Preliminary Board View: *The Preface to the Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*

Introduction

1. The purpose of this Preface is to highlight characteristics of the public sector that underpin the development of International Public Sector Accounting Standards (IPSASs) and Recommended Practice Guidelines (RPGs). The *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (*Conceptual Framework*) acknowledges and responds to these characteristics.

2. The public sector includes national, regional and local governments, and related governmental agencies. It also includes international public sector organizations.

3. Governments generally have broad powers, including the ability to establish and enforce legal requirements, and to change them. Globally the public sector varies considerably in both its constitutional arrangements and its methods of operation. However, the governance of governments and other public sector entities generally involves the holding to account of the executive by a legislative body (or equivalent).

4. The primary objective of most public sector entities is to deliver services to the public, rather than to make profits and generate a return on equity to investors. Consequently the performance of such entities can be only partially evaluated by examination of financial position, financial performance and cash flows. Users of the general purpose financial reports (GPFRs) of public sector entities also need information to support assessments of such matters as:

   - Whether the entity provided its services to constituents in an efficient and effective manner;
   - The resources currently available for future expenditures, and to what extent there are restrictions or conditions attached to their use;
   - To what extent the burden on future-year taxpayers of paying for current services has changed; and
   - Whether the entity's ability to provide services improved or deteriorated compared with the previous year.

The Volume and Financial Significance of Non-Exchange Transactions including Involuntary Transfers

5. In a non-exchange transaction, an entity receives value from another party without directly giving approximately equal value in exchange. Such transactions are commonplace in the public sector, where many entities are substantially financed by taxation (or contributions) or transfers from other entities, which are initially financed through taxation. The level and quality of services received by an individual, or group of individuals, is not normally related to the amount contributed by them through taxation. Depending on the provisions of the program, an individual may have to pay a charge or fee and/or may have had to make specified contributions to access certain services. Notwithstanding this characteristic, such transactions are, generally, of a non-exchange nature,

because the amount that an individual or group of individuals obtains in benefits will not be approximately equal to the amount of any fees paid or contributions made by the individual or group. The prevalence and importance of non-exchange transactions may have an impact on how they, and the resulting balances, are recognized, measured, and presented to best support assessments of the entity by service recipients and resource providers.

6. The collection of taxation is a legally mandated involuntary transaction between individuals or entities and the government. Tax-raising powers can vary considerably between jurisdictions, particularly the relationship between the powers of the national government and those of sub-national governments and other public sector entities. International public sector entities are largely funded by transfers from national or regional governments. These may be governed by treaties and conventions or may be on a purely voluntary basis. The involuntary nature of taxes and transfers is one of the main reasons why the accountability objective of financial reporting is important in the public sector.

The Importance of the Approved Budget

7. Most governments and other public sector entities prepare annual financial budgets typically covering the revenue to be raised and other spending plans. In many jurisdictions there is a constitutional requirement to prepare and make publicly available a budget approved by the legislature (or equivalent). Legislation often defines the contents of that documentation. A government's approved budget is the primary method by which the legislature exercises oversight and constituents and their elected representatives hold the entity's management financially accountable. The approved budget is often the basis for setting taxation levels, and is part of the process for obtaining legislative approval for spending.

8. Because of the approved budget's significance, information that enables users to compare actual spending, revenues and the resulting surplus or deficit with the budget estimates is important. Reporting against budget is commonly the mechanism for demonstrating compliance with legal requirements relating to the raising and use of public finances. Comparisons between forecast and actual information also facilitate an assessment of the extent to which a public sector entity has met its financial objectives and therefore promotes accountability and informs decision making in subsequent budgets.

The Nature and Purpose of Assets in the Public Sector

9. In the public sector, the primary reason for holding property, plant, and equipment and other assets is generally to provide services rather than to generate cash flows. Because of the nature of public sector service provision, a significant proportion of assets deployed by public sector entities are specialized in nature, for example roads and military assets. There may be a limited market for such assets and, even then, they may need considerable adaptation in order to be used by other operators. These factors may have implications for their measurement.

10. Governments and other public sector entities may hold items that contribute to the historical and cultural character of a nation or region (for example, art treasures, historical buildings, and other artifacts). They may also be responsible for national parks and other areas of natural significance with native flora and fauna. Such items and areas are not generally held for sale, even if markets exist. Rather, governments and public sector entities have a responsibility to preserve and maintain them for current and future generations.

11. Governments also often have powers over natural resources such as mineral reserves, water, fishing grounds and forests. These powers allow governments to grant licenses for the use of such resources or to obtain royalties and taxes from their use. Governments may also assume rights over phenomena such as the electromagnetic spectrum. In these areas, and in the areas outlined above, there may be implications for both the definition of an asset, as well as for the recognition and measurement of any such assets.

The Longevity of the Public Sector and the Nature of Public Sector Programs

12. The going concern principle that underpins the preparation of the financial statements has often been difficult to interpret in the public sector. Because of sovereign powers, particularly the power to tax, the net assets/liabilities position may not be the overriding factor in determining whether a national government can meet its obligations as they fall due.

13. There are two further reasons why going concern has been difficult to interpret. The first reason is that many public sector programs are long term and the ability to meet commitments depends upon future taxation and contributions. Many commitments arising from public sector programs do not meet the definition of a liability and the power to levy future taxation may not meet the definition of an asset. Such commitments and powers may therefore not be recognized in the financial statements.

14. Consequently the financial statements cannot provide all the information that users need on long-term programs, particularly those delivering social benefits. Reports on the long-term sustainability of key programs are therefore relevant to assessments of accountability by resource providers and service recipients. The financial consequences of many decisions will have an impact many years or even decades into the future, so GPFRs containing prospective financial information on the long-term sustainability of an entity’s finances, covering lengthy time horizons, are necessary for accountability and decision-making purposes.

15. The second reason is the nature and longevity of governments and public sector entities themselves. Although political control may change regularly, national governments generally have very long lives. While they may encounter severe financial difficulties and may default on sovereign debt obligations governments continue to exist. If sub-national entities get into financial difficulties, national governments might act as lenders of last resort or provide large scale guarantees. The main service delivery commitments of sub-national entities may continue to be funded by a higher level of government. Sub-national entities may also be amalgamated. In other cases public sector entities that are unable to meet their liabilities as they fall due may continue to exist by restructuring their operations.

The Regulatory Role of Public Sector Entities

16. Many governments and other public sector entities have powers to regulate entities operating in certain sectors of the economy, either directly or through specifically created agencies. The underlying public policy rationale for regulation is to safeguard the interests of consumers, in accordance with specified public policy objectives. Regulatory intervention also occurs where there are market imperfections or market failure for particular services, or to mitigate against factors such as pollution, the impact of which is not transmitted through pricing. Such regulatory activities are carried out in accordance with legal processes.

17. Governments may also regulate themselves and other public sector entities. Judgment may be necessary to determine whether such regulations create rights of, and obligations on, public sector entities that require recognition as assets and liabilities, or whether the public sector entity's ability to amend such regulations has an impact on how such rights and obligations should be accounted for.

Relationship to Statistical Reporting

18. Many governments produce two types of ex-post financial information: (a) government finance statistics (GFS) on the general government sector for the purpose of macroeconomic analysis and decision making, and (b) general purpose financial statements (GPFS) for accountability and decision making at an entity level, including GPFSs for the whole of government reporting entity.

19. The overarching standards for macro-economic statistics are set out in the *System of National Accounts* (SNA). The SNA is a framework for a systematic and detailed description of the national economy and its components, including the general government sector. Internationally recognized macroeconomic statistical methodologies are harmonized with the SNA to the extent possible, while remaining consistent with their own specific objectives. In the public sector, for non-European Union government finance statistics, the Government Finance Statistics Manual (GFSM), issued by the International Monetary Fund, is the key source of guidance for the compilation of government finance statistics and is consistent with the SNA. The European System of Accounts (ESA) provides the legislative rules for nations that are member states of the European Union. ESA is broadly consistent with the SNA and GFSM as regards the definitions, accounting rules and classifications, but has some presentational differences.

20. IPSAS financial statements and GFS reports have much in common. Both show (a) financial, accrual-based information, (b) a government's assets, liabilities, revenue, and expenses and (c) comprehensive information on cash flows. There is also considerable overlap between the two reporting frameworks that underpin this information. IPSASs and GFS reporting guidelines do have some important differences, as a result of their different objectives, their focus on different reporting entities and the different treatment of some transactions and events. The removal of differences between the two bases of accounting that are not fundamental to their different objectives and a reliance on a single integrated financial information system to generate both IPSAS-compliant financial statements and GFS reports can provide benefits to users in terms of report quality, timeliness and understandability.

21. In developing its *Conceptual Framework* and other literature the IPSASB has considered the objectives and requirements of statistical accounting guidance and the concepts that underpin them.

Published by: International Federation of Accountants®