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Your ref ED – Key Characteristics
of the Public Sector
Our ref
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31 August 2011

Dear Ms. Fox

ED – Key Characteristics of the Public Sector with potential implications for financial reporting

Summary comments

We appreciate the opportunity to respond to the International Public Sector Accounting Standards Board's ('IPSASB' or the 'Board') Exposure Draft ('ED') entitled *Key Characteristics of the Public Sector with potential implications for financial reporting*, dated April 2011. We have consulted within the KPMG network in respect of this letter, which represents the views of the KPMG network.

We recognise that the Public Sector has a number of specific characteristics that set it apart from other sectors (e.g. commercial entities or not-for-profit organisations); these characteristics can give rise to assets and liabilities that are very different from those in other sectors. We therefore welcome this ED, which should be a fundamental part of the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* ('the Conceptual Framework').

We acknowledge the need to approach the development of the Conceptual Framework, including the Key Characteristics, in phases as is the current approach being undertaken by the Board. However, we do not consider that the final result should be separate documents, one for each individual phase of the Framework and an additional Key Characteristics standard. Instead, we consider that a single Conceptual Framework document, incorporating the complete Framework and Key Characteristics, should be issued. The Framework is a single project and a single standard will make this clearer and easier for preparers and users to understand how the different aspects relate with each other and form part of the whole. In order to accomplish this, we recognise that later phases of the Board's joint framework project may need to include amendments to those parts of the Framework completed in previous phases.

We consider that the relationships between the concepts addressed in each phase of the Framework, including this Key Characteristics document, are sufficiently interdependent such that an opportunity to provide commentary on the whole Framework should be provided once all phases are tentatively completed. We therefore consider that the complete Framework should be exposed in proposal form for public comment prior to issuance in a final standard.

While supportive of the draft, we have considered the specific matters for comments in the ED and also have some comments on specific issues addressed in the ED. These follow below:

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Specific Matter for Comment 1

You ask whether “*this document provides useful background information on the key characteristics of the public sector and identifies some potential implications of those key characteristics.*” Whilst we have a number of comments on specific issues, raised later in this letter, we consider that the document does provide useful background information. However, it only gives a brief overview of the key characteristics. This is perhaps unavoidable, as a comprehensive discussion would require “a book”, and we do believe that the relative brevity of the discussion does not detract from the value of the document; however, this should be acknowledged in the introduction.

More important, however, the ED does not always state clearly what are the potential financial reporting implications of the specific characteristics described, or how they would be taken into account. We consider that the final document, when incorporated into the Conceptual Framework, should include references to where the reporting implications are described in more detail, whether in the Conceptual Framework or in specific standards.

Specific Matter for Comment 2

You ask whether “*this document should be included as part of IPSASB’s literature and, if so, where should it be located.*” As noted above, we consider that it provides useful information which will help those new to Public Sector accounting to understand the Conceptual Framework, and that it should therefore be included as an integral part of the Conceptual Framework, in the same way that Bases for Conclusions and Implementation Guidance are integral to International Public Sector Accounting Standards.

Comments on specific issues raised in the ED

Section 1: Introduction

While we agree with the example public sector entities in Section 1.3, the section would be more helpful if it also provided a clear definition of the public sector. The section should include a discussion on the treatment of specific groups among the public (e.g. First Nations) and their inclusion in or exclusion from the public sector. Similar discussion should be included regarding treatment of quasi-government bodies such as state funded school systems.

Whilst we concur with the IPSASB’s comments in this Section, we would wish to add the following to Section 1.4:

“Moreover, the success of public sector entities often reflects the effectiveness with which they deliver services and/or the efficiency of their delivery, rather than the impact of the activities. For example, a department with responsibility for collecting taxes would be assessed on whether taxes were collected efficiently and in accordance with the law, and on the comparison of the actual amount collected with the estimate in the budget. It is only at the Whole-of-Government level that the overall income and expenses can be examined.”

Section 2: The Volume and Financial Significance of Non-Exchange Transactions

We concur that the high incidence of non-exchange transactions is a feature of the public sector that currently distinguishes it from the commercial sector. However, we note that revenue recognition under International Financial Reporting Standards is moving to the concept of

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performance obligation; the distinction between exchange and non-exchange transactions will therefore diminish in future.

We would therefore stress the third paragraph of this Section (i.e. that the primary objective of public sector entities is to deliver goods and services and not to generate profits), rather than the first two paragraphs.

We would add that, in addition to non-exchange transactions, the public sector also has more examples of exchanges of assets with approximately equal value, which result in little or no change in the economic status of either entity. Two examples of such exchanges are:

- 1 Exchanges of parcels of land between an urban public sector agency and a developer, enabling the agency to obtain land in a blighted area in order to redevelop it; or
- 2 Exchanges of artifacts between museums.

Whilst we concur with the questions listed in Section 2.3, we would add the following to the list:

“Was the entity’s ability to provide services greater or less than had been anticipated in its budget and workplan?”

Section 2.8 describes public goods (also called social goods). We concur with the definition but we would add the following additional factors:

- Some business models in the commercial sector include assets that are public goods, as defined here. One example is open-source computer coding (e.g. Linux); and
- Some public goods have competing uses, where the consumption by one set of users can impair the consumption by another. For example, national parks can be used for conservation, research or public recreation. However, if one of these uses is given clear priority, it will reduce the use for other purposes.

Section 3: The Importance of the Budget

Further differences between the public and commercial sectors are that:

- In the commercial sector, income and expenses are closely related. An entity incurs expenses in order to generate income; some of this income is then used to pay for further expenses, which in turn generate additional income. (Some expenses are not intended to generate income in the current period, but are important for the growth and development of an entity – e.g. research and development, marketing, etc.) In the public sector, income and expenses are often unrelated activities below the ‘whole of government’ level of reporting and, as a result, the budgets for income and expenses are often unlinked; and
- In the commercial sector, organisations incur expenditure on fixed assets (tangible or intangible) in order to generate additional income; the budgets for such assets need to assess whether they will generate sufficient income to justify their costs. In the public sector, expenditure on fixed assets usually leads to additional running costs; the budgets for these assets need to include such costs and the assessment is normally whether the assets will generate sufficient services to justify their cost (capital expenditure and running costs).



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Section 4: The Nature of Property, Plant and Equipment

We concur with this section and have no comments to add.

Section 5: Responsibility for National and Local Heritage

We concur with this section and have no comments to add.

Section 6: The Longevity of the Public Sector

Whilst we generally concur with the section, we note that some commercial sector activities also have a long lifespan. In particular, some mortgages and other insurance policies can last more than one generation.

Moreover, the example of changes in Section 6.1 is good but will quickly become dated. We therefore recommend the following changes (the additions and deletions are highlighted):

“There are certainly **recent** examples of the division or fragmentation of nation-states into a number of smaller nation-states, **particularly e.g.** in the former Soviet Union and Eastern Europe in the 1990s.

Section 7: The Regulatory Role of Government

We concur with this section and have no comments to add.

Section 8: Ownership or Control of Rights to Natural Resources or Phenomena

We concur with this section and have no comments to add.

Section 9: Statistical Bases of Accounting

We concur with this section and have no comments to add.

We appreciate the opportunity to respond to this Exposure Draft. Please contact Archie Johnston at +1 604 527-3757, Peter Greenwood at +1 604 691 3187, Mark Jerome at +856 20 7808 3399 or Mary Tokar at +44 207 694 8871 if you wish to discuss any of the issues in this letter.

Yours sincerely

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