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The Technical Director

International Public Sector Accounting Standards Board

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Per e-mail

12 December 2014

Dear Stephenie,

COMMENT ON CONSULTATION PAPER ON THE APPLICABLITY OF IPSASs TO GOVERNMENT BUSINESS ENTERPRISES AND OTHER PUBLIC SECTOR ENTITIES

We welcome the opportunity to comment on the Consultation Paper on *The Applicability of IPSASs to Government Business Enterprises and Other Public Sector Entities.*

Overall, we are supportive of the IPSASB's reconsideration of its policy on the applicability of IPSASs to GBEs and other public sector entities.

There was support amongst our stakeholders for the preliminary view expressed by the IPSASB, with clear support for Option 1(a), and no support for Option 1(b). A number of issues were however identified with each of the options. These issues, along with our proposals, are reflected in the responses to the specific matters for comment and the preliminary view. These are included as Annexure A to this letter.

The views expressed in this letter are those of the Secretariat and not the Accounting Standards Board (Board). In formulating our comments, the Secretariat consulted with a range of stakeholders including auditors, preparers, consultants, professional bodies and other interested parties.

Please feel free to contact me should you have any queries relating to this letter.

Yours sincerely

Stuart.

Chief Executive Officer

ANNEXURE A – DETAILED RESPONSES

Preliminary View

The IPSASB expressed a unanimous preliminary view (PV) that Approach 1 is the best way forward. A majority of IPSASB members expressed a PV on support for Option 1a.

Specific Matter for Comment 1:

Do you agree with the IPSASB's PV? If so, do you prefer Option 1a or Option 1b? Please give the reasons for your view.

Option 1a: using IPSASB's current and developing terminology

We support the IPSASB's preliminary view, with clear support for Option 1a, as it reflects the concepts and descriptions developed in the *Conceptual Framework*. We believe that it is important for the IPSASB to draw on these concepts as it confirms the fundamental importance of the *Conceptual Framework's* role in the future of global public sector standard setting and the IPSASB's standard setting activities.

We believe that when the regulators and other relevant authorities in each jurisdiction understand the foundational concepts in the *Conceptual Framework* they will be able to apply better judgement in determining which entities should be required to prepare general purpose financial statements and the appropriate reporting framework for those entities.

Option 1a outlines the high level characteristics of public sector entities for which the IPSASB develops IPSASs. We are concerned that these high-level characteristics will be difficult to interpret and apply in different jurisdictions. To avoid these application and interpretation issues, we believe that clear supporting guidance should be provided for certain aspects of these characteristics. Clear guidance would also assist in establishing a clear boundary between public sector entities that should apply IPSASs, and other entities such as GBEs which should apply IFRSs (or a national equivalent).

The discussion that follows outlines those areas where we believe additional guidance or commentary would be useful to ensure consistent interpretation and application of the characteristics.

(a) *Are responsible for the delivery of services to the public with assets held primarily for their service potential and/or to make transfer payments to redistribute income and wealth.*

This characteristic suggests that a public sector entity will use its assets, which are non-cash-generating in nature, to provide goods and services to the public. We are concerned that the characteristic may be open to different interpretations, especially where an entity's objective is to use the assets to make a profit and to fulfil its community service obligations.

We propose that supporting guidance is included to assist jurisdictions with addressing these instances, particularly when it is not immediately clear whether the assets held are non-cash-generating or cash-generating. We believe that the supporting guidance could be based on paragraph 6.23(b) of the revised definition in option 2b in the Consultation Paper. We believe it would be useful to clarify that a public sector entity is not an entity which delivers services in the normal course of its business, to other entities (i.e. individuals and non-government organisations as well as other public sector entities outside the reporting entity) with a profit-oriented objective.

(b) *Finance their activities, directly or indirectly, by means of taxes and/or transfers from other levels of government, social contributions, debt or fees.*

This characteristic indicates that the activities undertaken by public sector entities may be financed from various sources, including charging of fees. In our view, this characteristic is also open to different interpretation, as it does not clearly state the nature of the fees that can be charged and/or the basis on which these fees can be charged by public sector entities.

Similar to the shortcomings identified in (a) above, we believe that there is a need for explanatory guidance to be provided to clarify the nature and basis of the fees that can be charged by public sector entities. We propose that the guidance should reflect the notion that a public sector entity may charge a fee to recipients of services to recover some or all of the costs of providing the services without the aim of making a profit.

At present, this characteristic merely indicates that a public sector entity is one which is financed directly or indirectly though taxes and transfers from other levels of government. There are many entities that receive funding from government in these forms. For example some GBEs might receive transfers from government for undertaking certain activities, to undertake capital projects etc. What is important is the extent to which an entity is funded by such transfers, as well as the nature of the funding received.

The guidance in paragraph 6.18(d) of the Consultation Paper, which clarifies the terms ñnot reliantò and ñcontinuing government fundingò in relation to the paragraph 6.19(c) of the revised definition under option 2a, could be useful in describing the nature of the funding received. As such, the guidance should explain that a public sector entity will be substantially dependent on continuing government funding to fund its ongoing operations.

(c) *Do not have capital providers that are seeking a return on their investments or a return of the investment.*

We question whether this requirement provides a solid boundary between a public sector entity and other types of entities. Our stakeholders noted that it is unclear what is meant by ñdo not have capital providers that are seeking a return on their investmentsò. In particular, whether it is the existence of the capital providers that distinguishes public sector entities from other entities, or that they are not seeking a return.

We noted that the notion of ñnot seeking a return on their investmentò can be difficult to apply because the capital provider can hold the investment for purposes other than to receive a return on its investment. This in itself would not mean that the entity is a public sector entity. The following illustrates this point:

- In some jurisdictions, there may be entities with capital providers which have surrendered a return on their investments for strategic purposes. For example, a government may invest in an entity that controls ports, railways and other strategic assets/operations, and foregoes returns on its investment on the premise that it is given preferential access to those assets/operations in specific circumstances. The fact that government is clearly not seeking a return does not mean that the other organisation is a public sector entity.
- In other instances, there may be capital providers that exist and are theoretically making a return but have elected not to seek that return for policy decisions, for

example, to ensure that any returns are used to grow the operations or make the entity more sustainable.

Our stakeholders also noted that clarity is required about whether “capital providers” refers to providers of debt capital or equity capital.

While we accept that the entity would need to demonstrate the other characteristics to conclude that it is a public sector entity, we were not persuaded that the mention of capital providers and their not seeking a return as outlined in the Consultation Paper is useful in distinguishing public sector entities from other entities.

<u>Option 1b: using Government Finance Statistics reporting guidelines and explanatory guidance</u>

We do not support the IPSASB’s proposal to use Government Finance Statistics (GFS) reporting guidelines in option 1b. We believe that the use of GFS reporting guidelines would only be useful and well understood in those jurisdictions that are familiar with the GFS reporting guidelines. The relative importance of the GFS reporting guidelines in the context of the preparation of financial statements may differ from jurisdiction to jurisdiction. For example, from a South African perspective, the GFS reporting guidelines are only understood, considered and applied by statisticians, and economists and other professionals from the National Treasury and the central bank. Accounting professionals working in other government organisations preparing financial statements do not consider or apply GFS reporting guidelines at all.

Apart from the fact that only a limited number of individuals within a jurisdiction may consider, apply and understand the GFS reporting guidelines, we believe that the objectives of the GFS reporting and the IPSASs differ fundamentally. The objective of the GFS reporting guidelines is to evaluate the impact of the general government and public sector on the economy while IPSAS-based financial statements are used to evaluate financial performance and position, hold management accountable, and inform decision making. Because the objectives of the two reporting frameworks are different, their users are also different, and will result in fundamental differences on how and what information is reported.

During our consultation process, our stakeholders made the observation that the application of the proposed characteristics under this option could result in those GBEs that operate in monopolistic environments no longer being classified as GBEs. They noted that such entities may not be able to demonstrate that they sell goods and services at economically significant prices because they are usually the sole supplier of the goods and services and may not have discretion about adjusting supply based on price. As a result these entities are likely to be public sector entities under Option 1b, even though they have a profit-making objective.

Stakeholders indicated that they found the concept of “economically significant prices”, and how this could be assessed, useful. In particular, they noted that the idea of what is considered an economically significant price (as outlined in paragraph 6.14 of the Consultation Paper), together with the assessment of 50% sales to cost ratio over several years, is a useful boundary for classifying entities.

Although we do not support Option 1b, certain aspects may be useful in clarifying certain characteristics of option 2, should this option be supported by respondents. This is discussed under our response to specific matter for comment 2.

Specific Matter for Comment 2:

If you do not agree with the IPSASB's PV, please indicate whether you support Option 2a or Option 2b in Approach 2 or identify an alternative approach. Please give the reasons for your view.

While Approach 2 aims to resolve the current problems in the application of the current definition of GBE, we have reservations with the Approach as it is difficult to define what a GBE is given different legal and policy issues applicable to GBEs in each jurisdiction. As such, we support the principle based approach taken in Approach 1 and the linkages to the *Conceptual Framework*. While we agree in principle that some of the changes made to clarify and/or modify the current definition may be useful, we are not in support of the two options as outlined below.

Option 2a: clarifying the current definition

While we support option 1a, if option 2 is supported by other respondents, our stakeholders suggested the use of the following GFS concepts.

Paragraph 3.14 of the Consultation Paper indicates that the treatment of government subsidies received by an entity on its goods and services is unclear in determining whether it has recovered its costs in full or not. Stakeholders suggested that guidance, similar to that of the GFS reporting guidelines outlined in paragraph 5.16, should be developed that requires an assessment of the nature of subsidies and its impact on full cost recovery.

In addition, we question whether the reference to ñé at a profit or to achieve recovery of all fixed and variable costs of the *reporting period*ò would result in a change in classification of an entity as a GBE in those reporting periods when the profit or full cost recovery objective is not achieved. If adopted, we would suggest that supporting guidance, similar to that of the GFS reporting guidelines, be developed for the assessment to be undertaken over a sustained multiyear period rather than a single reporting period. It will clarify that entities making losses at a particular point in time can also be considered a GBE. Alternatively, it should be clear that the intention of the entity is considered in making this assessment, rather than whether full cost recovery is achieved or not.

Option 2b: narrowing the current definition

Our stakeholders indicated no support for option 2b as it may result in some entities applying a different reporting framework from year to year. For instance, depending on the funding, being a going concern could change from one year to the next.

We recognise that a specific quantitative threshold should not be applied to determine the level of reliance on government funding. However, we believe it is important to clarify at what level the government funding received by an entity becomes so significant that it impacts its ability to conduct commercial activities.

We also agree with the IPSASBõs observation that the application of option 2b would restrict the number of entities that meet the definition of a GBE. From a South African perspective, there are GBEs that operate with a full cost recovery objective and also receive financial support from government, and would therefore not meet the proposed definition of a GBE under this option. In South Africa all GBEs have a mandate to address some policy objective such as providing services to recipients in remote areas, where under a profit objective no services could be rendered economically.