

MINISTRY OF FINANCE

Letter

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31.03.2009

Technical Director
International Public Sector Accounting Standards Board
International Federation of Accountants
277 Wellington Street West
Toronto Ontario Canada M5V 3H2

The IPSASB Consultation Paper, September 2008, to which Comments are requested by March 31, 2009

Dear Sir or Madam

Attached there are Comments of the Finnish State Accounting Board on the Consultation Paper: *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: The Objectives of Financial Reporting, The Scope of Financial Reporting, The Qualitative Characteristics of Information Included in General Purpose Financial Reports & The Reporting Entity.*

The commentary is relatively compact but it tries to argue convincingly that there is a real need for revisions in the Conceptual Framework.

Hopefully these comments are helpful. If any of them need further clarification, please, do not hesitate to contact me. As a member of Finnish State Accounting Board, I will be more than delighted to deliver Your questions or feedback any kind to our State Accounting Board for further discussions on these issues.

Yours truly,

Mr. Jukka Nummikoski
Head of Accounting & Finance
Ministry of Finance

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Comments of the Finnish State Accounting Board on the Consultation Paper of Phase 1 of the IPSASB Framework Project

Ministry of Finance
Snellmaninkatu 1 A, Helsinki
PO Box 28, FI-00023 Government
FINLAND
www.financeministry.fi

Tel. +358 9 160 01 or +358 9 578 11 (switchboard)
Fax +358 9 160 33123
valtiovarainministerio@vm.fi
Business ID 0245439-9

Finnish State Accounting Board

COMMENT LETTER

30 March 2009

COMMENTS ON THE CONSULTATION PAPER OF PHASE 1 OF THE IPSASB FRAMEWORK PROJECT

The Consultation Paper of Phase 1 of the IPSASB Framework Project

The International Public Sector Accounting Standards Board (IPSASB) initiated in November 2006 the development of its Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities (the IPSASB Framework) with participation from a group of national standard setters and other similar organizations. In September 2008 the IPSASB issued a Consultation Paper as the product of Phase 1 of its Framework project. The Consultation Paper covers the following components of the IPSASB Framework:

- the role and authority of the IPSASB Framework;
- the objectives of financial reporting;
- the scope of financial reporting;
- the qualitative characteristics of information included in general purpose financial reports; and
- the reporting entity.

The IPSASB has announced that it welcomes comments on all of the matters addressed in the Consultation Paper. The IPSASB would particularly welcome comments on each of Preliminary Views developed on nine key issues. Comments are requested by March 31, 2009.

General comments

The introduction of the Consultation Paper states that the objective of the IPSASB's project is to develop a conceptual framework for general purpose financial reporting primarily for public sector entities. The Consultation Paper (e.g. paragraphs 2.9, 2.18–2.21, 3.9, 3.11 and 5.8) indeed properly identifies such characteristic features of the public sector entities where there are drastic differences in their activities compared to those of the private sector business entities.

However, the Consultation Paper has been drafted too slavishly on the basis of the IASB Framework, which has been developed for private sector listed companies and other publicly accountable large entities, currently under review in a joint project of the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) of the USA. According to the IASB Framework, the principal objective of the preparation of financial statements and of the financial reporting is to

determine the value of listed company's equity for decision making purposes of investors. This approach is not well-suited for the cornerstone of developing a conceptual framework for financial reporting by public sector entities. Unlike the private sector entities, the objective of public sector entities' operations is the provision of tax-financed public services following the principle of long-term financial sustainability so that the efficiency, economy and effectiveness of their activities are of a high level.

Instead of copying the IASB Framework, it would be much more realistic to develop the conceptual framework for financial reporting by public sector entities from a starting point that the amounts of cash or cash equivalents arisen from the service production and other activities are registered in their accounting records. The financial statements are then constructed primarily on the basis of such accounting data. This change in the development of the conceptual framework would mean *inter alia* early consideration of premises and concepts that underpin the cash or modified-cash basis of accounting. This analysis should not be postponed until the final phase as currently planned by the IPSASB.

Detailed comments on the Consultation Paper will follow presented in the order of the main chapters of the Paper.

The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities (paragraphs 1.1–1.17)

The Role of the Conceptual Framework

The Consultation Paper does not define the term "Conceptual Framework". However, its description (e.g. in paragraph 1.1) gives this concept about the same meaning as the word "theory" when the concept of theory is understood as an agreed-upon coherent set of logical principles expressed in specific terms. The acceptance of such conceptual framework is a matter of agreement and does not depend on the support of observable real-world facts. The Conceptual Framework should be developed more towards an empirical theory, so that the viability of the conclusions and propositions derived from it can be verified by empirical facts using the so called scientific method.

Authority of the IPSASB Framework

Contrary to the view in the Consultation Paper (paragraphs 1.5 and 1.7 along with *IPSASB Preliminary View 1*), the conceptual framework should not be subordinated to the existing IPSASs. The IPSASB Framework must become a logical basis for all future IPSASs. If an IPSAS currently on issue conflicts with the IPSASB Framework, the IPSASB has to revise that IPSAS to be in line with the premises and concepts of the Framework.

General Purpose Financial Reports

The definition of General Purpose Financial Reports (GPFRs) included in the Consultation Paper (paragraph 1.10 and *IPSASB Preliminary View 2*) has been left on

an unrealistic general level. It is necessary that the definition specifies the primary users of the information in GPFRs by public sector entities. It is impossible to satisfy the conflicting information needs of all users equally with GPFRs.

Figure 1 (following paragraph 1.14) clarifies the content of GPFRs by public sector entities in relation to special purpose financial reports and to other information (economic, statistical, demographic and other data). It reflects that GPFRs comprise of financial statements (including notes) and additional information which may include non-financial material. The last-mentioned phrase is an understatement taking into account the central position of performance reporting in the annual and other periodic reporting by public sector entities. As a result, the reports should be called, instead of financial reports, financial and performance reports. Furthermore, the term "All Financial Reporting" should be "All Financial and Performance Reporting".

In GPFRs by public sector entities, information about compliance with budgets is much more essential, than is indicated in the Consultation Paper (paragraph 1.15). In the case of public sector entities, the accountability is concentrated primarily on the use of budget appropriations and on the services provided and effects achieved from "Value for Tax Money" point of view. The discharge of such accountability is evaluated on the basis of budget out-turn statements and performance reporting. However, the discharge of accountability is not possible to evaluate on the grounds of general purpose financial statements (the statement of financial performance and the statement of financial position) prepared on a different basis, even if they would give other useful information about the public sector entity's economy, such as the surplus or deficit for the period and its assets and liabilities (or indebtedness).

Differential Reporting

The information needs of the primary users of GPFRs are different for public sector entities operating on different levels (e.g. national, state, provincial, local government and agency level) so much that the IPSASB Framework should acknowledge the need for differential financial reporting paying attention to these different needs.

The Objectives of Financial Reporting (paragraphs 2.1–2.25)

Users of GPFRs of Public Sector Entities

The Consultation Paper (paragraph 2.3) lists many potential users of GPFRs of public sector entities and (paragraphs 2.5–2.7 and *IPSASB Preliminary View 3*) compiles these users based on their common information needs. However, the compilation is incomplete as the users have not been grouped to external and internal ones. In addition, the priority order of the users has not been identified, although it is vital for the development of a realistic conceptual framework. The legislature or other relevant authority, which approves the budget, is generally by far the most important user of GPFRs of a public sector entity. As a result, the legislature or other relevant authority must be raised to this top priority role also in the IPSASB Framework.

Information Needs of Users of GPFRs of Public Sector Entities

The Consultation Paper (paragraphs 2.11–2.16) examines properly the different information needs of potential users of GPFRs of public sector entities. However, the analysis needs to be emphasized, so that the information needs of the most important user, the legislature or other relevant authority, will be recognized in first place (primarily for controlling compliance with budgets).

The Objectives of Financial Reporting

In the Consultation Paper (paragraphs 2.18–2.22 and *IPSASB Preliminary View 4*), providing information for accountability purposes and making resource allocation, political and social decisions has been defined as the objectives of financial reporting by public sector entities. Such definition of objectives is obviously unrealistic, because for accountability purposes information is needed about the facts that have occurred. On the other hand, forecasted information is needed for decision-making purposes. As a result, one of these purposes must have priority in the IPSASB Framework. In the case of public sector entities, the primary objective of financial reporting is definitely to provide information for accountability purposes, as in the Consultation Paper (paragraphs 2.23 and 2.25) has been recognized too.

The Scope of Financial Reporting (paragraphs 3.1–3.22)

General Purpose Financial Reports

The Consultation Paper (paragraphs 3.5–3.18 and *IPSASB Preliminary View 5*) defines the scope of financial reporting very widely and (paragraph 3.21 and *IPSASB Preliminary View 6*) actually leaves it open. The definition is too ambiguous for the development of a realistic conceptual framework. Thus, the scope of financial reporting should be connected more closely with the primary objective of financial reporting by public sector entities, i.e. providing information for accountability purposes about the facts that have occurred.

The view copied from the IASB Framework, the central idea of financial reporting by public sector entities would be to provide information about economic resources of the reporting entity at the reporting date and claims to those resources, is defective and tends to lead to development of an unrealistic conceptual framework. Understanding the financial accounting of public sector entities to be the description of their monetary process is much more useful starting point, than the one in the Consultation Paper. For the preparation of financial statements the items recorded in the accounts of a public sector entity are, in this case, grouped according to their economic substance to expenditures, revenues and (pure) financial transactions.

The Qualitative Characteristics of Information Included in General Purpose Financial Reports (paragraphs 4.1–4.41)

The Consultation Paper (*inter alia IPSASB Preliminary View 6*) presents the qualitative characteristics of information included in GPFRs, but the presentation has

remained incomplete and partly shallow in view of developing a logical conceptual framework. Simply listing the qualitative characteristics of information is not enough. Instead, they should be derived from the essential requirement that the information included in the financial reports is useful for its users. Furthermore, the qualitative characteristics of information should be portrayed distinctly in hierarchical order, also taking into account their interrelationships. In addition, they should be defined according to their normal scientific meaning.

The fundamental qualitative characteristics of information useful to users are in hierarchical order *relevance* and *reliability*. The concept of *faithful representation* should be replaced with the more often used and general concept of reliability.

The qualitative characteristics enhancing the level of the before-mentioned fundamental characteristics are concerning relevance *confirmatory value*, *predictive value*, *understandability*, *timeliness* and *comparability* and concerning reliability *verifiability* and *supportability*.

On the other hand, the qualitative characteristic moderating the level of the fundamental qualitative characteristics is *sufficiency*. The dimensions of moderation are *completeness*, *neutrality*, *materiality* and *cost-benefit-reasonableness*.

The term "faithful representation" should not be used in the IPSASB Framework, because its meaning would be very different from its established meaning in the theory of measurement. The term "verifiability", which should be considered subordinate to the term "reliability", should be used in its normal scientific meaning, which is more restricted than in the Consultation Paper. As a qualitative characteristic subordinate to the fundamental characteristic "reliability", the term "supportability" should be defined more distinctly and separate from the term "verifiability". Supportability in contrast to verifiability does not contain empirical verification by using the scientific method.

The Reporting Entity (paragraphs 5.1–5.35)

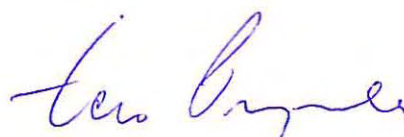
Characteristics of a Reporting Entity

The Consultation Paper (paragraph 5.6 and *IPSASB Preliminary View 8*) explains correctly that the key characteristic of a reporting entity is the existence of users who are dependent on GPFRs of the entity in satisfying their information needs. Also in this context, the analysis should be connected more closely to the provision of information for accountability purposes.

The Group Reporting Entity

The Consultation Paper examines properly how to define the group reporting entity within different kinds of jurisdictions. The preliminary view (*IPSASB Preliminary View 9*), in which the definition of the group reporting entity is based on the "power" criterion and the "benefit or financial burden/loss" criterion seems to be appropriate.

Chairman



Eero Prepula

Secretary



Päivi Vanne