Accounting Standards in the Australian and New Zealand Public Administrations: Experiences and Perspectives

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Abstract:

This paper examines the current move to the international harmonisation of public sector accounting standards in Australia and New Zealand. It argues that an examination of the historical arrangements to standard setting will do much to inform the current dilemmas posed by the current international harmonisation process. New Zealand has always had an 'adoption' culture and has had sector-neutral standards. On the other hand, in Australia the private sector has dominated the consciousness of the professional accounting standards regulators. The public sector has been the forgotten sector, and rather than being allowed to develop its own standards that suit its unique operating characteristics, it has had to fall in line with the political decisions made on behalf of the private sector. The paper draws on examples to illustrate the unintended consequences of these decisions.
Introduction

Australian and New Zealand government and professional bodies have long been regarded, and promoted themselves through out the world, as leading the way in developing innovative accounting standards and accounting reforms in both the private and public sector administrations (Collett, et al 1998)). They also purport to have played a prominent role in the development of the International Accounting Standards Board (IASB). Also that they are currently playing a significant role in the program of revising International Accounting Standards (IAS) to a quality suitable for them to be among the early adopters of the International Financial Reporting Standards (IFRS’ s) from periods on or ending after 1 January 2005 for Australia, and for New Zealand from 2007 (QAO, 2003).

Similarly, in public sector administration, Ball (2003) argues there is a significant relationship between the innovation in government financial management that has occurred in Australia and New Zealand, and the developments that have taken place in the International Financial Accounting Committee (IFAC). Australian and New Zealand public administrations and governments have taken bold initiatives to reform public sector accounting and reporting since the early 1980s to the present (Guthrie, J. et al, (2004, forthcoming); Guthrie, Olson, O. and C. Humphrey, (1999); Guthrie, J., Parker, L.D. and Shand, D. (1990); Jones, L. R., Guthrie, J. and P. Steane, eds., (2001a; b); Olson, O., Guthrie, J. and C. Humphrey, (1998). Also the Australian and New Zealand professional accounting bodies have similarly made significant contributions in developing accounting standards and have provided significant leadership roles in the IFAC work in its Public Sector Committee (PSC) (CPA News, 2003).

There has been a considerable amount written about the contemporary harmonisation process, but scant attention has been given to the impact of the decision on the public sector. This paper focuses on the issues of harmonization for the public sector in Australia and New Zealand, and argues that an examination of the history of the accounting standard setting process in both jurisdictions can explain the current position
of the public sector in relation to harmonization. Moreover, in relation to Australia, an historical examination also reveals that once again, decisions on standard setting are led by private sector wishes to the detriment of the public sector. Indeed, the pattern of events currently being witnessed in public sector accounting standard setting in Australia, is a case of history repeating itself. In the early 1980s in Australia, the public sector accounting standard setting process was colonized by private sector regulators with no consideration of the unintended consequences (Mack et al 2001). In 2003, the pursuit of the harmonization of international public sector accounting standards is again being promoted by the private sector regulators with no consideration of the unintended consequences for the public sector.

The paper proceeds as follows. The next section examines the institutional arrangements surrounding public sector accounting standard setting. The section following examines various aspects of the decision to adopt International Financial Reporting Standards. Specific implications for the public sector are then highlighted and in the final section, conclusions are drawn.

2. Development of Institutional arrangements for public sector accounting standard setting

New Zealand and Australia have followed different paths in their institutional arrangements for standard setting. The New Zealand Society of Accountants (NZSA) produced its first set of accounting pronouncements, in 1946 (Bradbury, 1998). These were based on English standards, and Bradbury (1998) argues that there was a 'culture' of adoption from the outset. This contrasted to the approach adopted in Australia, which modified the English standards to the local environment. In 1974, New Zealand became an associate member of the International Accounting Standards Committee (IASC), a year after it was established. From this time, New Zealand took its membership seriously, and Bradbury (1998, p19) notes that "the first issue of its new accounting standard series carried the IASC crest". The other striking difference between Australia and New
Zealand, is that New Zealand have always had sector-neutral standards. Unlike the situation in Australia, the public sector as a group, has not been vocal in pushing for a separate identity.

In Australia, in 1966, the professional accounting bodies, through their jointly funded Australian Accounting Research Foundation (AARF) started to become involved in accounting standard setting in Australia. The AARF had an Accounting Standards Board (AcSB) to develop standards, however, few were issued until around the mid seventies, and compliance was limited to conformity by members of the profession.

The setting of rules, directives or standards for public sector accounting was historically in the hands of Treasury departments and Departments of Finance up until the early 1970’s (Nicholls, 1991; Ryan, 1998). From the mid 1970s there was constant pressure exerted by Auditors-General particularly from the Commonwealth, NSW and Victoria on the accounting profession to consider accounting standards for the public sector (Guthrie, 1987; 1990; Ryan 1995). This pressure was also exerted by the rank and file professionals working through the Australian Society of Accountants Government's Committee (now CPA Australia). However, the profession failed to respond, and the Commonwealth Auditor General in conjunction with the Department of Finance commenced producing their own public sector accounting standards. A Report of the Joint Committee of Public Accounts in 1982 (JCPA, 1982) made a case for a conceptual framework for government accounting and the need to establish a Public Sector Accounting and Audit Committee by the public sector.

The public sector was effectively promoting its own accounting standard setting body because of a complete lack of interest in the sector by the profession (Ryan, 1999). However, the accounting professional bodies quickly responded, by establishing the Public Sector Accounting Standards Board (PSASB) to work along side an Accounting Standards Board (AcSB), within their jointly funded Australian Accounting Research Foundation (AARF) structure. The Australian accounting professional bodies under a self regulation regime quickly developed general purpose financial reporting (GPFR) for
the private and public sectors by working in parallel in developing a set of common Australian Accounting Standards (AAS) which it required its members to follow.

Concerns of the accounting profession’s dominant influence on accounting standard setting and government concerns of non-compliance issues (Walker, 1989), resulted (in standard setting for the corporate sector being taken away from the profession, and a new supposedly independent government sponsored Accounting Standards Review Board (ASRB) being formed in 1984. While the AARF relinquished its direct responsibility for approving private sector standards, the PSASB of AARF continued to develop a parallel set of non-mandatory standards (AAS series) with application to the public sector and not-for-profit entities. Walker (1987) claimed regulatory capture of the ASRB by the professional accounting bodies and cites a number of circumstances in support of the claim, including the large representation of members from the professional accounting bodies on the Board, and that AARF controlled the agenda of the ASRB by initiating almost all development and submission of standards for review.

During the 1980s, the control of the private sector accounting standard body alternated between the profession, to government and back to the profession. However, the PSASB continued to develop public sector specific standards. From the mid 1980s the private sector board and the PSASB worked on joint projects under the same conceptual framework. Once again, the agenda of the private sector dominated (Wise and Wise 1985) and progress on the development of public sector standards was hampered (Shand, 1989).

Towards the end of the late 1980s, the public sector became so frustrated about the lack of progress on public sector accounting standards that the Treasuries and Departments of Finance in each Australian jurisdiction commenced funding the PSASB (a profession sponsored board) to produce specific public sector standards. (Ryan, 1999). As a consequence, in Australia, in the early 1990’s, three accounting standards that specifically applied to the public sector were produced:- AAS27: Financial Reporting by Local Government”, in 1991; AAS29: Financial Reporting by Government Departments
(in 1993); and Financial Reporting by Government, in 1996 were issued. Other issues such as infrastructure and heritage assets were addressed using conceptual framework principles. Parallel with this during the 1990s, various accounting reforms at state and federal level, saw states and the federal government adopt an accrual basis consolidated accounts, and accrual accounting for reporting and financial management practices (Ryan, 1999). The public sector was relatively satisfied with the attention being paid to their specific issues, but as has been argued it was only once again because of the intervention of the public sector itself over the accounting standard setting bodies. This theme is to be replayed in the harmonisation decisions of the early 2000s.

During this time, Australia issued a number of policy statements with the aim of achieving harmonisation within Australia and with New Zealand. In 1994 the AASB issued Policy Statement 2 (PS2): The Operation of Consultative Groups to the AASB and PSASB which aimed to harmonise accounting standards between the AASB and the New Zealand Accounting Standards Review Board (NZASRB). In 1992, the AASB issuing Policy Statement 6 (PS6): International harmonisation, which set a course for the AASB to embark on harmonisation with international accounting standards of the IASC (now IASB), although the statement acknowledges that not all differences would be resolved. This was later made redundant when a later change in policy resulted in the issue in 2002 AASB Policy Statement (PS4): International Convergence and Harmonisation Policy.

In 1997, the Corporate Law and Economic Reform Program (CLERP) bought another major regulatory change to standard setting institutions and arrangements. A new standard setting structure saw the establishment of the Financial Reporting Council (FRC), with the government obtaining more control in choosing members of the Council which had powers to set the strategy of the AASB. In May 2000, another significant institutional change occurred when a new government sponsored Australian Accounting Standards Board (AASBnew) was formed to take over the exiting AASB and the PSASB, to assume responsibility for accounting standard setting for all entities including companies, public sector and not-for-profit entities (Collett et al 1998). Widespread
anecdotal evidence existed that the fear was that the public sector would, once again fall to the priorities of the private sector, and public sector specific projects such as BOOT arrangements that were still outstanding would not be advanced.

According to Ball (2002), at this point both Australia and New Zealand were truly harmonised to the extent of having one set of sector neutral accounting standards, and in instituting radical programs of reforms in the area of government financial reporting and budgeting and various levels, thereby setting the benchmark for other countries. He maintains that these reforms were hugely important innovations that have unquestionably influenced the attitudes of governments and international institutions as to what constitutes “best practice” for public sector reporting.

The FRC in Australia announced somewhat unexpectedly in July, 2002 a new convergence policy and plans to fully adopt international Accounting standards, from reporting periods beginning on or after 1 January 2005. The New Zealand Accounting Standards Board (NZASB) also announced its plans in December 2002, to adopt from reporting periods on or after 1 January 2007.

While this section has developed the theme of an Australian accounting standard setting regime that was unresponsive to a public sector, the next section examines the specific details surrounding the decision to adopt international financial reporting standards.

3. The Decision to Adopt IFRS

There are a number of issues to consider in making a momentous decision about whether to converge with international accounting standards. Ryan et al (2004) analyses these issues such as: what form of convergence; what are the perceived benefits; what are the costs and risks involved? Then there other implementation issues such as when to adopt, and what will the level and scope of the adoption be. The rest of this section will briefly outline how it will be operationalised in Australia.
Operationalising the adoption policy

According to the latest AASB plans for adopting IASB standards by 2005 (updated 27 October, 2003) the intention is that international financial reporting standards will apply to all reporting entities in the private and public sector, including not-for profit reporting entities. The exact means by which this will be operationalised is still being finalised. It is planned to also adopt the IASB’s conceptual framework project in place of Australia’s Statements of Accounting Concepts, and at this stage the AASB intends to retain SAC1: Definition of the Reporting Entity, although it may be modified by the IASB’s small to medium business project.

The reporting entity concept in SAC1 is currently used to determine entities required to prepare general purpose financial reports and the applicability of AASB standards. SAC1 defines a reporting entity as:

Reporting entities are all entities (including economic entities) in respect of which it is reasonable to expect the existence of users dependent on general purpose reports for information which will be useful for them for making and evaluating decisions about the allocation of scarce resources.

The update suggests that all non-reporting entities will still need to apply recognition and measurement criteria, but not all disclosure requirements will apply. Non-corporate entities that are not reporting entities will only be required to apply the accounting standards deemed necessary by the members of the governing body. Where the trust deed or other governing constitution requires a “true and fair” view to be provided, then all the material recognition and measurement criteria of the IFRS’s will apply.

The AASB may permit only one of a number of options available in IASB standards. Australia, and particularly in the public sector, has traditionally not allowed alternatives within standards, and therefore in the interest of aiming for the highest quality of financial reporting in adopting IASB standards, the AASB may permit one of a number of options available in IASB standards. It can be argued that the approach of avoiding
offering alternatives and, obliging the use of the ‘best choice’ as determined by the AASB, subject to due process, simply creates an Australianised version of the IASB standards (CPA Policy Brief, 19 September, 2003). As a result, it could be argued that this approach is really a continuation of the process of harmonisation and convergence, rather than full adoption. The alternative is to implement IAS standards word for word, including any alternatives offered. CPA Australia have suggested a compromise view which suggests that there should be word for word adoption (including options) if there is no equivalent standard in Australia, however if there is an equivalent Australian standard that specifies one treatment that is also a treatment provided for in the IFRS, then the alternative treatments should not be allowed.

The AASB may require additional disclosures, particularly where these are already required under an existing AASB standards. In this way the minimum requirements of the IASB standards will be met, but additional requirements may be required to maintain the current high standard of reporting, and to conform with the local conditions and environment. The alternative is to have full word for word adoption, without additional disclosures, and to achieve additional disclosures in some other way, such as through stock exchange listing requirements would be one way, at least for listed corporations. The criticism of this second alternative is that it ignores the private nature of stock exchanges, and also ignores non-listed and not-for-profit entities.

It is planned that suitably identified additional text, such as by the designate NFP’, will be included to deal with those limited cases where there is a need to have different or additional requirements for not-for-profit entities. This reflects the approach of adopting a single set of standards that are applicable to both for-profit and not-for-profit entities. The Public Sector Committee of the IASB will be used to make the IASB aware of issues that require different or additional requirements.

The AASB also plans to retain the practice of using commentary guidance in its standards, which do not actually form part of the standard, even though commentary is not included in the equivalent IASB standards. Guidance can be provided in dealing with
situations commonly encountered in the Australian environment but which is not catered for in the IASB standards.

Finally, the AASB will prohibit the early adoption of AASB equivalents of IASB standards to prevent what it refers to as the potential adverse impact on users of financial reports if different entities were to prepare reports using different sets of standards in the same period. While this rational is understandable, it is the same when the AASB allows early adoption of newly issued standards where early adopters are reporting under a different standard to late adopters.

4. **Public sector Impact and Issues**

The Financial Reporting Council's decision to adopt International Financial Reporting Standards is equally applicable to the public as well as private sector. This was foreshadowed in ED 102: *International Convergence and Harmonisation*, issued in July 2001, which not only referred to harmonisation and convergence with IASB standards but also referred to the International Financial Accounting Committee’s (IFACs), Public Sector Committee (PSC) standards, with the intention to give equal recognition to the need to harmonise AASB standards with both IASB and PSC Standards. The adoption announcements since confirm this with respect to the new adoption policy that is said to deliver one set of sector neutral financial reporting standards that will serve the needs of the public, private as well as not-for-profit sectors.

The PSC began the first phase of the standards project in late 1996 where it began the process of developing international public sector accounting standards (IPSASs) based on the International Accounting Standards (IASs) (Alfredson, 2002). It is intended that these standards and supporting commentary will provide the minimum benchmark for financial reporting by public sector government entities and their agencies at national, state and local level. Mackintosh and Sutcliffe (2003) report that by the end of 2003 the IFAC will have issued twenty IPAS’s based on IASs/ IFRSs for application in the preparation of accrual accounting financial statements adapted for public sector circumstances, to the
extent that those standards were applicable to the public sector. In addition, it has released an Exposure Draft of a standard on Financial reporting under cash Basis Accounting. Further it has issued a study to provide guidance to assist government and other public sector entities’ in transitioning from the basis of accounting the entity uses, to the accrual basis.

The second phase of the PSC standards project has identified a number of public sector specific issues not addressed, or not adequately addressed, by international accounting standards. Some of the areas that have not been dealt with in IASs include:

- Taxes and other non-reciprocal revenue
- Provisions arising from social initiatives
- Non-financial performance reporting
- Government budgets
- Public/private sector arrangements
- Harmonisation of IPASS with GFS and system of national accounts
- Measurement of infrastructure and heritage assets

Again, in a further effort to get some prominence placed on public sector issues in the push for internationalisation, the Australian Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC) established a working group to prioritise the forward work programs of the IASB, AASB, UIG and PSC of the IFA. The aim of this is to formulate a HOTARAC position and submissions to the AASB. In addition, to the harmonisation of international accounting standards, the FRC also issued strategic direction under s.225 of the Australian Securities and Investment Commission Act 2001 which required the AASB to pursue the harmonisation of Australian Accounting Standards (AAS) applicable to the public sector, and Government Finance Statistics (GFS) for public sector reporting. GFS are required to be used by all governments by the Australian Loans Council, in presenting their budget and statistical reports in accordance with the uniform presentation framework (UPF) that allows comparison between jurisdictions and the formation of national aggregates. UPF is based on internationally
accepted GFS concepts and classifications used by the Australian Bureau of Statistics in preparation of public sector finance reports.

The issue of convergence between GAAP (accounting professions perspectives) and IMFs Government Financial Statistics (GFS) (economic professions perspectives) of public sector performance reporting is not only limited to Australia and New Zealand. These issues are being debated in forums such as the IMF, OECD, IFAC PSC and EUROSTAT. However, currently the IASB is not considering public sector issues and this important issue (Challen, 2003).

In Australia, harmonisation of AAS and GFS is a high priority of the HoTARAC along with convergence of international accounting standards (HoTARAC, 2003). As part of these developments, the current domestic AAS standards that are specifically applicable to the public sector (AAS 27, 29 and 31) will also be subject to review and change that will make them more relevant and aligned with IFRS and other developments.

5. Conclusions

There are two major conclusions that can be drawn about the current debate on international accounting standards and its impact on the public sectors in Australia and New Zealand. The first concerns the headlong rush to include the public sector in the international umbrella, without considering the unintended consequences which may arise: “the successful adoption of IFRS in Australia will be measured by our ability to deliver one set of financial reporting standards that serve the needs of Australia’s public, private, and not-for-profit sectors…” (CPA Information Centre, “International financial reporting standard”, September/October, 2003). Moreover, Larsen (2002) has argued that if we get the transition right, Australian business and Australia’s economy will benefit and therefore we must support the ongoing integration of Australia’s economy in the world economy, to deliver lower costs of capital for business and to aid your business’s international expansion. However, these arguments have been entirely premised from the private sector viewpoint. The continuing debate over the internationalisation of
accounting standards is reminiscent of the debate which occurred over a quarter of a century ago when the needs of the private sector were placed above the public sector. The public sector was asked to 'tag along' with the development of standards. It took the public sector itself to argue their unique features and to argue for a real consideration of their own cause. The exact same situation is repeating itself in Australia currently in the name of harmonisation.

The second conclusion concerns the impact of the internationalisation process. Haswell and McKinnon (2003) argue that the FRC has made an enormous gamble and suggest that “if the gamble is wrong, then we end up with inadequate standards that do not suit Australia and cannot be easily be changed.” Further, the FRC Chairman, Jeff Lucy stated (AFR, 8 July, 2002) that “Australian accounting standards have always been of the highest quality. The problem that we suffer is no one else understands them [and so] If you want to play the an international game, you have to use a language that everyone understands. Haswell and McKinnon (2003) argue that this statement represents the most significant reversal of thinking in 20 years of Australian accounting regulation, implying that local requirement and innovations are now less important than the need for uniformity. Although they acknowledge that many other country’s standard setters have been influenced to some degree by the IASB in various ways, but point out that only a few countries in the developing world have adopted IFRS as a complete template, and suggest that this was because they did not have the resources to develop their own. Further, they argue that “Australia’s eminent role as a provider of accounting knowledge, combined with efforts made over several decades to develop an Australian financial reporting system, make the proposed switch to IFRS all the more intriguing”. In the case of both Australia and New Zealand, it could be argued that the move to IFRS has meant that there has been an ad hoc movement away from sector-neutral standards, instead of a planned and reasoned revisititation of the unique issues relating to the public sector. In the rush towards harmonisation, Australia has lost an opportunity for the public sector, the jury is still out in the case of New Zealand.
In summary, Haswell and McKinnon (2003) argue that “attempts to downplay problems in international standard setting mask a set of political decisions which emphasize expediency, favour large corporate interests over smaller, and make questionable assumptions about the future risks to corporate governance.

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