

September 8, 2011

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

RE: PSAB STAFF COMMENTS ON EXPOSURE DRAFT: “KEY CHARACTERISTICS OF THE PUBLIC SECTOR WITH POTENTIAL IMPLICATIONS FOR FINANCIAL REPORTING”

Thank you for the opportunity to provide input on the proposals in this Exposure Draft. We would like to express our support for the concepts set out in the Exposure Draft, although we do raise some issues for the consideration of the IPSASB below.

Responses to the Specific Matters for Comment are set out in Appendix A to this letter. In particular we draw your attention to our response to Specific Matter for Comment 2, where we advocate that these characteristics be integrated into the Conceptual Framework and their accounting and reporting implications explicitly set out, with links to existing accounting standards (guidance) and financial reporting requirements as appropriate.

As well, we wish to raise the following issues for the consideration of the IPSASB:

- (i) **Public accountability is the overriding characteristic of public sector entities and providing information to demonstrate such accountability is the primary objective of public sector reporting.**

It is crucial that the nature of public accountability as the primary driver for financial reporting in the public sector be further developed and emphasized in the IPSASB conceptual framework.

Governments are elected through a democratic process to have certain rights, powers and responsibilities that require broad accountability to the public and their elected representatives. The governing bodies of many government organizations are appointed or elected; however, these organizations are part of government. They use public resources and may have been given

delegated powers and responsibilities that also demand broad accountability to the public and their elected representatives. Broader accountability to the public and their elected representatives is expected from all public sector entities as a function of the democratic process (hereafter referred to as “public accountability”).

Public accountability requires a public sector entity to justify the raising and management of public resources and how the resources are used. Public accountability is based on the premise that the public has the “right to know” (i.e., a right to receive openly declared facts that may lead to debates by the public and its elected representatives). Financial reporting plays a major role in fulfilling a public sector entity’s duty to be publicly accountable.

The case for public accountability as an overriding objective for public sector financial reporting must be made in the framework and it must be made strongly. Accountability must be described, its importance explained and supported and its implications for public sector financial reporting set out for scrutiny. The text of the Exposure Draft does not directly do this now. Yet the inclusion of compelling text on accountability is fundamental to crafting a conceptual framework that is tailored to the needs of the users of public sector financial reports. A similar weakness downplays accountability in the current Canadian framework and it will be addressed in PSAB’s current project, *Concepts Underlying Financial Performance*.

In addition, we note that, other than the statistical basis of accounting, the key characteristics identified in the Exposure Draft all add to the case that public accountability is the overriding characteristic of the public sector.

(ii) Some items discussed under “non-exchange transactions” require separate consideration.

We agree that this is a key characteristic of the public sector. We also agree that the public sector focuses on service provision, a focus which is also described in the text about “non-exchange transactions”. In fact, we feel that there are at least four distinct characteristics dealt with in the category “non-exchange transactions” and that their implications should be separately identified and described.

- (a) The predominance of non-exchange transactions means that public sector standard setters must develop accounting standards for them. Do they give rise to assets, liabilities, revenues or expenses, and when?
- (b) The service provision (versus profit motive) of public sector entities has a number of potential implications for what is reported in financial statements and other financial reports - such as those set out in Exposure Draft paragraph 2.3.
- (c) There may also be a third characteristic buried in the discussion of non-exchange transactions - the re-allocation of resources. The re-allocation of resources, primarily through transfers, is another objective in the public sector and it might have both accounting and reporting implications. Transfers have accounting implications - a special standard on non-exchange revenue in IPSAS 23 deals with the recipient side of this re-allocation. The transferor side has yet to be addressed. The re-allocation of resources might also have reporting implications - for example disclosure of expenses by object of expense would highlight the extent of these re-allocations.
- (d) Fourth, the provision of goods in a non-market or limited market environment probably should be identified separately as a key characteristic. No competitive market for most government outputs means that there is no independent indication of their value. And many of the services provided by government are unlikely to be provided by anyone else, such as welfare and defense. The benefits of government services cannot be measured solely by a bottom line that shows net revenues or expenses. The implications of characteristic are likely that:
 - The net cost of services and affordability of services need to be reported/disclosed, but these are not enough to show the efficiency and effectiveness of government services.
 - Performance measurement information is needed, too. There is no one measure of government performance. Non-financial performance measures are also needed.
- (e) Public sector entities also have an objective of policy development (similar to strategic planning for a business) to manage issues arising or expected to arise in the jurisdiction. Some of these policies, such as fiscal and monetary policies and foreign affairs, will transcend the service provision and/or resource reallocation orientation of most government activities.

This objective is not set out in the Exposure Draft and yet all governments will have this objective as will some government organizations.

Each of these sub-characteristics may have individual accounting and reporting implications. In our view these will be easier to interpret and understand if they are set out, described and explained separately (see response to Specific Matter for Comment 2 - suggested table).

(iii) Powers, rights and responsibilities of governments should be separately identified.

The rights, powers and responsibilities of governments give them the ability to directly and indirectly affect the environment (and the economy) they operate in, as well as the nature and extent of the public accountability they provide.

Governments can:

- tax;
- penalize and fine;
- issue licenses to act/use/access, etc.;
- make and enforce laws and regulations;
- set monetary policy; and
- set fiscal policy.

These rights, powers and responsibilities may vary by level of government.

In return, governments have the responsibility to (and/or the expectation that they will):

- meet their Constitutional or devolved duties;
- set policies to manage the socio-economic issues of the jurisdiction (for example, the effective functioning of the economy, foreign affairs, social welfare, economic and political sovereignty, pollution, education, health, the proclaiming and safeguarding of borders and maintaining peace, order and good government within those borders, etc.) in an efficient, effective, sustainable and transparent manner through the stewardship and application of the public resources entrusted to them;
- deliver services and reallocate resources (for example, establishing and maintaining the legal system, national defence, providing public safety, education, health and transportation

services) to meet identified policy objectives that have been subject to democratic scrutiny;

- bear risks of significant breadth and scope and thus act as residual risk holder in their jurisdiction in extraordinary circumstances (for example, natural disasters, economic intervention) and sometimes in cases where a risk to the public is otherwise unassumed or uninsured, regardless of whether the government has a contractual requirement to bear the risk.
- be accountable for the efficient, effective, sustainable and transparent management, stewardship and application of the public resources entrusted to them;
- exist and operate in perpetuity (i.e., long-term sustainability) to meet the needs of the jurisdiction; and
- be good managers of the economy and the business of government (including managing the trade surplus/deficit, the value of the dollar, government debt and other liabilities, as well as the sustainability and affordability of programs and policies).

Governments may choose to exercise these powers or meet these responsibilities directly or indirectly through various government organizations or in some cases through a reallocation of resources outside of government.

These powers, rights and responsibilities are alluded to in the section on non-exchange transactions and in the Introduction but they are not set out as a key characteristic of the public sector. In our view they should be separately highlighted - and likely split up. These are the primary reason for the requirements for public accountability. “With great power comes great responsibility” and broad accountability.

We believe that these powers, rights and responsibilities are key characteristics of governments (and government organizations to whom such powers, rights and responsibilities might be devolved). They should be given greater individual prominence in the key characteristics of the public sector part of the IPSASB’s Conceptual Framework.

(iv) Regulatory role of government is not the whole story.

The regulatory role of government is one of the “powers, rights and responsibilities” mentioned in (iii) above. So we are not sure why this power deserves separate mention when others do not.

(v) Operating and financial frameworks set by legislation need to be reflected in the key characteristics.

The Exposure Draft does not mention the pervasiveness of the legal frameworks within which government must work.

Public sector entities must operate within and illustrate their compliance with legal requirements – not merely in the sense of engaging only in legal activities but also in the sense that the specifics of their operating and financial frameworks are set out in, or flow from, legislation. Compliance with those frameworks is mandated and public accountability reporting of compliance with the letter and spirit of those frameworks is integral to the requirements. All of the activities of governments and their organizations (including the nature and level of expenses/expenditures) and the financing of those activities are established in legislation. Transparent and public accountability against the promises and policies set out in legislation is fundamental to public sector reporting.

These legal requirements and public accountability go hand in hand; they are a function of the democratic system. The legal requirements have evolved to be the checks and balances that assist a government in remaining publicly accountable.

We appreciate the opportunity to comment on this Exposure Draft. We are very supportive of your conceptual framework initiative and wish you success in integrating this piece of the framework with the other phases.

Please note that these comments are the views of PSAB staff and not those of the Public Sector Accounting Board (PSAB). PSAB has initiated a project to review the concepts underlying financial performance in that framework and may be in a position to share developments in that project with the IPSASB in the future.

Sincerely,



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Principal
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Appendix A
Responses to Specific Matters for Comment

1. **Do you agree that this document provides useful background information on the key characteristics of the public sector and identifies some potential implications of those key characteristics for financial reporting? If not, please indicate how you would modify the document.**

We believe that the Exposure Draft provides crucial information about key characteristics of the public sector - not just background information. The key characteristics of the public sector are a foundational piece for establishing a stand-alone conceptual framework.

The key characteristics set out the environment within which a public sector entity operates. Once identified, the key characteristics of public sector entities can be evaluated to determine which have accounting or financial reporting implications. A characteristic should only give rise to specific accounting or reporting requirements if those requirements meet users' needs for information about the public sector entity.

The nature and quality of the financial information reported in financial statements is determined by users' needs for information about the public sector entity and the attributes that make that information useful to users and support the achievement of the objectives of financial reporting.

Some key characteristics may only provide context about the environment in which a public sector entity operates and may have no specific accounting or financial statement reporting implications. Some key characteristics may have implications for reporting outside of the financial statements.

2. **Do you think that this document should be included as part of the IPSASB' literature? If you agree, where do you think that the material in this document should be located:**
 - (a) **As part of the Conceptual Framework;**
 - (b) **As a separate section of the *Handbook of International Public Sector Accounting Standards*; or**
 - (c) **Elsewhere with some other status - please specify?**

We believe that the key characteristics of the public sector should be set out as an integral part of the Conceptual Framework.

They should be located at the beginning of the framework because they are the reason a framework tailored to the public sector will exist in the first place.

They should each be identified and described. Then, a table should set them out indicating whether they:

- have accounting implications.

That is, does the characteristic require that a specific public sector standard exist or be developed? Does it require that a particular treatment within a public sector standard that is comparable to a private sector standard exist or be developed? Does an asset, liability, revenue or expense exist? When/how should an item be recognized in annual results? Is the entity a going concern? The implications should be described and explained.

- have reporting implications.

That is, does the characteristic require that a particular item or indicator or comparison (e.g., actual to budget) be reported in the financial statements? Or is a new/different financial statement or a new/different financial statement format required? The implications should be described and explained. These implications may affect the indicators reported in the financial statement reporting model for public sector entities.

- are purely contextual in describing the environment within which a public sector entity operates.

As such, they should be taken into account in developing any new/amended standards or guidance.

If a characteristic has accounting or reporting implications, the table should indicate where in the framework or accounting standards or financial reporting requirements these implications

have been addressed or indicate that they will be the subject of future IPSASB deliberations.