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29 January 2012

Mr Ethiopis Tafara  
Chairman  
The Monitoring Group

**Re: Roundtable on the governance of public sector accounting standard setting**

Dear Mr Tafara

I would like to thank you and the Monitoring Group (MG) for the kind invitation to attend the above Roundtable. Unfortunately, due to existing commitments, and to the budget constraints existing within the public sector, I will be unable to attend what sounds like a very interesting and important Roundtable.

However, given the importance to us of the topics being considered, I have summarised below our views on the two main questions being considered at your Roundtable. Further detail on these views, is set out in our submission to the Public Interest Oversight Board (PIOB) and MG consultation of June 2012 (Attachment 1).

**Question 1 Identify stakeholder needs that argue for or against the need for IPSASs.**

Australia has not, to date, adopted International Public Sector Accounting Standards (IPSASs) in part due to reservations regarding the governance arrangements around the International Public Sector Accounting Standards Board (IPSASB). However Australia remains highly involved with the development of IPSASs with public sector entities in Australia applying IFRS equivalents with limited modifications for not-for-profit entities, based in some cases on IPSAS requirements, and Australia deliberately achieves a high degree of compliance with IPSASs in doing so.

Fundamentally Australia has adopted *the principle of transaction neutrality*. This and other key features of the system of financial reporting in Australia are outlined in Attachment 2, *Public Sector Financial Reporting in Australia*, which describes how the system serves the long term needs of stakeholders, and outlines what we believe are the attributes of good systems of public sector financial reporting.

Transaction neutrality is defined as:

*“Irrespective of whether an entity is for-profit or not-for-profit and whether it is in the private or public sector similar transactions should be accounted for in the same way unless there is a good reason to account for them differently”.*

This view has implications for the need for a separate set of accounting standards in the public sector that are outlined in the table below from Attachment 3: *How the AASB sets Accounting Standards for the Australian Public Sector*.

Consistent with the transaction neutrality concept, the standards developed by the Australian Accounting Standards Board (AASB) for the public sector are based on IFRS, with additional or modified standards only where necessary to give effect to significantly different public sector circumstances. The arguments for or against using IFRS will, of course, depend on a jurisdiction’s relative starting point. In the argument made in the table we are comparing IPSAS against another high quality system, whereas in another jurisdiction the choice may be between IPSAS and a traditional cash based system.

Table: *Arguments for and against separate IPSASs flowing from principle of transaction neutrality.*

<b><i>For separate IPSAS</i></b>	<b><i>Against separate IPSAS</i></b>
<p>IFRS are written for for-profit entities</p> <p>IFRS do not deal well with:</p> <ul style="list-style-type: none"> <li>Non-exchange transactions (e.g. grants, donations, taxes)</li> <li>Non-cash generating activities (e.g. heritage or infrastructure assets)</li> </ul> <p>Consolidating Government business entities into Government’s financial statements may entail aligning accounting policies</p>	<p>Entities in different sectors can be compared</p> <p>IFRS provide a rigorous framework for standards-setter’s decisions, based on responsive high quality global standards</p> <p>Accountants are mobile between sectors</p> <p>Lower systems costs due to lower need for tailored public sector systems solutions (IT etc.).</p> <p>Users can understand government accounts without specialist public sector knowledge</p>

The adoption of comprehensive sets of international reporting standards in Australia (IFRS for accounting standards, ISAs for auditing standards, and the International Monetary Fund's Government Finance Statistics or GFS for statistical reporting) allows standards for reporting that are set independently of the executive (by the AASB, Australian Auditing Standards Board (AUASB) and Australian Bureau of Statistics respectively): another desirable attribute (please see Attachment 4: *International Perspectives on Sovereign Financial Reporting* for a paper outlining more generally international stakeholder needs for high quality accounting by governments). The AASB's use of IFRS means that in some cases IPSASs are not appropriate in Australia for public sector accounting although they are the basis of additional material for the public sector where possible.

Of course Australia's adoption of public sector standards utilising IFRS is one where we have come from a background of already utilising an existing high quality international accounting system

## **Question 2: The Characteristics of an appropriate oversight framework**

In respect of IPSASB oversight the FRC accepts a possible PIOB model in the shorter term for practical reasons. However, it is of the view that in the longer term a separate body should be charged with IPSASB oversight, on the basis that this approach would maintain consistency and build on the framework and processes of other leading accounting standard setters, providing an oversight body each of whose members fully understands public sector issues, and therefore achieving greater credibility with stakeholders. The FRC generally favours a model for the oversight body which is compatible with a goal of convergence between the IASB and IPSASB.

We do not support expanding the role of the Monitoring Group (MG) in order to better represent the public interest as it does not seem appropriate to expand the MG role into areas already filled with skill and enthusiasm by those on the PIOB and Consultative Advisory Groups (CAGs). We believe this could lead to duplication, inefficiency and almost certainly increased cost, when it is difficult to identify the benefits.

Please feel free to contact me or the FRC Secretary ([Bruce.Donald@treasury.gov.au](mailto:Bruce.Donald@treasury.gov.au)) should you have any queries.

Yours sincerely



Lynn Wood  
Chairman

## Attachment 1 – FRC submission to IFAC IPSASB Consultation June 2011



### **Australian Government**

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### **Financial Reporting Council**

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2 July 2012

The Monitoring Group and Public Interest Oversight Board

### **Re: Public Consultation to Monitoring Group Review and Public Interest Oversight Board Work Program**

#### Overview

The Australian Financial Reporting Council (FRC) is pleased to make a submission to your public consultation process. The FRC is the peak body responsible for overseeing the effectiveness of the financial reporting framework in Australia. Its key functions include the oversight of the accounting and auditing standards setting processes for the public and private sectors, providing strategic advice in relation to the quality of audits conducted by Australian auditors, and advising the Minister on these matters. The FRC monitors the development of international accounting and auditing standards, works to further the development of a single set of accounting and auditing standards for world-wide use and promotes the adoption of these standards.

We have a wide range of stakeholders including a broad spectrum of preparers and users of financial statements, the Commonwealth as well as State and Territory governments, and other government bodies such as standard setters and regulators. Key stakeholder bodies are represented on the FRC as members. In addition, the Australian and New Zealand governments have established cross-appointment arrangements to promote closer economic relationships between the two countries. The FRC accordingly has a New Zealand representative as one of its members.

Australia was one of the early adopters of International Financial Reporting Standards (IFRS) in 2005 – and this is because we recognised early on, that with the current pace of globalisation, the movement to a global set of accounting standards is a

logical transition. Australia's auditing standards have been harmonised with International Standards on Auditing (ISAs) since the mid-1990s. More recently, since the clarity revision of ISAs, in 2009, Australian Auditing Standards (ASAs) have been fully converged with ISAs. In addition, the Australian Accounting Professional and Ethical Standards Board (APESB) uses the pronouncements of the International Ethics Standards Board for Accountants (IESBA) to develop Australian standards consistent with those issued by the international body.

We have not, to date, adopted International Public Sector Accounting Standards (IPSASs) in part due to reservations regarding the governance arrangements around the International Public Sector Accounting Standards Board (IPSASB). However Australia remains highly involved with the development of IPSASs with public sector entities in Australia applying IFRS equivalents with limited modifications for not-for-profit entities, based in some cases on IPSAS requirements, and Australia deliberately achieves a high degree of compliance with IPSASs in doing so.

The FRC has decided to provide a more general response, with particular detailed comments to be provided by other Australian organisations, such as the Australian Accounting Standards Board (AASB), the Auditing and Assurance Standards Board (AUASB), and the Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC)<sup>1</sup>, with specific interests in the processes of particular Boards. We also note that the New Zealand External Reporting Board (XRB) has made a detailed submission and we generally support the content of that submission.

### Governance Matters

We note that the perception of public interest generally would become much less vexed if the governance arrangements were able to sever the overarching link with the International Federation of Accountants (IFAC), which is a representative body of the profession.

We agree that the core difficulty that the Public Interest Oversight Board (PIOB) will face in increasing the public membership<sup>2</sup> on the standards setting bodies will be the difficulty in achieving the necessary level of technical expertise. It will also be the case that the individual standard setting boards will need to be better resourced to achieve the considerable project and outreach work demanded of boards, their members and their staff. The public interest can generally be seen to be served if having a majority of public members is achieved by having equal representation of the profession and public membership with an independent chairman.

The FRC does not think that is necessary to have a majority of what are currently defined as public members to achieve work from the Boards in the public interest. Having the right independent super-structure and then selecting the best people with the right skills and backgrounds for the Boards is the fundamental process for achieving the perception and acceptance of the work of the Boards.

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<sup>1</sup> HoTARAC is an intergovernmental committee that advises the Australian Heads of Treasuries on accounting and reporting issues. The Committee is comprised of the senior accounting policy representatives from all Australian States, Territories and the Australian Government.

<sup>2</sup> A public member is a member nominated by organisations outside the IFAC structure, as opposed to nominated only by organisations inside the IFAC structure e.g. IFAC member bodies.

Some of the questions in the consultation documents raise the prospect of expanding the role of the Monitoring Group (MG) in order to better represent the public interest. We do not believe this would serve a useful purpose for a monitoring group, which should remain separate from the actual work of the oversight body, in this case the PIOB. It does not seem appropriate to expand the MG role into areas already filled with skill and enthusiasm by those on the PIOB and Consultative Advisory Groups (CAGs). This would lead to duplication, inefficiency and almost certainly increased cost<sup>3</sup>, when it is difficult to identify the benefits. We also note that, while the PIOB is broadly geographically representative, the MG seems much less so. Indeed the FRC is concerned that the focus of the MG as a collection of regulators is insufficiently representative of the complete public interest to be an arbiter of the strategic direction for the PIOB and standards setters. The role of these regulators can vary greatly in different jurisdictions, and may exclude a legislative role. The existing focus of the MG – which at least on the IOSCO website for the MG, is primarily on audit, as is the membership - seems somewhat at odds with the variety of work of the bodies overseen by the PIOB, and would be particularly so if IPSASB were brought under the PIOB umbrella. It would be desirable to fix the above flaws, or review the model before expanding the MG's remit. We do see that paying attention to the concerns of the G20 could be a useful counter balance to aspects of these apparent existing imbalances.

In general we would advocate adopting a similar structure to that used for the International Accounting Standards Board (IASB), in particular its separation from the administrative links with the profession: this would abrogate the need to resolve many of the difficult balances discussed above, given that standards would be set by boards removed from IFAC influence.

We definitely concur with the XRB that the structure, roles and processes of the various bodies involved with IFAC standard setter oversight need to be better articulated to stakeholders and propose that at a minimum a diagram setting out the relationships should be placed on the websites of IFAC, the PIOB and the MG with links to the other bodies. Public, easily accessible charters for each body would also seem appropriate.

### Funding Issues

As the consultation papers note, current funding for the PIOB and standard setting Boards is provided largely by IFAC. While the Boards undoubtedly have due process arrangements that promote transparency and are designed to protect their independence, the funding of standards setters by a body that represents the profession may give rise to a perception of limits to that independence.

In the FRC's view, funding for the PIOB and standards setters should ideally be independent of the profession and specific stakeholders to ensure the credibility of the bodies and their standards. Thus we encourage work to build alternative funding models, while recognising that in the current environment seeking external funding will indeed be a difficult task.

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<sup>3</sup> This would tend to make the shifting of funding responsibility outside IFAC more difficult.

## International Public Sector Accounting Standards Board

In respect of IPSASB oversight the FRC accepts the PIOB model in the shorter term for practical reasons. However, it is of the view that in the longer term a separate body be charged with IPSASB oversight, on the basis that this approach would maintain consistency and build on the framework and processes of other leading accounting standard setters, provide an oversight body each of whose members fully understands public sector issues, and therefore achieve greater credibility with stakeholders. The FRC generally favours a model for the oversight body which is compatible with a goal of convergence between the IASB and IPSASB.

While the question of funding is not aimed at addressing IPSASB funding requirements, the FRC is of the view that the funding of IPSASB is a critical issue for that Board, and of sufficient importance that it should again be brought to your attention.

Full details of the FRC views on IPSASB funding and governance are contained in its previous *Submission of the Australian Financial Reporting Council on the IFAC Consultation Paper 'Proposals for the Oversight of the IPSASB'* (June 2011), which is included as an Attachment.

Please feel free to contact me or the FRC Secretary ([fcsecretary@treasury.gov.au](mailto:fcsecretary@treasury.gov.au)) should you have any queries regarding the FRC submission.

Yours Sincerely

A handwritten signature in cursive script that reads "Lynn Wood".

Lynn Wood  
Chairman

30 June 2011

Mr Ian Ball  
Chief Executive Officer  
International Federation of Accountants  
545 Fifth Avenue, 14<sup>th</sup> Floor  
New York NY 10017  
USA

Dear Ian

I refer to the consultation paper issued by the International Federation of Accountants (IFAC) in March 2011 with the title 'Proposals for the Oversight of the International Public Sector Accounting Standards Board (IPSASB)'.

I am pleased to attach a submission by the Financial Reporting Council (FRC) to the paper. I would like to thank you for giving us the opportunity to comment on the proposals in the paper, and for extending your deadline allowing us to consult with all our Members on the submission.

My contact details are provided above should you have any questions about our submission or any other matters with which I could assist you.

Yours sincerely

A handwritten signature in cursive script that reads "Lynn Wood". The signature is written in dark ink and is positioned above the typed name and title.

Lynn Wood  
FRC Chairman



# Submission of the Australian Financial Reporting Council on the IFAC Consultation Paper ‘Proposals for Oversight of the IPSASB’

## Summary of recommendations

The recommendations in this submission may be summarised as follows:

- The establishment of a Public Sector Exclusive Oversight Body is the best long-term solution to improve the oversight of the IPSASB;
- However, the adoption of the Public Interest Oversight Body (PIOB) model can be supported for practical reasons as a short-term measure; and
- The paper should be expanded to include information on IFAC’s vision for the longer-term arrangements for the IPSASB, including its future relationship with the International Accounting Standards Board (IASB).

## Introduction

The Australian Financial Reporting Council (FRC) supports IFAC in its objective to enhance oversight and governance of the IPSASB. Having an effective oversight and governance process is important to all standard-setting organisations, and the credibility of the IPSASB is substantially influenced by how potential stakeholders regard the governance arrangements, resourcing and due processes of the IPSASB. Regardless of which of the two oversight models is chosen the FRC supports all the key IPSASB governance proposals, namely:

- an appropriate oversight arrangement;
- a full time chair;
- a consultative advisory group (CAG); and
- greater resourcing.

The FRC has some concerns as to whether the analysis and the options presented in the consultative paper are sufficient to address the fundamental challenges affecting the IPSASB. Detailed comments on this issue are included in the following text.

## Questions 1 and 2: Which Model and Characteristics

The FRC suggests that in the longer run the formal governance arrangements that are put in place for IPSASB should be consistent with those adopted by other leading standard-setters. This ultimately implies an oversight structure which is independent of the accounting profession as well as appropriately funded and professionally resourced. The design of those arrangements should take into account why those of other standard-setters exist and how they have developed.

The FRC considers that the proposals in the paper address the short to medium term position, but fail to address the appropriate longer term arrangements for the IPSASB. In the longer term the process for establishing public-sector accounting standards will need to remain relevant, and this may change the relationship between IPSASB, IFAC and other standard setters. For example, some stakeholders consider that this should be achieved through a merger with the IASB, or at the least through the formation of a similar independent body.

IFAC's views and vision on the appropriate longer term arrangements are not addressed in the current consultation paper. In particular, the relationship between IPSASB and the IASB is an important strategic consideration, which we acknowledge extends beyond issues of governance. The FRC considers that building the credibility of IPSASB will mean, at least in part, mapping out a satisfactory relationship path between IPSASB and the IASB.

We strongly encourage IFAC to include in the paper information for users, stakeholders and potential funders giving an indication of what IFAC considers are the progressive steps in the longer term process. It is currently a critical stage in the development of IPSASB, and the outcome of the current exercise will significantly shape its future direction. Keeping stakeholders informed and managing their expectations will be important to maintaining their engagement over the next 3 to 5 years.

The FRC does not consider that the consultative paper provides an adequate basis for assessing the alternative governance arrangements that could apply as they are not placed in the longer term strategic context, nor do they consider the lessons learned from the experiences of the IFRS Foundation. We strongly encourage IFAC to further develop the paper prior to the fuller next stage consultation to consider those experiences and to position the current proposals in the light of those experiences and the longer term strategic context.

The current version of the consultation paper focuses on costing and IFAC matters and does not include a clear vision for the future or provide the relevant comparisons and analysis needed to develop such a vision. The risk of this approach is that the changes to the IPSASB arrangements that are proposed and eventually approved may be perceived to be marginal improvements, whereas the same changes may be more positively embraced if seen in the context of a longer term vision for IPSASB.

### *Comments on the Two Models*

The FRC acknowledges the preference of IFAC for the Public Interest Oversight Body (PIOB) model and the reasons for this choice. Given the current situation in which IPSASB has no oversight body, and the realistically available funding, this approach has significant advantages. These include the fact that it builds on existing frameworks and that PIOB members are already familiar with standard-setting processes similar to those IPSASB uses. Above all this model is cost effective and administratively easier and faster to implement. It would also enable IPSASB's operations and processes to evolve in a manner which is consistent with IFAC's other standard-setting boards, and allow IFAC to focus on responding on oversight issues to one body.

This model also takes account of the view held by some stakeholders that IPSASB is insufficiently developed as a standard-setting body to move to an independent oversight model at this time. According to this view a number of significant milestones (capability, governance, membership and technical) remain to be met before the IPSASB would be ready to move to this model. These stakeholders also consider that seeking to establish such a model at too early a stage may consume goodwill, commitment and resources that would be better spent establishing the quality, credentials, viability and membership of IPSASB.

We note that there are a number of conceptual and practical considerations in relation to this model that would need to be resolved if it is to be implemented. These include ensuring that current PIOB members are willing to accept additional responsibilities, and that this role fits within the current scope and capability of the PIOB (historically the PIOB has focused on the quality of external audit). Another problem that comes to mind is that the PIOB's attention to the IPSASB may be limited given the scope of its current responsibilities. The PIOB is already responsible for overseeing a number of different standard-setters and committees, and with only two additional members with specific public sector interests being proposed to join the PIOB, it is unlikely that public sector issues will receive the attention they warrant.

The FRC therefore considers that two additional members with relevant expertise would represent the absolute minimum to ensure that the PIOB is adequately equipped to handle its proposed public sector responsibilities, and that it would be better to increase this number to three additional members. In addition, the composition and expertise of the Monitoring Group would have to be reviewed, adapted and increased as appropriate to match the PIOB's expanded responsibilities. It would also be important to review and clarify the respective roles of the PIOB, the Monitoring Group and IPSASB to ensure that they are clear, consistent and free of unnecessary overlap or critical gaps.

While the FRC would not oppose a move to use the PIOB model as a relatively quick and convenient means to achieving an improvement in IPSASB's governance arrangements, as stated above we do not consider that this model represents a long-term solution to its challenges in this area. The FRC has a clear preference for Model 2 - establishment of a Public Sector Exclusive Oversight Body for the IPSASB - on the basis that this approach would maintain consistency and build on the framework and processes of other leading accounting standard-setters, provide an oversight body each of whose members fully understands public sector issues, and therefore achieve greater credibility with stakeholders. In addition, this approach would ensure that any moves made at this stage would constitute a step in the direction of achieving the ultimate objective of a fully independent and appropriately resourced oversight body.

An IPSASB specific governance arrangement is more likely to meet this requirement than one that is still an integral part of the IFAC framework.

If IFAC proceeds with the PIOB model, the FRC recommends that IFAC include in the paper a commitment to conducting a review in a couple of years (or once particular milestones have been achieved). Such an approach acknowledges the PIOB model as a stepping stone and provides a suitable opportunity, at a later date, to consider the broader questions of whether or not it is still appropriate for IPSASB to remain under the umbrella of IFAC and to continually reassess the relationship with the IASB.

### **Question 3: Consultative Group**

The FRC supports the formation of a Consultative Advisory Group (CAG). With respect to the representatives on the CAG, we consider that they should come from a range of countries that is broader than the current IPSASB membership. In particular, the range should include countries at various stages of development, including countries with different financial cultures. It would also be useful to include international bodies such as the OECD, IMF, EU, UN etc., some of which currently have observer status, as in many ways these bodies are among the key users of government financial statements. Finally, a small number of others with an interest and expertise in public sector accounting issues such as academics and professionals from closely related disciplines could be considered.

We note that the CAG should be of a constrained size (drawing from the history of the IFRS Advisory Council of the IASB for lessons learned). The paper mentions 40 members, but in our view 25-30 members may be the maximum for effective operations.

We support the proposed scope of the CAG to provide advice on the IPSASB agenda, project timetable and priorities, technical advice on projects and advice on other matters of relevance to the activities of the IPSASB.

It may also be necessary to clearly define the respective roles of CAG and IPSASB to avoid overlap. In doing this it would be instructive to consider the changes in the IASB environment. The IASB is moving to a more dynamic, targeted consultation process through its extended outreach program. This raises questions, even for the IASB, about the roles of advisory groups. Once its role is refined, membership of the CAG may also need to be reconsidered.

### **Question 4: Funding**

The FRC notes that in order to become an international standard-setter of choice the IPSASB needs to achieve a number of benchmarks, including critical mass, adequate resourcing, strong independence and appropriate governance. In addition to mapping out a way forward for governance, the FRC agrees that the IPSASB urgently needs to address the issue of the volume and the nature of its funding.

Australia is making a substantial contribution to the work of the IPSASB, currently mainly through in-kind support from the Australian Accounting Standards Board (AASB). We are informed that the AASB is committed to continuing the work it is doing in support of the IPSASB.

We support a broadly-based funding model (including continued support from IFAC) and contributions from a wide range of countries and observer entities, rather than relying on the contributions of a select few. A broad-based approach will provide greater stability and sustainability in the longer term, facilitate the actual and perceived independence of the IPSASB, and reduce IPSASB's reliance on IFAC funding in the future should there be a change of organisational arrangements. One option to achieve this would be to leverage moral support from an umbrella international organisation, for example the G20, as a means to gain financial support from a wider range of countries. In addition, at least in the near term, IFAC funding should continue while IPSASB operates under its umbrella

A further means of increasing the resources available to the IPSASB would be to increase the level of support it obtains from the national standard setters (NSS).

These entities are an important constituency of the IPSASB, but it currently suffers from having few NSS who actually set standards for the public sector. The IPSASB should encourage countries to realise the importance of NSS in furthering the work of IPSASB and leverage its own efforts more through NSS.

In the longer run we are not persuaded that the proposed levels of funding and the ambitions to have a full-time chair and a small number of additional staff (all of which are, without question, needed) are adequate to give the IPSASB the status to which it aspires. The FRC considers that the current funding of the IPSASB is seriously inadequate, which is illustrated by the fact that the IASB applies more resources to some single topics than are available in total to IPSASB.

Fundamentally the IPSASB must be capable of being contemporaneous in its activities with those of the IASB, otherwise it will face the prospect of double handling of debates on topics of common interest to both sectors and unnecessarily duplicating or replicating work already done. At the same time the IPSASB has to maintain its focus on issues that are important to the public sector. Achieving these objectives ultimately implies much greater levels of funding than those proposed in the consultation paper.

Following final decisions on the oversight and resourcing matters IFAC is currently considering, the FRC is willing to consider an appropriate course of action in relation to the establishment of a long-term funding agreement for the IPSASB, subject to the final decision of the Australian Government.

## **Question 5: Additional Matters**

Governance and oversight are important but should not be the sole consideration when looking to the overall viability and relevance of IPSASB to stakeholders and potential users. Sound governance and oversight need to be matched with sectoral relevance and technical viability of IPSAS and strong growth in international acceptance/adoption of IPSAS – broad acceptance/adoption along with good standards and standard setting is critical. We encourage IFAC and IPSASB to continue to address all aspects of establishing IPSASB as a strong, relevant and credible standard-setter.