New South Wales
TREASURY

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Dear Sir / Madam

IPSASB Consultation Paper on the Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities

New South Wales Treasury welcomes the opportunity to respond to the IPSASB's Consultation Paper on the Conceptual Framework.

NSW Treasury supports the ongoing review of international public sector standards and pronouncements, aimed at achieving consistency with the requirements promulgated by the International Accounting Standards Board.

Given this, we are concerned that the development of a separate public sector Framework, not based on the IASB Framework as a starting point, will make future convergence with the IASB much harder and will take much longer. NSW Treasury does not believe that there are fundamental differences that would justify a separate Framework for the public sector. We believe this is demonstrated by the extent of the similarities between the IPSASB and IASB draft Frameworks, particularly in relation to the qualitative characteristics.

Accordingly, our preferred approach is that the original text of the IASB draft Framework should be used to the extent possible, with modifications made where differences between the public and private sector are justified. This is also consistent with the IPSASB document *Process for Reviewing and Modifying IASB Documents.*

These comments, as well as more detailed comments, are provided in the attachment. If you have any queries, please contact me (612 9228 3019) or Dianne McHugh (612 9228 5340).

Yours faithfully

Robert Williams
for Secretary

NSW Treasury comments on the
IPSASB Conceptual Framework Consultation Paper (September 2008)

General comments

Some commentators believe that it is valid to develop a separate Framework for the public sector, on the basis that:

- the IPSASB is communicating with its stakeholders; and
- there are differences between the public sector and private sector.

While this may be true, the difficulty with this approach is that it focuses on the differences rather than the similarities; even though there are vastly more similarities than differences.

As a result, NSW Treasury believes that the IPSASB approach is contrary to long term convergence between the IPSASB and IASB requirements. The development of a separate public sector Framework will make future convergence much harder and will take much longer. This is the essence of what is detailed in the following comments.

NSW Treasury supports transaction neutrality. This is reflected in the approach to Standard setting in Australia, where the IASB Framework is applied to the public sector, with minor modifications. Accordingly, NSW Treasury does not believe that there are fundamental differences that would justify a separate Framework for the public sector (that is not based on the IASB Framework). We believe that the ultimate aim should be for one world standard setter for all types of entities.

By having a separate IPSASB project on the Conceptual Framework, the IPSASB risks losing the discipline of rigorously analysing and justifying departures from the IFRS, which is present in the IPSASB's approach to individual IFRSs. This is confirmed in IPSASB's document *Process for Reviewing and Modifying IASB Documents*, which provides that a separate project should only proceed where the public sector issues are so significant that a public sector specific project is justified (which we do not believe to be the case).

As currently drafted, there would be considerable overlap / duplication between the content of the IPSASB and IASB draft Framework (e.g. qualitative characteristics). Where this is the case, we believe that the original text of the IASB document should be used, wherever possible. However, where differences are apparent between the public and private sector, these differences could be minimised if IPSASB adopted the approach of modifying the IASB proposals. For example, by using the term 'resource providers' rather than 'capital providers', the differences between the IPSASB and IASB proposals could be reduced.

NSW Treasury also continues to encourage the IPSASB and IASB to work together on not-for-profit entity issues so that their Frameworks are consistent. It is noted that the IASB will be considering the application of the proposed framework to not-for-profit entities as part of Phase G of its project. Therefore, some of the IPSASB issues may be addressed as part of that process.

Further, we suggest that the IPSASB refers to the four national standard setters' paper *A report on the application to not-for-profit entities in the private and public sectors* (July 2008) on the IASB Exposure Draft. This paper identifies areas where modifications for the public sector may be necessary but, by starting with the IASB ED, it acknowledges that there are many similarities with the private sector.

Preliminary Views

Preliminary View 1 - The Authority of the IPSASB Framework

The IPSASB Framework will not establish new authoritative requirements for financial reporting by public sector entities that adopt IPSASs, nor will it override the requirements of existing IPSASs.

In selecting accounting policies to deal with circumstances not dealt with in IPSASs or other guidance issued by the IPSASB, public sector entities will refer to, and consider the applicability of, the definitions, recognition criteria, measurement principles, and other concepts identified in the IPSASB Framework.

NSW Treasury comments

NSW Treasury agrees. However, we note that the IPSASB Framework project is not simply interpreting the IASB Framework to the public sector, but rather developing a public sector conceptual framework that makes explicit the definitions, principles, etc that underpin the IPSAS. This is different from the approach to many of the IPSASs, which are based on IFRS and draw on IASB's definitions etc that underlie the IASB Framework.

Therefore, the proposed approach in the IPSASB Framework may be inconsistent with some of the IPSAS (which are implicitly based on the IASB Framework) and could be interpreted to represent a fundamental change in approach that could promote divergence rather than convergence with IFRS.

Preliminary View 2 - General Purpose Financial Reports (GPFRs)

GPFRs are financial reports intended to meet the common information needs of a potentially wide range of users who are unable to demand the preparation of financial reports tailored to meet their specific information needs

NSW Treasury comments

NSW Treasury agrees. This Preliminary View is consistent with the IASB-FASB Exposure Draft on the Conceptual Framework – *The Objective of Financial Reporting and Qualitative Characteristics and Constraints of Decision Useful Financial Reporting Information*.

Preliminary View 3 - The Users of GPFRs

As a mechanism for focusing on their common information needs, the potential users of GPFRs of public sector entities are identified as:
- recipients of services or their representatives;
- providers of resources or their representatives; and
- other parties, including special interest groups and their representatives.

The legislature is a major user of GPFRs. It acts in the interest of members of the community, whether as recipients of services, providers of resources, or citizens with an interest in, or need for, particular services or activities.

<u>NSW Treasury comments</u>

NSW Treasury agrees in principle with the Preliminary view. However, we note that the information needs of these three user groups are substantially the same (refer IPSASB Consultation Paper, paras 2.11-2.15). Therefore, a possible approach is to use 'resource providers' as a proxy for all three user groups, which would represent the public sector equivalent to the IASB's proposed primary user group of 'capital providers'. The advantage of this approach is that it would promote convergence with the IASB's proposed Framework.

Also, we believe that if a primary user group is identified in this way for the public sector, it should exclude 'recipients of goods and services', as we do not believe that the primary purpose of the financial report is to address customer needs (in the public *or* private sectors). However, there is minimal impact of excluding this group because, in the public sector context, most if not all customers are also resource providers, as potential taxpayers.

Preliminary View 4- The Objectives of Financial Reporting (following paragraph 2.22)

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

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

<u>NSW Treasury comments</u>

NSW Treasury agrees. Also, arguably, accountability should be a separate objective for both public and private sector entities. This has been strongly argued by many commentators. In response, this was partially addressed by the IASB by amending their proposals to include stewardship as part of the decision usefulness objective (although in NSW Treasury's view, this still does not go far enough).

However, the differences between the proposed IASB Framework and the IPSASB Framework could be minimised, without significant effect, by encompassing 'political and social decisions' as part of 'accountability'. Alternatively, the second dot point could say just 'making decisions' (without explicitly saying the type of decisions), which is consistent with the proposed IASB Framework.

Preliminary View 5 - The Scope of Financial Reporting)

The scope of financial reporting encompasses the provision of financial and non-financial information about:

- economic resources of the reporting entity at the reporting date and claims to those resources;

- the effect of transactions, other events, and activities that change the economic resources of the reporting entity and claims to those resources during the reporting period, including cash inflows and outflows and financial performance;
- the reporting entity's compliance with relevant legislation or regulation and legally adopted or approved budgets used to justify the raising of monies from taxpayers and ratepayers;
- the reporting entity's achievement of its service delivery objectives; and
- prospective financial and other information about the reporting entity's future service delivery activities and objectives, and the resources necessary to support those activities.

It also encompasses explanatory material about: (a) the major factors underlying the financial performance of the entity, the achievement of its service delivery and other objectives and the factors which are likely to influence its performance in the future; and (b) the assumptions underlying and major uncertainties affecting the information included in GPFRs.

NSW Treasury comments

NSW Treasury agrees with the Preliminary View, except we do not support including prospective information and information regarding the achievement of service delivery objectives in financial statements and notes. However, if the IPSASB believes that this type of information is included in the scope of a financial reporting framework, we believe that it needs to differentiate between the audited financial statements and the unaudited 'annual reporting' information (or financial reporting information outside of the financial statements). For example, at present, prospective management information and information about service delivery objectives generally do not form part of the audited financial statements.

While the nature of what is included in the audited financial statements may change over time, this distinction between financial (audited) and annual reporting (unaudited) should be explicitly acknowledged.

Preliminary View 6 - Evolution of the Scope of Financial Reporting

The scope of financial reporting should evolve in response to users' information needs, consistent with the objectives of financial reporting.

NSW Treasury comments

NSW Treasury agrees. Refer our comments made in response to Preliminary View 5. However, while the concept of what is included in a general purpose financial will evolve, it is not realistic or desirable for financial reports to ever provide *all* information that is useful for accountability and decision making purposes. Therefore, it is best to limit non-financial and prospective information that may form part of a general purpose financial report to information best communicated in financial reports.

Preliminary View 7 - The Qualitative Characteristics of Information Included in GPFRs

The qualitative characteristics of information included in GPFRs of public sector entities are:

- relevance, which encompasses confirmatory value, predictive value, or both;

- faithful representation, which is attained when depiction of economic or other phenomena is complete, neutral, and free from material error;
- understandability;
- timeliness;
- comparability; and
- verifiability (including supportability).

Constraints on financial reporting are materiality, cost, and achieving an appropriate balance between the qualitative characteristics.

NSW Treasury comments

NSW Treasury agrees with the above qualitative characteristics, and notes that with the exception of the omission of the distinction between ‘fundamental’ and ‘enhancing’ characteristics, the qualitative characteristics are identical to the proposed IASB Framework. This illustrates that the differences between the public and private sector are not fundamental. Therefore, consistent with the IPSASB *Process for Reviewing and Modifying IASB Documents*, we believe that the IPSASB text should be consistent with the IASB proposal (as far as possible), rather than using different words to say, in essence, the same thing.

Further, we note that there does not seem be a justifiable public sector-specific reason to omit the IASB proposed distinction between ‘fundamental’ and ‘enhancing’ characteristics. While commentators may debate the validity of making such a distinction, arguments for it have not differentiated the public sector.

NSW Treasury believes that it is important that the IASB Framework should only be departed from where there is a public sector-specific justification. This is necessary to maintain sector / transaction neutrality and to minimise differences between the IASB and IPSASB requirements.

Preliminary View 8 - Characteristics of a Reporting Entity

The key characteristic of a reporting entity is the existence of users who are dependent on GPFRs of the entity for information for accountability purposes, and for making resource allocation, political, and social decisions.

A public sector reporting entity may be an entity with a separate legal identity or other organisational structure or arrangement.

NSW Treasury comments

NSW Treasury agrees.

See also comments for Preliminary View 4 above.

Preliminary View 9 – The Composition of a Group Reporting Entity

A group reporting entity will comprise the government (or other public sector entity) and other entities when the government (or other public sector entity):

- has the power to govern the strategic financing and operating policies of the other entities (a "power criterion"); and
- can benefit from the activities of the other entities, or is exposed to a financial burden that can arise as a result of the operations or actions of those entities; and can use its power to increase, maintain, or protect the amount of those benefits, or maintain, reduce, or otherwise influence the financial burden that may arise as a result of the operations or actions of those entities (a "benefit or financial burden/loss" criterion).

NSW Treasury comments

NSW Treasury agrees with the Preliminary View above; however, we have difficulties with some of the wording, as follows:

- *"Govern" versus "direct"*

The word "govern" contained within the power criterion could be interpreted to mean "regulate", which could lead to problems. Although the section on the reporting entity does not specifically refer to "regulation", the question of regulation versus control should be considered. "Regulate" has several possible interpretations, including legislate or restrict or control.

Further, paragraph 17.9(d) of AASB 127 *Consolidated and Separate Financial Statements* states that the power of government to establish the regulatory environment in which entities operate or to impose conditions or sanctions on their operations does not of itself constitute control of the assets deployed in those entities. For example, governments regulate the operations of entities operating in the gaming industry, but those entities are not controlled by government unless the assets or residual assets of those entities can be deployed for the benefit of government.

NSW Treasury suggests that the word "direct" be used instead of the word "govern". This is the word used by the IASB in its proposed working definition of control. The use of the word "direct" would avoid any possible confusion over the meaning of the word "govern". It would also bring the basis for determining the composition of the group reporting entity closer to the IASB proposal and promote convergence.

- *Control*

NSW Treasury questions the IPSASB's decision to avoid using the term "control" when it discusses the composition of a group reporting entity. None of the reasons put forth in the paper convinced us of the need to stay away from referring to control. In fact, IPSASB is still using the IASB concept of control with slightly different wording.

- *Financial burden versus amount or incidence of losses*

We are unclear why the IPSASB has amended the IASB working definition of control by changing the reference to reducing "the amount or incidence of losses" to a reference to "financial burden". The IPSASB should also explain why being exposed to a financial burden that can arise as a result of the operations or actions of another entity would not be encompassed by benefiting (which encompasses positive and negative benefits) from the activities of that entity.

As above, NSW Treasury recommends retaining the IASB wording as we do not see any significant difference between exposure to a financial burden (IPSASB) and reducing the incidence of losses (IASB). This is another example why we do not believe that there are fundamental differences to justify a separate Framework for the public sector.