

Understanding the Needs of Users of Public Sector Financial Reports: How Far Have We come?

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The approach taken to the development of the accounting Conceptual Framework in Australia has been “sector neutrality”, that is no distinction has been drawn between the public sector and the private sector for financial reporting purposes. The prevailing view has been that a transaction is a transaction, regardless of the sector in which it has occurred, and implicitly that the needs of users do not differ between the public sector and the private sector. This essay provides an outline of the literature in relation to the development of “decision-useful” accounting and the subsequent empirical research on the needs of users of private sector and public sector financial reports. The development of conceptual frameworks and other professional pronouncements, including the recent International Public Accounting Standards Board (2008) Consultation Paper are reviewed. The findings of a survey by Clark (2001) in respect of users public sector annual reports in Victoria, Australia are contrasted with the findings of a later survey of the needs of users of public sector financial reports conducted in Cyprus (Krambia-Kapardis & Clark 2010). The survey of users of Victorian public sector annual reports indicated that the purposes for using annual reports were not adequately reflected in the purposes identified in the Statement of Accounting Concept 2 (AARF, 1990). In contrast, the findings of the survey of users of public sector financial reports in Cyprus suggest that the identified purposes for use, according to the IPSASB Consultation Paper, reasonably describe the information needs of users.

1. Introduction

The approach taken to the development of the accounting Conceptual Framework in Australia, to underpin the development of accounting standards, has been “sector neutrality”, that is no distinction has been drawn between the public sector and the private sector for financial reporting purposes. The prevailing view has been that a transaction is a transaction, regardless of the sector in which it has occurred, and implicitly that the needs of users do not differ between the public sector and the private sector. The Australian accounting conceptual framework, adopted in 1990, does not distinguish between the needs of users of public sector financial reports and the needs of users of private sector financial reports.

Following this introduction, the essay presents an outline of the literature in relation to the normative development of “decision-useful” accounting and the subsequent empirical research on the needs of users of private sector and public sector financial reports. The development of conceptual frameworks and other professional pronouncements, including the International Public Accounting Standards Board (2008) Consultation Paper are reviewed. The findings of a study by Clark (2001) in respect of users of public sector annual reports in Victoria, Australia are presented

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and also the findings of a later study of the needs of users of public sector financial reports conducted in Cyprus (Krambia-Kapardis & Clark 2010). A summary and conclusions then follow.

2. The Decision-Useful Model of Accounting

The decision-useful model researchers began to recognise the parties involved in transactions and their needs for information (May, 1943; Sanders, Hatfield & Moore, 1938; Staubus, 1961; Chambers, 1966). The research contains an implicit assumption that the purpose of accounting is to provide information, particularly for the providers of equity, to assist in decision-making. Chambers (1955, 1957, 1966) was much more intent on formulating a theory of accounting using a decision-useful model, and is generally credited with the development of a framework based on the needs of users (Henderson & Scherer, 1986:p5). c. The limitations of this research were that the decision-model of capital providers cannot be determined without empirical research, and further, capital providers are only one of the interested parties affected by external financial reporting (Pratt, 1988:pp42-3).

Since the early work of the decision-useful researchers, there has been considerable empirical research undertaken in order to identify the classes of users of financial reports and their information needs. Examples include, in the United States (US), Brenner (1971), Baker and Haslem (1973), Epstein (1975) and Epstein and Pava (1993); in the United Kingdom, Lee and Tweedie (1975a, 1977, 1990); and in New Zealand, Wilton and Tabb (1978). Australian studies include Goldberg and Clift (1968), Chenhall and Juchau (1977); Winfield (1978), Anderson (1979), Anderson and Epstein (1997) and Curtis (1982). There have been, however, fewer user needs studies of public sector financial reporting. These have been tended to be overseas studies; for example Coy, Dixon, Buchanan, and Tower (1997), Hay (1994), Ingram and Robbins (1992), Daniels and Daniels (1991), Butterworth, Gray and Haslam (1989), Gaffney and Lynn (1989), Hay (1988), Gaffney (1986), *Federal Government Reporting Study (FGRS)* (1986), Carlson (1986), Wrege and van Daniker (1986), Jones, Scott, Kimbro and Ingram (1985), Krambia-Kapardis and Clark (2010). Few studies of users of public sector financial reports have been conducted in Australia. These include a study of parliamentarians (Henderson & Scherer, 1986); surveys by Auditors-General (for example, Auditor-General Tasmania, 1993), and a study of users of the annual reports of government departments (Clark, 2001).

The practice of surveying the users of external reports is well established, yet a number of criticisms of the practice have been acknowledged (Hay, 1994; Sutcliffe, 1985; Likierman, 1992; Mayston, 1992; Gaffney, 1986; Herhold, Parry & Patton, 1987). One of the significant issues is the question of whether to survey those who use the external reports or those who presently do not use the reports but may do so if the reports were enhanced to better meet their needs. Whilst these studies have identified users of public sector general purpose financial reports, they have generally done less to explicitly identify the purpose for using the financial report.

3. Authoritative Pronouncements

Authoritative pronouncements from professional bodies, including conceptual frameworks, which identify the purposes for external reporting by firstly identifying the actual and prospective users of external reports for the public sector, or more broadly the not-for-profit sector, have been issued in a number of jurisdictions. These include the US (for reporting entities generally FASB [1980a, 1980b]; for the federal level of government FASAB [1993], and for the State and local levels of government GASB [1987]); Canada CICA [1984, 1990]; Australia AARF [1990]; New Zealand NZSA [1987, 1991, 1993], and, at an international level IFAC [1991]). These professional pronouncements and other authoritative statements tended to assert a priori who the users are and their information needs rather than refer to empirical findings. In seeking to apply the authoritative statements to the public sector, by generalising from a model applied to the private sector, there had been even less prior empirical research to inform those pronouncements (Rutherford 1992). Jones (1992), in reviewing that early history of the various US studies and pronouncements, characterises these developments as a “struggle for turf” (p. 254) between the GASB and the FASB, culminating most significantly in the study by Anthony (1978), commissioned by the FASB. Anthony (1978) provided a list of users, and users needs, common to business and non-business organisations.

The Australian conceptual framework, *Statements of Accounting Concepts 1-4* (AARF, 1990), adopted in 1990, does not distinguish between public and private sector reporting entities in identifying users, instead providing a comprehensive list of users of both sectors. *Statement of Accounting Concept 2, Objective of General Purpose Financial Reporting* (AARF, 1990), identified the objectives of general purpose financial reporting for reporting entities. Sutcliffe (1985), Greenhall, Paul and Sutcliffe (1988), Sutcliffe, Micallef and Parker (1991) and Micallef, Sutcliffe and Doughty (1994), review the professional pronouncements and the empirical evidence from other countries in their monographs for the Australian Accounting Research Foundation, which formed the basis of Australian Accounting Standards in respect of the public sector.

The accounting conceptual frameworks and other authoritative pronouncements for other countries appear to be quite similar in terms of the categories of users and the information needs identified. The frameworks, although using different broad groupings of users, essentially identify the same users. It is highly likely that the development of these various statements has been influenced by the preceding developments in other jurisdictions.

The approach in identifying user needs has been essentially the same: decision-usefulness (Jones, 1992), although Coy, Dixon, Buchanan and Tower (1997:p107), in reviewing the literature on the purpose of public sector reporting, observe an incremental process of deducing users' needs, and recognise a shift in emphasis. Of the 14 major empirical studies and professional pronouncements reviewed, decision-making was the sole or main objective of external reporting identified within the six publications prior to 1985, with accountability being identified as the main objective of reporting for the eight publications issued after 1985. Rutherford (1992) suggests that the elusiveness of a decision in respect of public sector users may explain the introduction of notions of accountability to conceptual frameworks.

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Coy et al. (1997) point to Anthony (1978) who summarised users' information needs as information to satisfy interest in financial viability, fiscal compliance, management performance and cost of services provided. The Canadian Institute of Chartered Accountants (1980) identified three further information needs: nature and objectives, performance, and future plans. Others (Skousen, Smith & Woodfield, 1975; Drebin, Chan & Ferguson, 1981) have added planning and resource allocations to information needs identified. Jones, Scott, Kimbro and Ingram (1985) identified comparisons with other government organisations and ability to repay debt. The Government Accounting Standards Board (GASB) (1987) referred to purposes for using the information, including assessing accountability and economic, social and political decisions.

Jones (1992) contended that the early US studies aimed at developing a conceptual framework for the public sector endeavoured to apply a commercial model. Anthony (1978) emphasised that there was nothing inherently different in accounting for business and non-business organisations (Jones, 1992). The FGRS (1986) study is essentially an exploration of the application of the commercial accounting model to national governments (Jones, 1992:p257). It should be noted that the New Zealand development of a conceptual framework initially proposed a separate framework for the public sector (NZSA, 1987), although when the conceptual framework was finally adopted there was one framework for both the public and private sectors (NZSA, 1993).

The Australian accounting professional pronouncements have not distinguished between the public sector and private sector in identifying the objectives of general purpose financial reporting. SAC2 identified the objectives as being to "provide information useful to users for making and evaluating decisions about the allocation of scarce resources" (AARF, 1990:SAC2 para.43) and to assist "in discharging their accountability" (AARF 1990:SAC2 para. 44).

Since Australia adopted International Financial Reporting Standards (IFRS), its standard setting process has been shaped by the International Accounting Standards Board. SAC1 and SAC2 remain effective alongside the *Framework for the Preparation and Presentation of Financial Statements* (2009) (the Australian equivalent to the IASB's Framework). Paragraph 12 of that Framework states:

"The objective of financial statements is to provide information about the financial position, financial performance and cash flows of an entity that is useful to a wide range of users in making economic decisions."

Thus, very clearly, the objectives of financial reporting remain focused on the provision of information for economic decision making. Even the subsequent Australian commentary paragraph (Aus15.1), in discussing not-for-profit entities, still focuses heavily on the reporting of financial information:

"In respect of not-for-profit entities, ownership groups and contributors of donations are generally not concerned with obtaining a financial return but are usually more interested in the ability of an entity to achieve its non-financial objectives, which in turn may depend upon the entity's financial position and financial performance."

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Whilst the objective of financial reporting focuses on decision making, the nature of the financial decisions being made by the array of users of public sector financial reports remains elusive.

4. International Public Sector Accounting Standards Board

In 2008 the International Public Accounting Standards Board (IPSASB) released the Consultation Paper, *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*. The Consultation Paper addressed: the objectives and scope of financial reporting as well as the qualitative characteristics of information. Comments were requested by March 31, 2009, with 55 submissions having been made. The Conceptual Framework, once adopted, is intended to establish the concepts that are to be applied in developing International Public Sector Accounting Standards. The Consultation Paper presented “Preliminary Views” on nine matters about which it sought comment. They arguably represent the best single contemporary source on the basic issues fundamental to public sector General Purpose Financial Reporting. The IPSASB Consultation Paper identified the potential users of public sector entities as:

- recipients of services or their representatives;
- providers of resources or their representatives; and
- other parties, including special interest groups and their representatives.

Importantly, Preliminary View 4- The Objectives of Financial Reporting, states that:

“The objectives of financial reporting by public sector entities are to provide information about the reporting entity useful to users for:

- accountability purposes; and,
- making resource allocation, political and social decisions.”

Thus, the IPSASB puts “accountability” first in listing the objectives financial reporting for public sector entities, and whilst it goes on to refer to decision making, it adds “political and social decisions” to the more traditional references to “resource allocation” decisions. The IPSASB has identified objectives of financial reporting based much less on a financial decision making model. It will be interesting to see how the Australian Accounting Standards Board, responds once the IPSASB adopts a Conceptual Framework following its consultation process given the AASB’s sector neutral stance on standard setting.

5. Australian Survey of Users Public Sector Financial Reports

Clark (2001), in a survey of the external users of the 1996-97 annual reports of Victorian government departments, asked respondents to indicate the purpose for which they use the annual report. The survey was carried out using a self administered postal questionnaire. The 414 respondents reported receiving 1154 of the total 5147 Victorian government annual reports between them representing a response rate of 22 percent. Using the then, SAC2, as a basis for the question, response categories were as shown in Table 1.

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Table 1 Purpose for Using the Annual Report

Q. For what purpose do you use the annual report?	Frequency	Percent
For making decisions about the allocation of resources	62	14.3
To evaluate decisions about the allocation of resources	125	28.9
For accountability purposes	106	24.5
Other	140	32.3
TOTAL	433	100.0

Note: Each respondent could provide more than one response, thus the number of responses is greater than the number of individual respondents.

For many respondents, their purposes for using the annual reports of government departments were not adequately reflected in the purposes identified in the *Statement of Accounting Concept 2* (AARF, 1990) as the reasons for using general purpose financial reports. Only 14 percent of the responses indicated that the purpose for using public sector annual reports was for “making decisions” with a further 29 percent of the responses being to “evaluate decisions”. Thus, less than half of the responses related to the making or evaluating of decisions. One quarter of the responses (24.5%) indicated that the purpose for use was “accountability” whilst the largest response category, one-third (32.4%) indicated that the purpose for using the reports was “other” than the purposes identified in the conceptual framework. The least frequently cited purpose for using the annual report was “for making decisions about the allocation of resources” (attracting 14.3% of the responses). It may be considered surprising that one of the three purposes identified by *Statement of Accounting Concept 2* (AARF, 1990) attracted only one-seventh of the responses.

Those who indicated their purpose as being “other” were provided an opportunity to specify the purpose. A list containing the key words used by respondents in reporting their “other” purposes for using the annual reports along with the frequency of occurrence is presented in Table 2.

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Table 2 “Other” Reasons for Using the Annual Reports: Key Words

Key Word	Frequency of Occurrence	Key Word	Frequency of Occurrence
Information	72	Objectives	2
General/ly	19	Assess	2
Compare/Comparison/s	16	Report/Reporting	2
/		(e)	2
- Comparative	11	Education	2
Programs	10	Responsibility/	
Research	9	- responsibilities	2
Activities	8	Review	2
Interest	8	Structure	2
Future	7	Performance (f)	2
Trends	7	Overall/Overview	1
Policy	7	Investigate	1
Direction/s	6	Impacts	1
Understand/understandi	6	Directory	1
ng	6	Analysis	1
Student/s	4	Social	1
Planning	4	Success	1
Evaluate/Evaluation	3	Staff	1
Political	3	Historical	1
Reference	3	Projects	1
Library	3	Procedures	1
Awareness	2	Wage	1
Benchmarking	2	Grants	1
Knowledge	2	Perusal	1
Monitoring		Roles	
Effectiveness			

The number of respondents citing their purpose for use as “information”, “general” or “comparison” purposes is significant. Many of the key words used do not suggest a financial context or purpose on the part of the annual report users responding, for example: “general information”, “activities”, “policy”, “direction”, “political”, “responsibility” or “responsibilities”, “structure”, “directory”, “social”, “staff”, “projects” and “procedures”. The sense that these words are not being used in a financial context is particularly strong if these words are read in their context as demonstrated by the following quotations from respondents:

- Social, policy research, policy evaluation and impacts of government policy.
- To evaluate the overall success and direction of the organization.
- To establish how the Department view issues and to ‘crystal ball’ the future.
- Basic information re departmental activities and programs.
- Information about government structure; objectives of programs; highlights.
- Mostly awareness of broader operations of a complex organization.
- General information about activities and structure.
- Information on staff and programs.
- General information on activities and responsibilities.

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- Contacts, breadth of work, policy and procedures. Information for making decisions generally not just allocating resources.

It is much less clear whether a number of the other words are being used in a financial or non-financial context, for example: “comparison”, “trends”, “future”, “planning”, and “benchmarking”. The findings of this survey as to the purpose for using annual reports, in particular the high response rate for the “other” category, are consistent with an argument that the descriptive and statistical performance information have a significant role to play in meeting users information needs relative to the financial statements and the notes to the financial statements.

6. Recent Survey of Public Sector User Needs in Cyprus

By way of contrast, a more recent survey of users of public sector financial reports conducted in Cyprus by Krambia-Kapardis and Clark (2010) suggests that the purpose for using public sector financial reports may have been more accurately identified in the IPSASB (2008) Consultation Paper. A group of 1,000 individuals that were likely to have used public sector financial information were sent the questionnaire by email, and additionally, the questionnaire was administered at a public sector accounting seminar organised by the Institute of Certified Public Accountants of Cyprus Public Sector Committee. There were 101 useable responses.

A key finding of the survey is that the responses to the questionnaire confirm that the IPSASB’s Preliminary Views presented in the Consultation Paper have an empirical basis in that each of the broad categories of users identified in the Consultation Paper is present amongst the responses, albeit in varying proportions (that is, recipients of services or their representatives 63%; providers of resources or their representatives 25%; and other parties, including special interest groups and their representatives 12%). In respect of the more specific user groups identified in the Consultation Paper, the survey findings confirm that all user groups are present with the exception of “donors including international organisations”. The presence of specific user groups may vary according to the circumstances of the country.

The questionnaire asked respondents to rate the information provided based on the purposes for using public sector financial reports identified in the Consultation Paper. Whilst respondents were asked to rate the information provided, rather than to rate agreement with the statements as to purpose for using the information, the high ratings suggest that the identified purposes for use, according to the IPSASB Consultation Paper, reasonably describe users information needs. In summary, financial reporting by the government is useful to users because:

- It is accountable.
- It makes resource allocation possible.
- It assists in political decisions.
- It assists in social decisions.
- It assists in decision making for the public sector.

7. Summary and Conclusions

The Australian accounting conceptual framework is likely to have been influenced by earlier overseas work towards the development of accounting conceptual frameworks. Arguably these frameworks have adopted commercial accounting models in identifying users, the purpose for which the financial reports are being used and the information needs of users. This is particularly likely in the case of the Australian accounting conceptual framework. Similarly, the subsequent *Framework for the Preparation and Presentation of Financial Statements* (2009) has been shaped within the International Financial Reporting Standards. Although both of these Australian Framework Statements have general application to both the private and public sectors. Such a framework may not necessarily serve well as the basis for public sector reporting.

As reported by Clark (2001), users identified the most common purpose for using the annual report as “other” (32.3%), ahead of evaluating decisions about the allocation of resources (28.9%), and accountability purposes (24.5%) with very little usage being for decision making about the allocation of resources (14.3%). This finding suggests that the *Statement of Accounting Concepts 2* (AARF, 1990) did not adequately reflect the purposes for using public sector financial reports. Thus the application of a general purpose conceptual framework, to both the private sector and the public sector, may have failed in respect of representing purposes for using public sector financial reports. The further analysis of the qualitative responses (shown in Table 2) indicated that the most widely used terms to describe the purpose for “other” use, were “information” and “general information”. By way of contrast Krambia-Kapardis and Clark (2010) reported that the purposes for using public sector financial reports as identified by IPSASB (2008) may better explain the reasons for using public sector financial reports.

There appears to be a need for research to further examine the purpose for use of public sector financial reports. The elusiveness of the concept of a “decision” is a fundamental problem in developing a conceptual framework which has application to the public sector. It seems reasonable to believe that until the purpose for using public sector financial reports is understood then preparers can only be guessing at the information needs of users.

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