has been identified in recent legislation at the Commonwealth level in the establishment of the Australian Charities and Not-for-profits Commission and there are Auditing Standards such as ASRE2415 which could be adopted for application in the case of assurance arrangements for PS-RDR3 entities; and

The simplification of the Whole of Government reporting arrangements and their alignment to GFS and the budget process is likely allow audit work to be undertaken across a number of areas without needing to undertake repetitive audit operations relating to the same primary data but reported differently.

Of course, ACAG is the proper entity for this to be considered by. However, the development of audit efficiencies are necessary in order to realise the targeted gains out of this process.
E. Westminster System of Government

As discussed in Report One in this series, the understanding held by Users and standard setters relating to the Westminster system of government and the place of Parliament as sovereign over the government is limited and this effects the acceptance for the need for change in terms of the Framework, the development of PS-RDR and of PS-RDR3.

There is a need to develop a strategy to increase standard setters’ and others outside of the public sector understanding of the Westminster System and to raise the level of debate within standard setting to take into consideration the relevant aspects of this political and constitutional arrangement.

6. Further Research

Additional to the main areas of this report and those in Report One in this series, the research to date has highlighted a number of prospective research areas which Curtin School of Accounting would like to pursue. These are indicated below as prospective research topics:

i) Extend the RDR and associated topics research (i.e. this research program) to include the Australasian Council of Auditors General (ACAG) with a view to expanding the input into the research.

ii) Define Users in the context of public sector accounting and reporting.

iii) Once Users are defined, undertake a research program designed to identify the needs of those Users.

iv) Develop a comprehensive review of the Conceptual Framework.

v) Undertake a mapping exercise with a view to documenting the reporting similarities and differences between the budget, GFS and financial reporting.

vi) Develop a gap analysis regarding the education requirements of Users and preparers.