

Choosing Between Tiers – Guidance for Public Sector

Background

1. The Board tentatively decided at its May 2010 meeting that public sector entities other than Federal, State and Territory Governments (both General Government Sector and whole of government) and Local Governments should be allowed to elect to apply the Reduced Disclosure Regime (RDR) unless relevant regulators require the application of full IFRSs as adopted in Australia.
2. Some respondents to ED 192 *Revised Differential Reporting Framework* (and related Consultation Paper) commented that, while they welcome the choice that the AASB has provided to public sector regulators, the AASB should develop non-mandatory guidance, in the form of qualitative criteria, to help public sector regulators consistently identify entities falling under the two tiers of GPFS reporting requirements.
3. These commentators also considered the possibility of using quantitative criteria but some opined it would not be appropriate for the AASB to introduce size thresholds. However, they did not rule out the possibility of the jurisdictions themselves using size thresholds.
4. Staff note that the AASB has in the past examined the use of size thresholds to distinguish between entities falling under different tiers of reporting requirements. 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* (issued in 2007) proposed size thresholds of \$25m of revenues and \$12.5m of assets for both NFP private sector and public sector entities. Entities exceeding either of the thresholds were proposed to apply Tier 1 requirements and those below both thresholds were proposed to apply Tier 2 requirements.
5. Some respondents to ITC 12 proposals were concerned about using size thresholds citing the following reasons:
 - (a) size thresholds are arbitrary;
 - (b) size thresholds will become outdated overtime;
 - (c) asset-rich not-for-profit private sector entities with insignificant revenues would be forced to report under Tier 1; and
 - (c) particularly in the public sector, unless jurisdiction-specific thresholds are prescribed, it would lead to similar entities applying different requirements across different jurisdictions.
6. Accordingly the Board did not propose the use of size thresholds in ED 192. Staff have interpreted this decision as implying that the Board would be reluctant to provide guidance involving size thresholds to public sector regulators to help them distinguish between Tier 1 and Tier 2 entities.

Constituent comments made in the context of ED 192

7. Constituents who have proposed issuance of guidance by the AASB have noted that:
 - (a) factors that should be considered in developing this guidance could include cost benefits, whether the entity is a material entity to be consolidated into the whole-of-government financial statements and the level of political sensitivity associated with the entity;
 - (b) a framework for decision making that considered the risk profile, level of complexity of the entity and size would be an appropriate benchmark; and
 - (c) the criteria for identifying Tier 1 and Tier 2 public sector entities in a jurisdiction should involve limited subjectivity, since, otherwise, it may lead to inconsistent outcomes when applied across a jurisdiction.

NZ experience

8. The current *New Zealand Framework for Differential Reporting* (the NZ Framework) uses public accountability, separation between owners and governing body of an entity and size thresholds as criteria to identify entities that do not qualify for differential reporting concessions. The NZ Framework defines public accountability as:

“An entity has public accountability for the purposes of this Framework if:

 - (a) at any time during the current or the preceding reporting period, the entity (whether in the public or the private sector) was an issuer as defined in the Financial Reporting Act 1993; or*
 - (b) the entity has the coercive power to tax, rate or levy to obtain public funds.”*
9. New Zealand ASRB published a discussion document titled ‘*Proposed Application of Accounting and Assurance Standards under the Proposed New Statutory Framework for Financial Reporting*’. The discussion document’s proposals in regard to identifying different tiers of public benefit entities (PBEs) in the public sector are summarised in the following table:

	PBEs in the Public Sector	Accounting standards
Tier 1	Crown Local authorities Other leviars of coercive revenue (such as Fire Services Commission, Accident Compensation Corporation, and Earthquake Commission) Other entities with expenditure \geq NZ\$20m	IPSASs
Tier 2	Entities with expenditure \geq NZ\$2m and $<$ NZ\$20m Entities with expenditure $<$ NZ\$2m which are issuers	Differential IPSASs
Tier 3	Entities with expenditure $<$ NZ\$2m	Simple format reporting

10. The notion of ‘coercive power’ to obtain public funds is one of the bases used to identify public sector entities subject to full NZ GAAP under the current regime or identify Tier 1 entities that would be subject to full IPSASs under the ASRB proposals.

Possible qualitative criteria

Coercive power to obtain public funds

11. The notion of having coercive power to obtain public funds could possibly be used as a qualitative factor to distinguish between Tier 1 and Tier 2 public sector entities. To operationalise the criterion, consideration would need to be given to whether the coercion applies only to ‘controlled items’ or whether an entity responsible for ‘administering’ coercive powers would meet the criterion. If it is considered that too many entities would be caught by such a criterion, regard could be had to the amount of public funds collected.
12. Staff note the coercive power to tax, rate or levy in the New Zealand context only encompasses entities that have that power and use the collected funds in their operations. Accordingly entities that ‘administer’ coercive power such as the NZ Inland Revenue Department which collects money on behalf of the Crown, would not have public accountability as envisaged in the ASRB document. On the other hand, entities such as Fire Services Commission, Accident Compensation Corporation, and Earthquake Commission would have public accountability since they control the collected funds.

Level of public funds used

13. Entities in the public sector vary in the degree to which they are publicly funded vs funded through user charges, the discretion over the distribution /expenditure of public funds, and the nature of that spending (eg operational, such as hospitals vs income redistribution such as Department of Veteran Affairs). It might be useful for a jurisdiction to consider these factors in deciding whether or not a particular public sector entity should fall within Tier 1 or Tier 2 reporting.

Risk profile

14. Generally, risk in the public sector is a reference to uncertainty in achieving an organisation's objectives. It may be argued that more comprehensive disclosures would be warranted where an entity is seen as having a high risk profile. Whether political risk should be a factor here is a moot point, and if it is not to be a factor how is it to be excluded?

Level of complexity

15. The level of complexity of public sector entities varies with the nature, diversity and range of their activities, which may also point to the existence of a wide range of stakeholders. Accordingly, 'level of complexity' might be a useful factor to consider in distinguishing between Tier 1 and Tier 2 entities.

Size

16. The size of entities could be indicative of their financial profile and point to their economic significance and ability in providing services, which would in turn have an impact on the level of public interest. Accordingly, 'size' might be a useful factor or a proxy for other factors in distinguishing between Tier 1 and tier 2 entities.

Possible approaches to non-mandatory guidance

17. Staff acknowledge that there might be benefits in all jurisdictions, as regulators, applying similar criteria in deciding which public sector entities are Tier 1 vs Tier 2. If the Board decides that the AASB should develop guidance to assist jurisdictions, the guidance could focus on one of these broad criteria:
- (a) Qualitative factors such as financial profile (size), risk profile and level of complexity. Size thresholds may be utilised where they provide a good approximation of the significance of these qualitative factors. In setting size thresholds often a number of thresholds relating to assets, revenue, number of employees and similar indicators of size could be used. A requirement to meet more than one threshold might help consistency in determining entities falling under different Tiers of GPFS reporting requirements within a jurisdiction.
 - (b) The significance of funds obtained through coercive power such as taxes, rates and levies, whether in controlled or administered category or both. Significance could be approximated by size thresholds set by jurisdictions; and
 - (c) The significance of any discretion over use of public funds whether in controlled or administered category or both. Significance could be approximated by size thresholds set by jurisdictions.

Staff recommendation

18. On balance, staff prefer coercive power to tax, rate or levy. We do not favour the 'public fund' broad criteria because almost all public sector entities use public funds. Staff note while the notion of financial profile (size) may provide a basis for differentiation, using risk profile and level of complexity as the basis to distinguish between tiers is less objective than the coercive power to tax, rate or levy.
19. Should the Board decide to provide guidance to public sector regulators, staff are of the view that the notion of 'coercive power to tax, rate or levy' may provide an objective basis for such guidance. The 'coercive funds' broad criteria is consistent with the fact that the Board has already deemed local governments who have the

coercive power to rate as Tier 1 entities. The Board needs to decide whether coercion applies only to 'controlled items' or whether an entity responsible for 'administering' coercive powers should also be regarded as having the coercive power to tax, rate or levy.

If the coercive power to tax, rate or levy is adopted by the Board as the qualitative characteristic that points to the need to consider whether an entity should be classified as a Tier 1 entity, the jurisdictions could then use their own criteria (such as size thresholds) to distinguish between entities with such a characteristic that should apply Tier 1 or Tier 2.

This approach may also help to put the differential reporting in the public sector in Australia on a more comparable basis with New Zealand, assuming New Zealand proceeds with its present proposals. Greater harmony between Australia and New Zealand would be consistent with the Outcome Proposals arising from the Joint Statement of Intent issued by the Prime Ministers of the two countries in August 2009.