

17 January 2017

Ms. Kris Peach  
Chair  
Australian Accounting Standards Board  
PO Box 204  
Collins St West Victoria 8007  
AUSTRALIA

By email: [standard@asb.gov.au](mailto:standard@asb.gov.au)

Dear Kris

**Invitation to Comment 37 *The AASB's Standard-Setting Frameworks for For-Profit Entities and Not-for-Profit Entities***

The Australasian Council of Auditors-General (ACAG) welcomes the opportunity to comment on the AASB's proposed standard-setting frameworks for for-profit entities and not-for-profit entities. The views expressed in this submission represent those of all Australian members of ACAG.

ACAG's comments are primarily in the context of the not-for-profit public sector, which reflects ACAG's audit experience and significant involvement in the sector.

ACAG observe that Australia's adoption and application in 2005 of the for-profit focused IFRS to both for-profit and not-for-profit entities, has in practice led to a suite of issued AASB standards which do not sufficiently or appropriately distinguish between the financial reporting accountability outcomes in the private sector (profit oriented) and that of the NFP public sector (service delivery/outcome oriented).

There is merit therefore in the AASB considering how these fundamental differences in financial reporting outcomes can be better taken into account in the proposed frameworks.

ACAG note that it is for regulators (including governments) to determine not only which NFP entities need to report publicly, but also to determine what framework and standards to adopt. ACAG has a neutral position in this regard, but clarify from an audit perspective, that we do not perceive any significant audit impediments or issues should the basis on which NFP standards are set be changed, or if the assumptions underpinning the process are varied.

ACAG appreciates the opportunity to comment and trust that you will find the attached comments useful.

Yours sincerely



Andrew Greaves

**Chairman**

**ACAG Financial Reporting and Accounting Committee**

## Specific Matters for Comment

The AASB would particularly value comments on the following:

**1. Is the term “not-for-profit” helpful to understand the nature of the entities in that sector? If not, what other term do you consider is more appropriate?**

The term ‘not for profit’ alone is not a useful distinction to aid understanding of the nature of entities that are not in the private (market) sector.

In the Australian context, it is common to categorise entities as participating either in:

- the private sector
- the public sector
- the ‘not-for-profit’ sector (for example, see the ACNC site [https://www.acnc.gov.au/ACNC/About ACNC/Research/Background NFP/ACNC/Edu/NFP\\_background.aspx?hkey=e88db8f0-3e48-4408-ab99-c2acb6ef8a1d](https://www.acnc.gov.au/ACNC/About_ACNC/Research/Background_NFP/ACNC/Edu/NFP_background.aspx?hkey=e88db8f0-3e48-4408-ab99-c2acb6ef8a1d))

Naming the ‘third’ sector ‘not-for-profit’ is of itself misleading, as some entities in this sector may be market participants, or some of the activities they undertake may be profit-oriented.

For the public sector also, some entities are designated as ‘for-profit’, although these entities, typically, are monopoly providers and as such do not compete in the market; and/or are price regulated; and/or have a significant cost associated with community service obligations that require subsidisation.

Other jurisdictions, notably the United Kingdom and New Zealand, use the term ‘public benefit entity’ to describe reporting entities whose *‘primary objective is to provide goods or services for the general public or social benefit and where any equity/risk capital has been provided with a view to supporting that primary objective rather than with a view to a financial return to equity shareholders’*.

This formulation is a positive statement about what these entities are ‘for’, rather than what they are ‘not for’. It serves to establish that the performance reporting framework for such entities needs both to reflect the differences in the type and nature of transactions entered into; and that the motivation for entering into these transactions is not profit. This should serve also to make it clearer that traditional measures of financial performance such as net profit and return on assets are less meaningful; and that non-financial performance measures of efficiency and effectiveness, are more meaningful.

ACAG notes that the term ‘for benefit’ has some support and traction with not-for-profit sector stakeholders. However, this formulation may require a change in stakeholder perception and understanding because the for-profit sector is seen to provide significant stakeholder benefits in terms of key profitability and returns on investment metrics.

**2. Irrespective of your response to question one, is there enough guidance about which entities are, for-profit entities and not-for-profit entities? The NZASB is commencing a project to improve its guidance. Should the AASB work with NZASB on this?**

The present definition—*an entity whose principal objective is not the generation of profit*—is circular, and so of little utility in guiding categorisation where there are both complementary and competing variables to consider, such as those outlined in our response to question one.

To overcome this circularity ACAG notes that the definition used by the Productivity Commission in its 2010 research report '*Contribution of the Not-for-profit sector*' may be one starting point for guidance (i.e. an organisation that imposes the non-distribution of profits to the members of the organisation).

ACAG supports collaborative research work on this topic with the NZASB. However, a significant amount of Australian-specific sector research has not been performed in recent years. A more contemporary study would be useful based on modern knowledge, research and experience.

**3. Do you have any other comments on the AASB's draft Standard-Setting Frameworks?**

ACAG notes that the objectives of the NFP Standard Setting Framework, as described in ITC 37, are to:

- maintain confidence in the Australian economy (including the NFP sector)
- obtain the benefits of comparability within and across sectors
- facilitate movement of professionals across sectors
- ensure the cost of complying with Australian Accounting Standards do not outweigh the benefits.

ACAG note further that to realise these objectives, the NFP framework is predicated on two key assumptions:

- IFRS Standards are appropriate as a base
- transaction neutrality.

ITC 37 states that 'When there is evidence these assumptions are no longer appropriate for the Australian context, this framework will be reconsidered'.

ACAG supports the assumption of transaction neutrality, but notes that the majority of significant transactions and balances in public sector NFPs do not have a direct corollary in the for-profit private sector (e.g. taxes, duties, fees and charges; recurrent operating grants; social infrastructure assets, the unfunded liability in defined benefit pension schemes). We note also that this assumption has not always been applied in practice (e.g. treatment of capital grants) with no clear rationale for deviation.

*International Public Sector Standards*

With regard to the use of IFRS as the appropriate base, ACAG notes that the '*AASB Policy and Processes*' include '*contributing to the technical agenda and processes of the IPSASB in order to foster the development of IPSASs on the basis that IPSASs are expected, in due course, to become the most relevant and appropriate Standards for public sector not-for-profit entities*'.

Given the AASBs own policy position it is timely to pose the question as to how and when it is to be judged that the IPSAS will become *the most relevant and appropriate standards*. At that time there would be a strong case to adopt the assumption that the IPSAS rather than the IFRS are the appropriate base.

ACAG note in contrast to Australia, almost all other major jurisdictions develop and maintain their own set of public sector specific standards, and of these most adopt International Public Sector Accounting Standards (IPSAS) issued by the IPSASB, recognising that the use of sectors and tiers is an appropriate proxy for the different user needs and the costs versus benefits of entities providing general purpose financial statements. As noted above, for example the NZASB in New Zealand made the decision to move away from International Financial Reporting Standards (IFRS) for public sector reporting in 2009 and has since converged with IPSAS.

ACAG notes there are 22 national governments, bodies and organisations who have adopted, or have stated plans to adopt IPSAS, including the European Union, Canada, China, and India. Australia, with its single set of standards, now stands largely alone.

#### Australia/New Zealand convergence

ACAG note that one of the assumptions underpinning the 'for-profit' framework is Australia/New Zealand convergence, but that this is not an assumption for the NFP framework.

The promulgation by the New Zealand External Reporting Board (XRB) of its '*Public Benefit Entities' Conceptual Framework*', premised as it is on IPSAS, is another strong indicator that the current IFRS assumption may no longer be appropriate for the Australian context.

In our view this is particularly the case for the public sector, where constituents are ordinarily more interested in whether programs, projects and initiatives have been delivered by the entity efficiently, equitably and effectively using public resources—rather than only its historical financial results.

Constituents are also interested in the financial accountability of public sector entities, from the perspective of whether the public at large are receiving 'value for money' outcomes from the public funds provided to such entities. ACAG considers these unique 'service performance' reporting requirements are not adequately covered in the proposed not-for-profit framework.

#### Reporting of service performance

ACAGs view is that reporting service performance by governments and their 'public benefit entities' requires a fundamental shift in thinking by the standard-setters and regulators.

These entities spend large amounts and control a significant value of assets, which affect almost all aspects of public lives through design and implementation of government policy. To this end they, and the governments they serve, need to be accountable for their performance and to justify the use of, the resources raised from, or on behalf of constituents. Yet ACAG's experience is that they collectively and repeatedly fall short in this regard.

A fundamental criticism of the general purpose financial statements of all public sector entities is that they tell us at best, how much was earned and how much was spent, but never how well the funds were spent toward achieving their public benefit purposes.

We argue that the general purpose financial statements of such entities provide limited insights into either the efficiency or effectiveness of public sector outputs, as their focus is on the cost of inputs, and so on this count, fail the objective of relevance.

ACAG notes that in the AASB's most recent work program, the AASB is undertaking a 'literature review' of reporting service performance information following on from ED 270 *Reporting Service Performance Information* that was subject to public comment during 2015 and 2016.

ACAG considers that existing reporting of service performance measures and outcomes remain an under-developed and under-utilised accountability mechanism for public benefit entities. It considers this in part is because the reporting of historical financial information through its general purpose financial statements is largely privileged as being the only appropriate reporting metric in acquitting public benefit entities accountability outcomes.

ACAG considers that the reporting of key service performance information should have at least equal standing to the entities' reporting of historical financial information. ACAG appreciates that there is no commonly accepted and adopted conceptual framework in Australia that sets out the qualitative (and where appropriate quantitative) characteristics of 'good' performance information; the elements of the performance statements; nor the nature and form of assurance that should be provided in regard to the reliable and fair presentation of such statements.

ACAG would support the development of a principles-based approach to the reporting of service performance information that is relevant and appropriate for differing circumstances. ACAG considered the proposed principles that were contained in ED 270 broad enough in nature to enable the various existing Australian frameworks to continue to be applied. The fact that frameworks exist for most, but not all Australian public sectors, means that there is demand for this information. A framework and specific standard on service performance information will help bring uniformity to the type, quantity and quality of information presented.

ACAG believes that a balanced approach to performance reporting would incorporate both whole of government outcomes and the intermediate or enabling outcomes attributable to specific services and entities. ACAG is of the view that based on a robust conceptual framework and supporting standards, audited general purpose performance reports will take their place alongside general purpose financial statements and serve to close the service accountability gap.

### Consultation

ACAG are of the view that greater consultation with key public sector stakeholders to the standard-setting process should occur much earlier in such process, rather than as part of the exposure draft process that currently applies. We consider this much more important now, given we acknowledge the AASB lacks current state public sector representation at Board level or technical staff with significant public sector experience. This early consultation will help drive continuous improvement, obtain stakeholder buy-in and ensure the AASB's proposals are well structured and thoroughly considered of all sector considerations prior to their release for public comment. ACAG therefore recommends this be incorporated into the frameworks.

### Clarifications required

ACAG seeks clarification on whether and how the proposed standard-setting framework allows for the specific development of reporting frameworks and standards that deal with non-financial information such as service performance outcomes and results reporting.

ACAG also suggests clarity is provided in the framework about how it interacts with the AASB's stated mission on its website to provide guidance that enhances 'external reporting' (also referenced in the published *AASB and AUASB Strategy 2017-2021* document). If this 'external reporting' includes non-financial elements, then this should be referenced and explained in the proposed framework documents.

ACAG also seeks clarification on how the proposed standard-setting frameworks interact with existing published AASB standard-setting documents, such as *AASB Policies and Processes*. There appears to be duplication and interaction between these critical documents. Additionally, ACAG suggests that the AASB could explain in its framework and/or the *AASB Policies and Processes* the reason for its departure from its stated objective to converge from NZASB standards, as they apply to the public sector.

#### *Special purpose financial statements*

In respect of the AASB's for-Profit entity and not for-Profit standard-setting frameworks, ACAG notes the draft framework states '*some individual accounting standards must be complied with, regardless of whether GPFS or SPFS are prepared*' and quotes AASB 1057, paragraph seven as the reference.

Paragraph 7 refers only to GPFS and not SPFS (special purpose financial statements). As the AASB noted in the draft framework it does not set standards for SPFS.