The Effect of the IFRS Reduced Disclosure Reporting Regime on the Australian Public Sector

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Paper submitted to the British Accounting Association 2012 Conference, Brighton United Kingdom, 17 – 19 April 2012

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Abstract

In the UK there is the Financial Reporting Standards for Smaller Entities (FRSSE) with discussions occurring around the International Financial Reporting Standards (IFRS) for Small Medium Enterprises (SMEs); in NZ there is the Exempt Company Scheme and the Framework for Differential Reporting; and in Australia there have been various attempts at reducing the complexity of IFRS, including the Australian Accounting Standards Board (AASB) Exposure Draft 192 Revised Differential Reporting Frameworks and now the Reduced Disclosure Regime (RDR). The regime was developed for implementation as an alternative to the International Accounting Standards Board’s (IASB) IFRS for Small-Medium-Enterprises (SMEs).

RDR is an example of a situation that because it relates to the public sector, would be almost too complex one would think for standard setters to do any sort of impact analysis prior to its implementation. Hence, this is a chance to present a unique look at the type of analysis that had it been undertaken by the AASB prior to adoption it may have resulted in a different outcome. This paper fills the gap in the current public sector literature by providing an in-depth look at the new reduced disclosure requirements and considers the potential benefits of the due process outlined in the EFRAG (2011) discussion paper. Couched within a modified New Public Management (NPM) / agency theory framework the research concludes that the RDR is just another layer of reporting for the already over-reporting public sector.

Key words: Reduced Disclosure Regime (RDR); Accounting Standards; New Public Management (NPM); Agency Theory; Public Sector; Transaction-Neutral.
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1. Introduction

Stephen Zeff (1978) is quoted at the beginning of the UK Accounting Standards Board (ASB) and the European Financial Reporting Advisory Group (EFRAG) Discussion Paper "Considering the Effects of Accounting Standards", January 2011, as having said:

What is abundantly clear is that we have entered an era in which economic and social consequences may no longer be ignored as a substantive issue in the setting of accounting standards. The profession must respond to the changing tenor of the times while continuing to perform its essential role in the areas in which it possesses undoubted expertise.

This paper considers that very issue in regards to standard setting for the public sector – specifically in this case the Australian public sector. Australia is a leader in adopting accounting standards early and is one of the only countries, other than New Zealand, that adopted the International Financial Reporting Standards (IFRS) for all reporting entities, including the public sector, not long after they were released.

The Australian Financial Reporting Council (FRC) (Information Paper, September 2003) claimed that Australia’s adoption of IFRS would assist the Australian economy by facilitating cross-border comparisons by investors, reducing the cost of capital in Australia, and improving access to overseas capital for Australian businesses. The Australian Accounting Standards Board (AASB) decided to adopt IFRS as equivalent Australian Accounting Standards (A-IFRS), with some minor amendments (these became the "Aus Paragraphs").

These equivalent Standards applied to all entities currently complying with Australian Accounting Standards.

According to Jones & Higgins (2006):

momentum for the adoption of IFRS in Australia has been galvanized by strong support for the proposal by key private sector regulators, such as the Australian Stock Exchange (ASX) and by the FRC.
High-profile government inquiries – such as the Wallis Report into Australia's Financial System and the HIH insurance company Royal Commission– were also the catalyst for the introduction of IFRS (Pilcher and Dean, 2008). The purported benefits in regards to an improved reporting regime for multi-listed companies were widely reported (for example, Lonergan, 2003). However, according to Ryan et al. (2007, p.475), "far less attention was given to the consequences for the public sector" while the not-for-profit sector was also largely ignored in the process of creating and adopting the A-IFRS. Anecdotally, the extent to which A-IFRS was of value to the public and not-for-profit sectors has been a topic of discussion since its adoption in 2005. However, some concerns regarding the applicability and utility of the standards for these sectors were no doubt raised prior to that date.

In responding to a developing consensus that A-IFRS was too complex for many entities, including SMEs, not-for-profits and public sector organisations, a reduced disclosure regime (RDR) was introduced by the AASB on 2 July 2010 (effective 1 July 2013 but with the option to early adopt). This regime was made operational under two standards AASB 1053 Application of Tiers of Australian Accounting Standards and AASB 2010-2 Amendments to Australian Accounting Standards Arising from Reduced Disclosure Requirements. The RDR is still framed within the transaction-neutral philosophy and still holds the decision-usefulness emphasis of the current Australian accounting standards. Perhaps more significantly here is the concern that the required changes have not been tested as to their expected impact. As well, given the timing of RDR – full implementation seven years after the adoption of IFRS – the question has to be asked as to whether the effort required to change is worth the cost of adoption. If this move to reduced disclosure also had the added benefit of harmonisation with NZ IFRS, then perhaps it could be worth consideration. However, the AASB and New Zealand Financial Reporting Standards Board's (FRSB) plan to issue joint exposure drafts of proposals to harmonise Australian and New Zealand Standards is inconsistent with RDR as to starting dates and some disclosures implying a number of differences will continue to exist.
Unfortunately, these differences will also exist between states within Australia. This is made even more apparent below.

This paper considers the potential impact of RDR on the Australian public sector within a modified New Public Management (NPM)/agency theory framework. The research has been undertaken for several reasons. Importantly it provides one of the first pieces of research designed to test the process of considering the effects of a new / revised set of standards on public sector reporting. Additionally, the study was completed with a view to identifying possible efficiencies that can be gained under RDR as well as to identify other areas where the idea of an alternative differential reporting system – other than the RDR sanctioned by the AASB – may have merit. At all times the balance between cost and utility is a paramount consideration as is the ultimate purpose of the reports themselves. It suggests that the philosophy behind NPM - especially that espousing the benefits of public-sector reporting in a private sector model - may not be as relevant to Australian public sector entities as policymakers currently consider. However, tinkering at the edges by reintroducing some aspects of sector specific standards is unlikely to be the answer. It may be time to accept that transaction neutrality combined with decision usefulness as underlying concepts for financial reporting in the public sector are ensuring higher reporting costs and lower utility in terms of the reports prepared and audited. Perhaps if some type of due process was introduced – similar to that currently being discussed in Europe and the United Kingdom (EFRAG / ASB) - then these results would have been available prior to the sector spending a lot of unnecessary time, money and resources.²

The next section reviews the background to the study, with Section 3 detailing the RDR. Sections 4 and 5 provide the theoretical framework and research design respectively, whilst the penultimate section presents the results. Finally, Section 7 includes a discussion and an overall conclusion to the study.
2. **Background**

*IFRS in Australia*

The Australian equivalents to IFRS (ie A-IFRS) came into force on 1 January 2005, although they were to be applied from 1 July 2004 when preparing comparative figures. According to KPMG (2003), there are many benefits of reporting under these standards, including better financial information for shareholders and regulators, enhanced comparability, improved transparency of results, and increased capability to secure cross-border listing and funding. However, in regard to the public sector, the benefits were not so clearly articulated (Ryan *et al.*, 2007).

The transition to A-IFRS was considered by many (eg Palmer, 2008) to be one of the most noteworthy events impacting on financial reporting in Australia for some time. Haswell and McKinnon (2002, p.9) considered IFRS to be "the biggest accounting disruption ever, eclipsing by far the introduction of the goods and services tax in 2000". Costs to companies in terms of time and resources in preparing for the change were highly significant (Ham, 2002). For the public sector, in-depth research into the cost of change has not been conducted to the same degree. Yet, the public sector in Australia employs over 162,000 people (as at June 2009)³ under the Public Sector Act with agencies such as Centrelink, the Australian Tax Office and the Department of Defence amongst the largest tax-payer funded organisations in the country.

One of the basic principles behind A-IFRS is that the standards are 'sector neutral', or what is now referred to as 'transaction neutral'. This philosophy considers that all transactions, regardless of the type of entity undertaking them, should be prepared consistently in order to allow for comparability. It is said by the proponents that it "provides a neutral financial management system which enhances accountability by allowing the production of impartial, representationally faithful and decision-useful financial reports" (Newberry, 2003, p.28). In
other words, the aim is to ensure internationalisation of reporting for comparative purposes and improved decision-making. It is generally accepted that in both the public and private sectors either the 'Big Four' firms (for the private sector) or State Treasury Departments (for the public sector) develop templates or model financial statements for all reporting entities (referred to as "boilerplate" disclosures by many, including Maiden, 2002 cited in Palmer, 2006). The private sector templates are often provided to clients and others as guides while Treasury-developed templates (of which there can be a number in each jurisdiction) are usually mandatory for government agencies within each Treasury’s purview. By doing this though, companies or organizations more often than not just comply with the template requirements and do not have a real understanding of the numbers behind the figures (Palmer, 2008). Additionally, some disclosures that have merely been reproduced might be irrelevant to the users (NIA, 2005; Pilcher and Dean, 2009). Hence, one of the reasons IFRS for SMEs and RDR were both proposed was to simplify reporting for those organisations that met the stated criteria.

Differential Reporting

It is common around the world for jurisdictions to have a framework that determines which entities prepare financial statements and the form those statements must take. Often, entities are sub-classified and different reporting requirements can apply to each class. These are referred to as ‘differential reporting frameworks’, in that not all entities have to prepare the same financial reports (AASB/FRSB 2009). The AASB published ITC 12 Request for Comment on a Proposed Revised Differential Reporting Regime for Australia and IASB Exposure Draft of A Proposed IFRS for Small and Medium-sized Entities in May 2007 containing proposals for a revised differential reporting regime.

If we compare this to what is happening in other countries, very few comparisons can be drawn given only a small number of countries have adopted IFRS for all reporting entities. In
New Zealand, the Ministry of Economic Development (MED) issued Discussion Document *The Statutory Framework for Financial Reporting* at the same time as ITC 12 was released. It proposed statutory financial reporting obligations for certain types of entities. The Accounting Standards Review Board (ASRB) contemporaneously issued Discussion Document *Proposed Application of Accounting and Assurance Standards under the Proposed New Statutory Framework for Financial Reporting*, which proposed financial reporting and assurance requirements for those entities that have a statutory obligation to prepare financial statements (AASB/FRSB 2009). In the UK, the Accounting Standards Board (ASB) published an exposure draft entitled *The Future of Financial Reporting* in 2011 in which it proposed that the UK Generally Accepted Accounting Principles (GAAP) be replaced with *IFRS for SMEs*. This would allow entities to take advantage of simpler measurement provisions. In Australia, adoption of the *IFRS for SMEs* was seen as a retrograde step in a country that has already adopted full IFRS recognition and measurement accounting policy options (Mackay, 2009). Hence, an alternative was produced and so began the process which led to the adoption and implementation of the RDR in Australia.

3. **Reduced Disclosure Regime**

The RDR has been established in Australia in order to remove perceived inefficiencies occurring out of the application of full accounting standards by certain reporting entities. Such entities have been identified as those for which the application of the full requirements for General Purpose Financial Statements (GPFS) is not efficient and for which a lesser reporting framework is sufficient in meeting the needs of users (AASB 1053, para. BC10). In practical terms, the RDR has been implemented by the addition of paragraphs to standards identifying those elements of each of the individual standards the application of which is sufficient for the application of the RDR. Those entities that are entitled to adopt the RDR are identified via the creation of two tiers against which reporting requirements are assigned. The application of the tier framework is outlined in AASB 1053. Tier 1 entities are required to meet the full A-IFRS
standards whilst Tier 2 are able to meet the reduced reporting requirements provided by the RDR (refer to Table 1 over the page).

The assignment of reporting entities to a particular tier depends on the extent to which the organisation has public accountability in the case of private sector entities while public sector entities can implement the RDR regime provided they are not governments (AASB 1053, para. 11/12). Public accountability is defined as "accountability to those existing and potential resource providers and others external to the entity who make economic decisions but are not in a position to demand reports tailored to meet their particular information needs" (AASB 1053, Appendix A, p.12). Interestingly, this definition does not apply to public sector not-for-profit entities. In essence, the RDR can be implemented by public sector not-for-profit entities provided the relevant regulator (ie the relevant Treasury) allows them to.4

The AASB is taking a staged approach to the introduction of a revised differential reporting regime. The standards are operative for reporting periods beginning on or after 1 July 2013, but early adoption using the tiers described in Table 1 is permitted for 30 June 2010 (phase 1). The AASB has left the reporting entity regime unchanged at this point so non-reporting entities can continue to prepare special purpose financial statements (phase 2). An AASB update on RDR stated that further research into the impact of the ED 192 Revised Differential Reporting Framework proposals on those entities currently preparing special purpose financial statements was needed (AASB July 13, 2010). The AASB has not released any further updates regarding this issue. However, many accounting practices are reporting that it is still undecided (eg Innovative Solutions, 2011).

The RDR is available to a wide range of entities in both the private and public sectors in preparing GPFS. Paragraph 13 of AASB 1053 provides that the following entities are able to apply the RDR:

(a) for-profit private sector entities that do not have public accountability:
(b) all not-for-profit private sector entities; and
(c) public sector entities other than the Australian Government and State, Territory and Local Governments.\(^5\)

Table 1 provides a matrix intended to highlight the application of the RDR to each type of entity.

**Table 1:** Tier 1 and Tier 2 Entities

<table>
<thead>
<tr>
<th>Sector</th>
<th>For-profit private</th>
<th>Not-for-profit private</th>
<th>For-profit and not-for-profit public</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tier 1: Full IFRSs as adopted in Australia</td>
<td>Publicly accountable</td>
<td>All not-for-profit private sector entities have a choice of applying Tier 1 or Tier 2 requirements</td>
<td>Federal, State and Territory Governments and Local Governments (including whole of government and general government sector)</td>
</tr>
<tr>
<td>Tier 2 Reduced Disclosure Regime (entities may choose to apply Tier 1)</td>
<td>Non-publicly accountable</td>
<td>Entities other than Tier 1 entities noted above.</td>
<td></td>
</tr>
</tbody>
</table>


The development and implementation of RDR constitutes a significant change in direction for the AASB in terms of policy as the AASB has decided to develop its own solution rather than adopt the International Accounting Standards Board’s (IASB) *IFRS for SMEs*. Indeed, the decision to adopt RDR stems from a number of factors that are somewhat unusual according to K. M. Stevenson, Chairman and CEO of the AASB (2010). Australia, unlike almost any other jurisdiction considering IFRS, adopted the framework in 2005 for virtually all reporting entities in both the private and public sectors. This decision was seen as a commitment to both high quality general purpose financial reporting and a desire to maintain transaction neutrality between sectors. Thus, when reviewing *IFRS for SMEs*, consideration was firstly given to whether there was any potential benefit in changing previously established recognition and measurement requirements. The second consideration was whether it could be done in a manner that retained the relationships between sectors. Finally, Stevenson (2010, p.1)
recognized that "Australia has progressively de-regulated micro entities in terms of financial reporting requirements meaning that the reporting entities to which AASB Standards apply are not only relatively experienced with IFRS they are more homogeneous in capability".

The idea of establishing a reporting framework that does not necessarily meet all of the Australian Accounting Standards is problematical for public sector regulators as there is a well-founded desire for compliance with accepted accounting principles on the basis that they represent better practice. Additionally, the relative paucity of resources available in the public sector for determining appropriate accounting and reporting frameworks in most jurisdictions means that considerable reliance is necessarily placed on the work of the AASB. However, there is a need for a balance between cost and utility of reports prepared. In NZ, IFRS were seen as an additional burden to the public sector, adding a lot of time and cost with little associated benefit (Brady, 2007, p.19). In Australia, a similar finding was reported in Pilcher and Dean (2009) regarding local government reporting. Costs associated with the preparation of reports include the direct costs themselves as well as the cost of model development by central agencies and the cost of audit.

Clearly, the simpler the models used for financial reporting, the less cost involved in their development, completion and audit. As such, the RDR regime may not represent a complete solution to the difficulties of public sector reporting in the context of cost and utility. However, the adoption of the regime may be taken to represent an acceptance that the philosophies surrounding the creation of accounting standards – those of transaction neutrality and decision usefulness - are not necessarily the best option giving permission for public sector regulators to consider alternative reporting regimes that might better suit their needs. Given the public sector consists mainly of service organisations, then assessing the "effect" of RDR as is done here may be more suitable than any other type of cost/benefit type analysis (UKASB/EFRAG, 2011).
4. Theoretical Framework

**NPM**

The term NPM was introduced in Europe in the 1980s. It involved a different conception of public accountability in that it sought to reduce the gap between the public and private sectors (Hood, 1995). The UK government under Thatcher was, according to Bovaird and Downe (2006), one of the first to launch NPM-type reforms. Although the implementation of NPM has been adjusted to suit different political agenda, in Australia all political parties have supported its underlying principles since its appearance in the 1980's (MacDermott, 2007). McLaughlin *et al.* (2002, p.200) considered that:

> Australian governments can be characterized as having adopted NPM, if to varying extents and in varying ways. What is important is that there is clear evidence that the principles underlying NPM have been accepted by governments of all persuasions with increasing acceptance over time …

There has been a great deal of debate about NPM and its application by government, much of which is based around Hood's (1991, 1995) conceptualisation of the term (eg, Lapsley and Pallot, 2000; Boyne, 1996). Lapsley (2009, p.2) claimed "… governments are under pressure to 'modernize' their public sectors" and hence varying forms of NPM are emerging. According to Hood (1995), most commentators have associated NPM with seven doctrines of change and it is the sixth doctrine which encompasses the introduction of private sector accounting standards into a public sector which is relevant here.

In 2002, Ferlie and Steane explored the extent to which the NPM 'wave' led to a process of convergence between jurisdictions toward a particular template for public sector management. They wanted to explore the extent to which strong variations still remained amongst individual jurisdictions despite the apparent application of this template. In Australia, notwithstanding the significant cultural, political and historical homogeneity, full homogenisation has not yet occurred (eg Pilcher and Dean, 2009). In terms of accounting standards, in what may have hastened the convergence process between the public and private
sectors, the AASB adopted IFRS in 2005 for all reporting entities. The AASB's Chairman claimed they "had a commitment to both high quality general purpose financial reporting and a desire to maintain our achievement of transaction neutrality between sectors" (Stevenson, 2010, p.1). This commitment was presumably thought to be met with the adoption of the transaction neutral standards. At the same time it cemented the adoption of NPM within the public sector psyche.

The development of NPM was seen as a means by which to enhance accountability and transparency of governments on the (debateable) basis that commercial models achieved this outcome. As such, it was considered that the achievement of that objective required the development of financial information that was more comparable, relevant and useful for decision making within the public sector. According to Bolivar and Galera (2007), IFRS could provide the benchmark for improving the quality of public sector financial reporting. Therefore, IFRS was seen as one element of a number that could increase transparency in public sector reporting – an important consideration in the context of democratic government.

NPM has in its roots a theoretical framework that draws upon various economic theories. These are primarily public choice theory, agency theory, and transaction cost theory (Bhatta, 2001). Additionally, Pilcher (2011) draws upon NPM and institutional theory in her examination of Australian local government financial reporting and Lapsley and Pallot (2000) and Boyne (1996) have also considered NPM in this light. In terms of agency theory, NPM seeks to apply the management principles and practices of the market sector to government (Newberry and Pallot, 2004). Generally, agency theory considers the contractual relationship between principals and agents in which the latter serve the former in accordance with the conditions in their contract. In the context of the public sector, the ministers are considered the "principals" with the officials representing the "agents" (Bhatta, 2001, p.4).
Agency Theory

Much of agency theory focuses on notions of accountability. As such, financial reporting and auditing emerged in order to reduce the agency costs of contracts between owner shareholders (principals) and debt holders (agents) (Jensen and Meckling, 1976). Although the majority of the literature relates to the private sector, Mayston (1993) argued that the principal-agent model and accountability still held in the public sector. However, a key concern when applying agency theory to the public sector is to consider the identity of the principal and agent. Contrary to Bhatta (2001), Mayston (1993, p.77) argued that public sector accountability is "not a simple one-to-one relationship between a principal and agent". Instead it is the relationship between a number of different groups whose economic and political interests overlap. In the public sector there can be multiple principal-agent relationships. As well, in modern democratic states, transparency, accountability and efficiency across the board are extremely important. As such, it is argued that, for the purposes of the research reported here, there are direct and indirect principals and agents in a democratic state. This argument conforms to that made by Pilcher et al. (2011) in relation to public sector auditing. Such clarification is important as it allows for a more direct assessment of the findings and their effects and more neatly reflects the true position of the parties, particularly in a hierarchical sense. For this research, the identification of the direct and indirect principals and agents is pivotal in determining which organisations should apply RDR and which should not as well as for commenting on the appropriateness of the reductions made.

Baber (1983) claimed that, in the public sector, public interest groups (the principals) and politicians (the agents) contract to share returns that accrue from the public service. In seeking to clarify this idea by identifying the direct principals and agents, Singleton et al. (2003, p.195) identifies that "members of the government (that is, ministers or the cabinet) will be punished by perceived inefficiencies in the public sector". Hughes (2003, p.236) reinforces this proposition by placing public sector accountability squarely in the political sphere and, as
such, he considers that "[t]here is a fundamental requirement in a democratic system for accountability from the administration to the political leadership". As such, a direct principle–agent relationship can be said to exist between the elected government (that is, those members occupying the Treasury Benches and from amongst whom the ministry is appointed) and the public sector which is charged with the implementation of the government’s policy (Pilcher et al., 2011). Obviously, there is an accountability and transparency responsibility from the public sector to the broader community. However, in reality, the government stands or falls based, in part, on its administrative record and so has a more direct and significant interest in the accountability and assurance framework that impacts the reduction of agency costs to it.

To reduce costs associated with the government’s need to rely on the public sector to implement its policies in an efficient and effective manner, principals (in this case all of the government members of parliament) demand and agents (restricted for this research to the public sector agencies) supply monitoring of their activities (Jensen and Meckling, 1976). This manner of increasing accountability is desired in order for the agent of the public sector entity to meet efficiently and effectively the demands of the principal (Mayston, 1993).

5. Research Design

In essence, this research considered the prospects for gaining efficiencies in financial reporting in the Australian public sector should RDR be adopted. In-depth content analysis was conducted to identify areas of reduced disclosure which may be of value to the public sector in terms of efficiencies and/or clarity for users while still maintaining adequate transparency. Initially standards that contain RDR paragraphs (refer to Table 2) were analysed with the view to determining the extent to which the reductions in disclosure requirements listed in the RDR are of value to the public sector. The state public service of Western Australia (WA) is used as an exemplar to illustrate how each state's adoption of a new
standard depends upon the local legislators agreeing to do so. In Australia, the Treasury Department of each state releases the financial models agencies must comply with. In terms of financial reporting models adopted in the WA public sector, the Treasury has the responsibility for determining the format and content of financial reports as well as the functional responsibility for considering the application of, amongst other things, A-IFRS. As at the writing of this paper, WA Treasury has promulgated four financial reporting models each considered to comply with the A-IFRS. These models are to be applied by Departments of State, Net Cost of Service Authorities, Commercial entities as well as Net Cost of Services Authorities with a 31 December balance date. As such, these models are to be complied with by the entities making up the WA Public Sector in accordance with their specific category.

Hence, additionally the analysis identified the potential impact of the RDR on each of the Model Financial Statements and considered the feasibility of adopting early the RDR Accounting standards.

**Table 2: 2009/10 RDR versions**

<table>
<thead>
<tr>
<th>No.</th>
<th>Australian Accounting Standards</th>
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<tbody>
<tr>
<td>1</td>
<td>AASB 1 First-time Adoption of Australian Accounting Standards</td>
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<tr>
<td>2</td>
<td>AASB 2 Share-based Payment</td>
</tr>
<tr>
<td>3</td>
<td>AASB 3 Business Combinations</td>
</tr>
<tr>
<td>4</td>
<td>AASB 5 Non-current Assets Held for Sale and Discontinued Operations</td>
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<tr>
<td>5</td>
<td>AASB 7 Financial Instruments: Disclosures</td>
</tr>
<tr>
<td>6</td>
<td>AASB 8 Operating Segments</td>
</tr>
<tr>
<td>7</td>
<td>AASB 101 Presentation of Financial Statements</td>
</tr>
<tr>
<td>8</td>
<td>AASB 102 Inventories</td>
</tr>
<tr>
<td>9</td>
<td>AASB 107 Statement of Cash Flows</td>
</tr>
<tr>
<td>10</td>
<td>AASB 108 Accounting Policies, Changes in Accounting Estimates and Errors</td>
</tr>
<tr>
<td>11</td>
<td>AASB 110 Events after the Reporting Period</td>
</tr>
<tr>
<td>12</td>
<td>AASB 111 Construction Contracts</td>
</tr>
<tr>
<td>13</td>
<td>AASB 112 Income Taxes</td>
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<tr>
<td>14</td>
<td>AASB 116 Property, Plant and Equipment</td>
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<td>15</td>
<td>AASB 117 Leases</td>
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<td>16</td>
<td>AASB 119 Employee Benefits</td>
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<tr>
<td>17</td>
<td>AASB 121 The Effects of Changes in Foreign Exchange Rates</td>
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<tr>
<td>18</td>
<td>AASB 123 Borrowing Costs</td>
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<tr>
<td>19</td>
<td>AASB 124 Related Party Disclosures</td>
</tr>
<tr>
<td>20</td>
<td>AASB 127 Consolidated and Separate Financial Statements</td>
</tr>
<tr>
<td>21</td>
<td>AASB 128 Investments in Associates</td>
</tr>
<tr>
<td>22</td>
<td>AASB 131 Interests in Joint Ventures</td>
</tr>
<tr>
<td>23</td>
<td>AASB 133 Earnings per Share</td>
</tr>
<tr>
<td>24</td>
<td>AASB 134 Interim Financial Reporting</td>
</tr>
</tbody>
</table>
Before considering prospective efficiencies represented by the RDR, it is important to understand, in general, the Australian public sector.

**Australian Public Sector, An Introduction**

The unique system of government in Australia has roots in both Westminster and US models of government (Funnell and Cooper, 1998). Included as part of the public sector are the various entities created to implement and monitor government policy. Collectively, these have come to be known as agencies but include departments of state, offices and government trading entities (GTEs). Essentially, in this paper we are concerned with what has been identified as the General Government Sector (GGS) and which does not include those entities that are classified as Public Non-Financial Corporations or Public Financial Corporations (see AASB 1049). In other words, we have not considered the application of RDR in the context of GTEs but only those organisations that provide services which the public recognise as being traditionally provided by the government. These include education, policing and defence. However, public sector reforms of the 1980s and 1990s sought to blur the boundary between the public and private sectors. Then, as a result of these reforms, a number of structural and accountability frameworks were altered. These adaptations, in turn, impacted on the Westminster models of ministerial responsibility and neutrality. A management approach to administration based on the private sector became apparent (Uhr, 1997; Glenny, 2002).
In regards to the role or place of public sector in the overall scheme of society and financial reporting, the WA Public Sector Management Act (1994, para. 7) enunciates the principles of public administration and management which are to be observed by the public sector:

(a) the Public Sector is to be administered in a manner which emphasizes the importance of service to the community; and
(b) the Public Sector is to be so structured and organised as to achieve and maintain operational responsiveness and flexibility, thus enabling it to adapt quickly and effectively to changes in government policies and priorities; and
(c) public sector bodies are to be so structured and administered as to enable decisions to be made, and action taken, without excessive formality and with a minimum of delay; and
(d) administrative responsibilities are to be clearly defined and authority is to be delegated sufficiently to ensure that those to whom responsibilities are assigned have adequate authority to deal expeditiously with questions that arise in the course of discharging those responsibilities; and
(e) public sector bodies should have as their goal a continued improvement in the efficiency and effectiveness of their performance and should be administered with that goal always in view; and
(f) resources are to be deployed so as to ensure their most efficient and effective use; and
(g) proper standards of financial management and accounting are to be maintained at all times; and
(h) proper standards are to be maintained at all times in the creation, management, maintenance and retention of records.

Hence the decision regarding the adoption and implementation of RDR is constrained by various social aspects of reporting. As well, it is clear there is a direct line of reporting to the respective minister (the principal) by the department / agency (the agent).

6. Results

With NPM infiltrating the culture of the public sector, many changes evolved as described above. As part of this, the decision-usefulness of the financial information produced by public sector entities was seen to be an important component (Galera and Bolivar, 2007). To determine whether RDR (as a sub-set of A-IFRS) satisfies this simple criterion, the potential impact on financial reporting was analysed to determine RDRs role (if any) in improving efficiency, transparency and benchmarking (Galera and Bolivar, 2007).
Based on the method described above, a number of significant reductions in reporting as required under the RDR were identified. However, it must be noted that these reductions do not necessarily have a major effect on the public sector due to the types of transactions reported. Often, the RDR reductions do not apply to reporting of transactions and elements that are common in the public sector but rather focus upon elements of reporting that are far more prevalent in the commercial sector. Where the effect is obvious and useful it is reported as such in the sections below dealing with specific standards. These elements are identified using bold italics. Additionally, the issue of qualitative materiality is not considered here. However, this might also be an important consideration for future research as, while some reductions are logical for Tier 2 commercial organisations, qualitative materiality may mean that public sector organisations should still report items considered immaterial in a monetary sense.

In terms of financial reporting models adopted in WA, the Treasury has responsibility for determining the format and content of financial reports as well as the functional responsibility for considering the application of, amongst other things, A-IFRS. Hence, in relation to the disclosure of accounting information to the public, the state often decides what the minimum disclosure will be through legislation (Puxty et al., 1987). In this case it is by way of the Treasury models. Further, in the public sector environment, the decision-making process is undertaken in the development of the formal budget. In the public sector environment, this is an important accountability and transparency activity that is undertaken before the financial reports are prepared. Therefore, decision-usefulness as a criterion for standards development is somewhat suspect.

The remainder of this section considers the reduced disclosure requirements of the RDR regime on the context of five accounting standards as they would apply to the public sector. While the entire RDR suite of changes was considered, the five standards reported upon here
were considered to represent the standards where opportunities for efficiencies were likely to be achievable. In undertaking this analysis areas were identified where it was likely that efficiencies and/or improvements in financial reporting could to be realised and which would represent real savings or improvements as opposed to representing an apparent saving or improvement.

**a) Financial statement presentation (AASB 101)**

An important element in terms of considering the reporting requirements of public sector entities relates to the content and format of reports. The RDR elements applicable to AASB 101 are discussed below and the areas where the reduced disclosure arrangements are likely to represent efficiencies from a public sector perspective are identified in bold italics. The following do not apply to entities preparing GPFS under the RDR regime:

- Dividends per share and dividends declared after balance date and not recognised.
- *Restate a statement of financial position as at the beginning of the earliest comparative period when an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements.*
- An entity classifying expenses by function shall disclose additional information on the nature of expenses, including depreciation and amortisation expense and employee benefits expense.
- Capital management disclosures.
- Disclosure the entity's domicile, legal form, its country of incorporation, the address of its registered office and the nature of the entity’s operations and its principal activities.
- *Auditor remuneration.*
- Franking credit disclosures.
- Capital and expenditure commitments disclosures.

If we consider classification of expenses, AASB 101.99 allows an ‘income statement’ format analyzing expenses using a classification based on either the nature of expenses (NOE) or based on the function of expenses (FOE) within the entity. This decision depends on management's assessment of which format provides information that is reliable and more relevant (Grant Thornton Australia, 2011). One would have to question the subjectivity
associated with the assessment as well as potential for less harmonization rather than more under IFRS (RDR).

b) Financial instruments (AASB 7)

Key disclosures are excluded under the RDR are as follows:

- **Details of loan breaches during the period.** It would seem that this is an important disclosure in a public sector environment. Arguably, in a commercial sense, such breaches don't need to be reported. However, the application of this reduction in a public sector environment obviates against appropriate levels of transparency.

- Fair value hierarchy disclosures; ie, the analysis for financial instruments measured at fair value into the hierarchy reflecting the significance of the inputs used in making the measurements

- The disclosures of the risks arising from financial instruments and how they have been managed. Typically including credit risk, liquidity risk and market risk.

- Qualitative disclosures (the exposures to risk and how they arise; its objectives, policies and processes for managing the risk and the methods used to measure the risk; and any changes from the previous period)

- Quantitative disclosures (summary quantitative data about its exposure to that risk at the end of the reporting period)

It is clear that some aspects of the RDR will still be required to apply to what might otherwise be considered Tier 2 public sector entities and AASB 7 is a prime example. While private organisations would not necessarily need to report on those items excluded by RDR, it is considered that the public sector would always be required to report in a number of these areas, including those listed in the dot-points above. For instance, the WA Trading Corporation would be required to disclose the above information as it is material to the consolidation of whole of government reports and possibly includes significant risk. Such information also serves to provide better accountability.

c) Statement of Cash Flows (AASB 107)

Key disclosures are excluded under the RDR are as follows:

- Reconciliation of cash flows from operating activities (when an entity uses the direct method)
• **Disclosure cash received or paid from subsidiaries and other businesses in respect of both obtaining and losing control of subsidiaries or other businesses.** Arguably, this element should continue to be disclosed. Again, small commercial entities may not need to report this element, however, public sector entities need to report all such sales as a matter of transparency.

• Disclosure of the amount of the cash flows arising from the operating, investing and financing activities of each reportable segment

Some of the disclosures in AASB 101, 107 and 108, although not required to be disclosed in RDR financial statements will be required in special purpose financial statements (AASB Phase 2).

d) **Accounting Policies, Changes in Accounting Estimates and Errors (AASB 108)**

Key disclosures are excluded under the RDR are as follows:

- Disclosure of initial application of an Australian Accounting Standard effects on the current period or any prior period (AASB 108.28(b), 28(d), 28(e), 28(h))

- Disclosure of future impact of Australian Accounting Standards not yet operative (AASB 108. 30, 31)

As well, AASB 108 has removed any guidance relating to the restatement of comparative information.

e) **Disaggregated Disclosures (AASB 1052)**

Key disclosures are excluded under the RDR are as follows:

- Schedule of assets and liabilities by service (AASB 1052. 10A, para 15 -21)

- Schedule of income and expenses by service (AASB 1052. 10A, para 15 -21)

AASB 1052 only applies to local governments (paragraphs 11-14) and government departments (paragraphs 15-21), remembering that local governments do not have the option of adopting the RDR.

7. **Discussion and Conclusion**

For public sector entities other than the Australian Government and State, Territory and Local Governments currently preparing GPFSs, there may be some benefit from the substantially
reduced work under the revised system. Such benefits would be realised by both preparers and auditors. However, it is likely that such benefits will need to be identified on an agency by agency, state by state basis. That is, a minority of agencies are likely to have a requirement to report elements excluded by the RDR notwithstanding they are considered Tier 2 entities by their regulators as they would likely need to report on transactions that are of interest to government ministers, the Parliament and the general public. Such reporting may be required due to the qualitative material nature of the transactions (for future research). The unique nature of the public sector and the application of agency theory in that regard suggest that the reduction of reporting requirements may best be considered according to the nature of the agency reporting and the effect of the transactions being reported in relation to accountability and transparency rather than decision utility.

Overall, public sector agencies may enjoy savings in time and effort required to prepare the disclosures if it is decided that they should adopt the RDR (Tier 2) reporting requirements. However, the extent to which material efficiencies are identified as a result of adopting the RDR may be minimal as most agencies currently do not undertake activities nor generate transactions and elements requiring reporting in those areas that are reduced. Additionally, some considerable savings may be accrued should issues such as fair value measurement be considered by individual jurisdictions in the context of accountability and transparency rather than decision utility. The focus by jurisdictions on the cost of reporting fair values for assets such as land under roads or community assets that constitute the cultural heritage of the body politic may see the identification of significant preparation and assurance savings while not reducing in any way the utility of reports in the context of accountability and transparency. Indirect costs, such as audit costs, may also be reduced as a result of the reduction in disclosure. However, the fact that agencies do not currently report in a number of areas that are excluded under RDR implies that such savings are likely to be minimal.
Although the above mentioned benefits are very clear, there are two major policy challenges facing public sector regulators in the implementation of RDR. Firstly, there is the issue of consolidation of financial statements from entity level into the Whole of Government reports. Taking Western Australia as the example, current Whole of Government consolidated financial statements include three broad sub-sectors: the General Government Sector; the Public Non-Financial Corporations and the Public Financial Corporations. Each agency produces its own annual report. All controlled agencies, regardless of funding source or sector classification, have been included in the consolidated financial statements as they are wholly owned by the Government of Western Australia.

A very real challenge would be for each jurisdiction’s Treasury to allow the application of RDR across the bulk of the sector whilst still ensuring those unique agencies with substantive reporting obligations (arrived at due to the materiality and types of their transactions) report information that allows for effective and meaningful accountability, transparency and consolidation. Treasuries may consider the adoption of RDR exclusions for Tier 2 agencies but identify those few agencies that need to be excepted due to the requirements of Whole of Government consolidation. Arguably, such an approach will increase complexity and central government costs of reporting as, presumably, additional financial reporting models would need to be developed, verified and promulgated.

The second, and perhaps more policy level challenge, is in Treasuries considering the outcomes associated with the reporting of financial information, performance commentary and the unaligned requirements of the A-IFRS, RDR, Government Finance Statistical (GFS). Reporting as well as the consideration of efficiencies might be found in a more nuanced application of the standards themselves. An example here may be where a public sector regulator reconsiders the need for the continued valuation of assets which are administered and of a cultural or infrastructure nature that will not be sold. Examples include Hyde Park in
Sydney and Kings Park in Perth as well as, of course, the ubiquitous issue of valuing land under roads. Here funds are expended in arriving at a valuation when such assets are not going to be available for deployment against objectives of the government save in terms of social objectives. Additionally, should such assets ultimately be subject to a change of policy and be available for sale, then it would be necessary and appropriate to value such items as that point in time. Therefore, the discontinuation of the valuation of these assets is likely to see the realisation of substantial preparation and assurance savings as well as improvements in terms of user understandability.

According to Chan (2003, p.16), "theories underlying government accounting standards are mostly normative, in contrast to the development of positive theory in (business) financial accounting". With NPM forming the framework within which much of today's public sector accounting arrangements are developed, commercial practices mean positive accounting theories, amongst others, have been considered when analysing accounting choices (eg Pallot, 1992; Broadbent and Guthrie, 1992; McCue and Prier, 2007; Collin et al., 2009).

As Chan (2003) implied, RDR falls under the auspices of normative theory in that Treasury provides financial reporting models to the agencies each year. Now, the choice of whether to implement RDR or not, is one that they (Treasury) legislators, account preparers and politicians will need to make. Whatever format the Treasuries decide upon, model statements will be released, however, within those it is necessary for managers to make decisions based on choices – choices such as how much to disclose under RDR, measurement, valuation of assets, depreciation, materiality thresholds and so on. Agency theory dictates that, if given the choice, managers (agents) will select RDR only if it increases their welfare. In other words, their decision will be based on the benefits from disclosure outweighing the associated costs (Ness and Mirza, 1991). Unfortunately for the portfolio Ministers (direct principals) the associated benefits may not necessarily be transferred across.
As mentioned above, the amount of disclosure that the myriad users (indirect principals) consider relevant will be different for each of the various agencies. With Ministers being the subject of close media scrutiny, choices made by their agents can have serious consequences. With public sector agencies having to be more like their commercial counterparts under the guise of NPM, reporting and disclosure choices are not only becoming more complex but may be irrelevant as far as qualitative materiality is concerned. As well, this different look at agency theory within a NPM framework is one which, like the overall adoption of commercial accounting practices by the public sector, raises more issues and questions. These issues will be investigated as part of future research.

It is clear that the introduction of the RDR whereby the AASB is amending current accounting standards - hence it would fall under the auspices of the UKASB / EFRAG Discussion Paper - is an example of a situation that because it relates to the public sector, would be almost too complex one would think for standard setters to do an effects analysis prior to its implementation.

In regard to the RDR itself, following this review, it is likely that its application as it stands may only bring marginal benefits unless:

- Specific deviations from reporting requirements are established by Treasury for specific agencies in order to facilitate the consolidation process;
- Other elements of reduced disclosure, not necessarily considered by the RDR, are considered by public sector regulators with a view to seeking efficiencies by way of reviewing specific reporting entities’ financial reports and allowing for reductions that will ensure true efficiency gains. This exercise will have the added benefit of informing regulators with regard to the prospective discussions to be had when the AASB and the IPSASB pursue their work plans. Public sector regulators will be much better placed when they seek to influence the discussions pertaining to these projects as they will better understand what they are seeking.
- The combining of GFS Reporting with financial reporting would increase utility and efficiency in audit and reporting.
- The users of the reports themselves together with user requirements are identified with a view to establishing the audience and therefore the key elements of information requirements of that set of people.
Clearly, there are a number of issues associated with in the prospective pursuit of the above concerns. The suggestions are made so that all stakeholders can consider the full picture when evaluating the opportunities extant in RDR. Although only five standards were included here and could be considered a limitation of the study, enough information was provided to draw the conclusions stated. Future research will examine the RDR requirements in each accounting standard and compare it with the requirements of each Australian state and territory model templates. Impacted areas will be identified. This exercise will take the form of an examination of key agencies against the RDR and current reporting requirements with a view to assessing the areas where real and substantial savings / efficiencies can be gained both from a reporting and auditing perspective. Both this paper and future papers will assist other countries conduct similar analyses and also, perhaps, encourage standard setters to conduct some type of due process (as is being considered by EFRAG / ASB) prior to implementing any major, costly, changes.
Notes

1. Aus paragraphs specifically apply to not-for-profit reporting entities (AASB 2009).


4. In practical terms, public sector entities will only adopt the RDR if Treasuries provide model accounts as well as their imprimatur.

5. In essence, the final point (c), is applicable provided public sector regulators in each jurisdiction allow entities to adopt (AASB 1053, paragraph 15).

6. We have not challenged the apparent primacy of decision usefulness as a criterion in this paper. Given the budget and estimates processes and the focus of government, parliament and the general public on the budget itself, we consider that the idea of decision usefulness is not of primary importance in the context of public sector financial reporting. Rather, we would consider that transparency, understandability and accountability are much higher priorities. However, this is a subject of future research we intend to undertake.

7. There are 6 states and 2 territories in Australia. The states are Western Australia, South Australia, New South Wales, Queensland, Victoria, Tasmania whilst the territories include the Northern Territory and the Australian Capital Territory.
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