

29 August 2011

Ms Stephenie Fox
The Technical Director
International Public Sector Accounting Standards Board
International Federation of Accountants
277 Wellington Street West, 6th Floor
Toronto, Ontario M5V 3H2 CANADA

Dear Ms Fox,

**Exposure Draft - Key Characteristics of the Public Sector
with Potential Implications for Financial Reporting**

Attached is the Australasian Council of Auditors-General (ACAG) response to the exposure draft referred to above.

The views expressed in this submission represent those of all Australian members of ACAG.

While ACAG strongly supports the development of a statement on key characteristics of the public sector and the related implications, we have significant reservations about the exposure draft in its present form.

ACAG is strongly of the view that the development of public sector financial reporting standards should proceed on the basis of what is most appropriate for the public sector and draw on the best available sources without favouring any particular pre-existing approach. Therefore, we are primarily concerned with the emphasis placed upon the statistical bases of accounting (GFS) at paragraphs 9.1 – 9.3 of the exposure draft and an earlier stated intention by the IPSASB to minimise divergence from GFS where appropriate¹.

As noted at paragraphs 9.1 – 9.2 the statistical bases of accounting are aimed at macro-economic analysis and the GFS system is designed to support fiscal analysis. Therefore, reports prepared on this basis best serve a particular user group. We have seen no compelling arguments for favouring GFS when developing standards for public sector general purpose financial reports intended to satisfy the needs of a broad range of users.

¹. Refer to 'Project Development' section in the background section of each of the three consultation papers for the conceptual framework project.

On the other hand, an argument can be made in respect of many governments that their participation in global financial markets, the size and nature of their public sector corporations engaged in commercial activities and the government's own involvement in significant private sector projects both directly and indirectly (via guarantees for example) mean that many users of financial reports would increasingly expect the financial performance and financial position of those governments to be measured in a manner consistent with the private sector.

This is not to advocate a preference for IFRS but merely to demonstrate that an argument can be mounted for favouring both GFS and IFRS, and that is without considering possible approaches to not-for-profit accounting that may also suit the public sector.

Expressing a preference for one pre-existing accounting approach over another sub-ordinates the standard setting development process and increases the likelihood of sub-optimal outcomes. ACAG have a strong preference for a neutral stance on the issue allowing alternative approaches to be judged on their merits in the particular circumstances.

The opportunity to comment is appreciated and I trust you will find the attached comments useful.

Yours sincerely



Simon O'Neill
Chairman
ACAG Financial Reporting and Auditing Committee

Exposure Draft - Key Characteristics of the Public Sector with Potential Implications for Financial Reporting

ACAG provides the following comments in response to specific questions raised by the IPSASB.

Specific Matter 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.

ACAG Overall Comment:

ACAG is of the view that the exposure draft, in its current form, provides limited useful background information on the key characteristics of the public sector. In what follows immediately below, we have summarised the suggested modifications. More detail appears later.

- We consider the “Introduction” section requires a more detailed description and discussion of the term “public sector” in order to provide a firm foundation for what follows in the exposure draft.
- There is no clear identification of what the public sector characteristics are (but we assume they are the items appearing at paragraph 1.6 and could be headed as such).
- Due to the deficiencies in the opening section (as mentioned above) there is no clear rationale for how the “list” at paragraph 1.6 was derived.
- We consider that two items on the (assumed) list – the budget and the statistical bases of accounting – are not characteristics having implications for financial reporting but are, in fact, financial reporting methods themselves which have emerged in response to underlying characteristics, as discussed later.
- As there is no clear rationale it is not possible to judge the completeness of the (assumed) list of characteristics.
- We consider the (assumed) list of characteristics is incomplete for the reasons set out later.
- As expressed in our covering letter, we are concerned with the emphasis placed upon the statistical bases of accounting (GFS) for reasons explained there.

Introduction (Paragraphs 1.1 -1.6)

We consider that it would be more useful to discuss the nature of government (and other public entities) in their own right rather than limit the introduction to a discussion of how governments and public sector entities differ from the private sector. The approach at present is limited in providing the understanding necessary for identification of key characteristics with potential implications for financial reporting.

ACAG note that the opening “Background” statement in each of the Phase 1, 2 and 3 of the Conceptual Framework project states that:

“IPSASs are developed to apply across countries and jurisdictions with different political systems, different forms of government and different institutional and administrative arrangements for the delivery of services to constituents. The International Public Sector Accounting Standards Board (IPSASB) recognizes the diversity of forms of government, social and cultural traditions, and service delivery mechanisms that exist in the many jurisdictions that may adopt IPSASs. In developing this Conceptual Framework, the IPSASB has attempted to respond to and embrace that diversity.”

ACAG suggest that the present exposure draft needs a much fuller discussion of that diversity in order to be useful. We suspect (but without more information, cannot be sure) that the diversity of political systems and forms of government will have implications for financial reporting. Without this discussion, a reader gains little understanding of “government” in its various forms.

ACAG also suggest that as part of that fuller discussion and better understanding of “government”, comparisons could be made with the not-for-profit private sector, generally regarded in Australia as the third sector after government and for-profit private sector and for which financial reporting standards are emerging.

As stated earlier, ACAG has assumed that paragraph 1.6 attempts to identify the key characteristics of public sector entities. However, it is not clear why some of the items are listed.

Take “the importance of the budget” for example. ACAG do not see the budget as an inherent characteristic of the public sector that “has implications for financial reporting” as it is a form of financial reporting itself. That is, it is a response to certain public sector characteristics and it is those underlying characteristics that we assume the paper wishes to identify. To do that, a consideration of the more detailed discussion in Section 3 “The Importance of the Budget” is useful:

- **paragraph 3.1:** ACAG suggest that the key characteristic here is not the budget itself but the fact that financial information is generally more available in the public sector compared to the private sector because of the commercial confidentiality aspect
- **paragraph 3.2:** ACAG suggest that it is not the budget which is the characteristic, but the Appropriations system (or its equivalent) of which the budget is simply a component
- **paragraph 3.3:** purely in terms of assessing actual results against planned results we doubt that a public sector budget is more important than a private sector one but, if it is, then one might say that the “characteristic” is that users of public sector financial information place greater emphasis on the ability to compare actual results with planned results.

ACAG notes that the public sector budget has assumed its important status because it is usually the only financial report which provides a reasonably comprehensive forward-looking financial picture. It may be that a fuller consideration of the underlying characteristics would lead to the design of a forward-looking financial report better suited to users' needs. (Refer to ACAG's submission to the consultation paper on Phase 2 of the Conceptual Framework.)

Likewise, ACAG don't see the statistical bases of accounting as a "characteristic" itself but, rather, it is the form of accounting adopted in response to certain underlying characteristics that are referred to in Section 9 "Statistical Bases of Accounting":

- **paragraph 9.1:** ACAG would suggest that the key characteristic is not the statistical bases of accounting but the importance of macro-economic analysis
- **paragraph 9.2:** the key characteristic here is the need for statistical information organised into the four sub-sectors mentioned.

To reiterate, ACAG suggest that a full consideration of all the underlying factors may lead to different bases of accounting being used for general purpose financial reports (otherwise the argument seems to be: This is the basis of accounting we have used in the past, it serves a particular purpose and therefore we should lean towards using it for general purpose financial reporting in future.)

As mentioned above, ACAG are of the view that a much fuller background discussion would lead to a fuller identification of characteristics. With that caveat, one omission from the list of characteristics might be the obligation which most governments have to maintain social cohesion through the provision of social services, law and order, and the like. There are potential implications in terms of the recognition and measurement of obligations and liabilities where transactions are often the result of moral considerations rather than economic ones.

A further omission may be the typical absence in the public sector of equity instruments and formal agreements which establish the rights and obligations of the various administrative units and other entities both between themselves and between them and the government as owner. One of the effects is that restructures, transfers of assets and some other transactions between entities cannot always be clearly categorised as being on capital or revenue account.

Additional Detailed Comments:

- There is inconsistency within the exposure draft about whether the term 'public sector' encompasses only not-for-profit entities or whether it includes both for-profit and not-for-profit entities. Paragraph 1.3 states that "they (other public sector entities) may be profit seeking or have a financial objective to break even". However, paragraph 2.3 notes that "the primary objective of public sector entities is to deliver goods and services and not to generate profits". ACAG suggests removing the inconsistency and clearly defining what the term encompasses.
- ACAG believes that the comments at paragraph 6.6 regarding prospective financial information have very important financial reporting implications and they emphasise the usefulness of the ACAG Conceptual Model provided in our response to Phase 2 of the Conceptual Framework project.

- At paragraph 7.2, it is unclear what is meant by the statement “the existence of such regulatory responsibilities will need to be considered in the determination of the reporting entity and the scope of financial reporting in the public sector.” ACAG suggests that the IPSASB clarify this paragraph to clearly explain what the implications could be. In our view, the government’s regulatory power over the private sector is less important than the ability of some governments, through their control of the legislature, to change the law to alter the government’s rights and obligations to other parties. For example, in extreme cases, the government could disown obligations it has entered into, or create assets by exercising its legal rights, such as by auctioning of the radio magnetic spectrum. We also suggest that the title at 7 could be expanded to "The Regulatory roles and Legislative roles of Government".

Specific Matter for Comment 2

Do you agree that this document should be included as part of the IPSASB literature? If you agree, where do you think 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 Pronouncements; or*
- (c) *Elsewhere with some other status – please specify?*

ACAG Comment:

We consider that a suitably modified document should be included as part of the IPSASB literature.

When complete, it should be integrated with other parts of the Conceptual Framework, clearly linked to and from the other statements in the Conceptual Framework so that together they form a robust and coherent basis for the development of related standards.

It is important to note that in Phase 1 of the Conceptual Framework, the Government Business Enterprises (GBEs) were clearly excluded from the scope. However, this paper states that the term ‘public sector’ includes GBEs. On the assumption that this paper and the Conceptual Framework papers are intended to be consistent it is important to clarify this issue in the exposure draft to avoid any confusion/misinterpretation by the users.