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

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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").[1] 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.

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.

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 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;

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).

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).

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

No.	Australian Accounting Standards	
25	AASB 136	Impairment of Assets
26	AASB 137	Provisions, Contingent Liabilities and Contingent Assets
27	AASB 138	Intangible Assets
28	AASB 140	Investment Property
29	AASB 141	Agriculture
30	AASB 1050	Administered Items
31	AASB 1052	Disaggregated Disclosures

(Source: www.AASB.gov.au)

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).

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 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) 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.

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.

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.[7] 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.

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