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**

The Australian Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC) welcomes the opportunity to provide comments to the International Public Sector Accounting Standards Board (IPSASB) on the Exposure Draft: *Key Characteristics of the Public Sector with Potential Implications for Financial Reporting* (the ED).

HoTARAC is an intergovernmental committee that advises Australian Heads of Treasuries on accounting and reporting issues. The Committee is comprised of the senior accounting policy representatives from all Australian States, Territories and the Australian Government.

HoTARAC commends the IPSASB’s efforts in providing background and justification for the development of a public sector conceptual framework (the Conceptual Framework). HoTARAC supports the development of this ED, but recommends the following points merit further consideration by the IPSASB:

- Amplifying the discussion of the public sector key characteristics by explicitly examining the implications on financial reporting and the link to the Conceptual Framework.
- Adding discussion on the broader role of General Purpose Financial Reports in the public sector, the role of risk sharing in government and the government’s regulatory role.
- Public Sector ‘significance’ as an additional criterion that may justify a different reporting approach to the private sector.
- Clarifying the inclusion of the Government Business Enterprises (GBEs) within the scope of the ED.

Consistent with HoTARAC’s previous comments on the draft IPSASB Conceptual Framework documents, HoTARAC believes that the IPSASB and IASB Conceptual Frameworks should be consistent, except to the extent that differences exist between the public and private sector which impact on transactions and user information needs.
In this regard, in addition to public sector specific issues, the IPSASB’s focus should be to provide accounting pronouncement/guidance on transactions, similar to private sector, but that are more significant or prevalent in the public sector in order to meet users need.

The majority of HoTARAC members strongly agree for the inclusion of the final document in the Conceptual Framework if it assists in developing the key concepts underlying public sector financial reporting. To this extent, HoTARAC recommends that the final document include for each public sector’s key characteristic identified, the associated implications for public sector reporting and the link to the IPSASB’s Conceptual Framework.

Alternatively, a minority of HoTARAC members proposes that the final document be used to supplement or enhance the IPSASB Process for Reviewing and Modifying IASB documents guidance.

Comments by HoTARAC on the Specific Matters for Comment in the exposure draft are attached.

If you have any queries regarding HoTARAC’s comments, please contact Peter Gibson from the Australian Department of Finance and Deregulation on 612 6215 3551.

Yours sincerely

[Signature]

Grant Hehir
CHAIR
HEADS OF TREASURIES ACCOUNTING AND REPORTING ADVISORY COMMITTEE

August 2011
HoTARAC RESPONSE TO IPSASB

EXPOSURE DRAFT KEY CHARACTERISTICS OF THE PUBLIC SECTOR WITH POTENTIAL IMPLICATIONS FOR FINANCIAL REPORTING

General Comments

Purpose of Document

The objective of the Exposure Draft (ED) is stated as:

“This Exposure Draft (ED), Key Characteristics of the Public Sector with Potential Implications for Financial Reporting, has been developed by the IPSASB as part of its project on the Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities (the Conceptual Framework). The ED highlights certain characteristics of the public sector that may have implications for the development of a conceptual framework for the public sector and therefore on accounting standard setting in the public sector.”

However, HoTARAC is concerned that the purpose and context for the ED and the relationship with the Conceptual Framework is unclear. That is, the link between the characteristics outlined in this document and the exposure draft and consultation papers issued by the IPSASB as part of the Conceptual Framework project is not sufficiently explained in the document.

In HoTARAC’s view, a list of key characteristics of the public sector, while of general interest, is of no real value unless the consequences of the characteristics on financial reporting and the Conceptual Framework are addressed. This should include examining the implications of the key characteristics on transactions and user information needs. HoTARAC does not believe that this has been done sufficiently.

Financial Reporting Implications

As mentioned above, HoTARAC recommends the document amplifies discussion of the financial reporting implications of the key characteristics and provides a rigorous reasoning regarding the potential impact on the development of a public sector accounting conceptual framework. Relevant links to the Conceptual Framework would be very useful and informative about the rationale for particular elements being dealt with differently in the framework. This should include a discussion of how, and in what circumstances the accounting/reporting arrangements should differ from the corresponding arrangements applicable in the private sector and the rationale for them being included in the public sector framework.

HoTARAC suggests that at the end of each key characteristic a section titled ‘Financial Reporting Implication’ be included to clearly state the impact on the Conceptual Framework, with a link to the relevant section(s) in the framework documents.
“Significance” as an IPSASB criterion

The ED indicates that at times public sector transactions are similar to the private sector, and that the concepts are probably the same, although the characteristics of the public sector may give rise to conceptual differences (paragraph 1.5). In HoTARAC’s view this needs to be more clearly explained, as many of the characteristics identified in the ED are not unique to the public sector, but are still relevant because they are more significant or prevalent in the public sector (for example, non-exchange transactions).

In HoTARAC’s view, significance or prevalence may give rise to different treatments compared to the private sector, but only where it can be demonstrated that it is necessary to ensure that user needs are met, while considering the balance between costs and benefits. This underlies the Australian Accounting Standards Board/ Financial Reporting Standard Board of the New Zealand Institute of Chartered Accountants Process for Modifying IFRSs for PBE/NFP.

HoTARAC recommends the IPSASB clearly indicates that, due to the public sector characteristics, certain accounting issues, even if these are also encountered for private sector reporting, create special challenges for public sector entities reporting and would require additional or different guidance for the public sector to ensure that faithful representation, understandability and comparability qualitative characteristics are met.

In addition to public sector specific issues, the IPSASB’s focus should be to provide accounting pronouncement/guidance on transactions that are more significant or prevalent to the public sector where this provides more important information for public sector reporting users than for private sector and hence would meet public sector users need. For example, private sector transactions also includes non-exchange transactions, such as charity donations, but not to the scale that public sector entities do. Non-exchange revenue in a government’s report is material and provides critical information to the users as to whether the government will be able to achieve its objective. Given this importance it is appropriate that, as it currently does, IPSASB provides guidance on non-exchange transactions.

Subject to balancing costs and benefits, specifically targeting these types of transaction will ensure consistency of accounting treatment to assist accountability/decision making and comparability. Below are some examples of such matters:

- Funding sources – taxation and other non-exchange transfers;
- The importance of Government budgets;
- Specialised Assets;
- The lack of markets;
- Longevity of public sector entities and programs (i.e. going concern less significant for the public sector, whereas long term sustainability report more critical);
- Government subsidies;
- Government regulatory power, and
- Statistical accounting

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A minority of HoTARAC members considered that statistical accounting was not a public sector key characteristic, further details on this matter are outlined in 'Other Comments' below.

Response to Specific Matters for Comments

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.

HoTARAC agrees the document provides useful background information on the key characteristics of the public sector.

However, as discussed in the 'general comments' above:

- HoTARAC believes that the consequences of the characteristics on financial reporting and the Conceptual Framework need to be addressed. This includes examining the implications of the key characteristics on transactions and user information needs.

- A number of the characteristics identified are not necessarily unique to the public sector, but rather they may relate to transactions that are more prevalent or significant. This may justify modifications to private sector requirements, where it is necessary to ensure that public sector user needs are met. This needs to be more clearly acknowledged in the ED.

HoTARAC recommends the following issues relating to the key characteristics be included in the document, either as standalone topics, or as additional commentary on the topics included in the ED:

1. Broader Role of General Purpose Financial Reports in the Public Sector

It would be useful for the ED to distinguish the public sector environment from the private sector in relation to the significant fiduciary and accountability responsibilities in managing and distributing public resources. This characteristic in particular relates to considerations of a meaningful General Purpose Financial Reports (GPFRs) for users.

Unlike the private sector, evaluation of this primary responsibility of the public sector may require a different or broader scope of financial reporting as the traditional accounting measure of profitability and net assets may not necessarily be the most appropriate metric for measuring the performance of public sector against these responsibilities. Separate, complementary non-financial performance reports may need to be prepared by the public sector especially when also considering the ED Item 3 on "The Importance of Budgets". The presentation formats of traditional financial statements generally do not align with the typical presentation formats of budget program announcements. In some Australian jurisdictions the primary document used to present and assess the performance of the government/Ministers against the budget is presented in the Budget Paper on Service Delivery, rather than the
Budget Paper containing the estimated financial statements. The service delivery presentation in one Australian jurisdiction includes four measures, three non-financial and one related to cost. Information regarding estimated key fiscal aggregates such as net debt is however sourced from the financial statements.

As the ED acknowledges in paragraph 2.3 that "...users of financial reports of public sector entities, may have broader information needs than users of financial reports of private sector entities." including "(a) has the entity provided its services in an efficient and effective manner?" A GPFR without consideration of other non-financial metrics is unlikely to provide public sector report users with this information.

Environmental considerations are increasingly important aspect of the measurement of organisational achievement. This is reflected in the reporting of the ‘triple bottom line’ (economic, social, environmental) and its potential inclusion in a broader IPSASB GPFR notion. Environmental accounting is particularly relevant to the public sector, where organisational goals are often perceived as acting in the public good, rather than profit maximisation.

**Financial Reporting Implications**

HoTARAC considers the breadth of information provided in public sector GPFRs a key characteristic of the public sector. Inclusion of this characteristic in the ED will provide an important nexus between this document and IPSASB’s Conceptual Framework project. This supports the IPSASB’s conclusion in the exposure draft *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: Role, Authority and Scope; Objectives and Users; Qualitative Characteristics; and Reporting Entity* that public sector GPFRs are more comprehensive than just financial statements and include a broad range of financial and non-financial quantitative and qualitative information.

2. **Risk sharing of Government**

Governments are usually able to access capital markets at lower interest rates than entities in the private sector. In turn, the government often leverage their borrowing power to provide guarantees to entities in the private sector and may enter into arrangements with the private sector to provide infrastructure through service concessional arrangements.

In addition, governments often act in the capacity as insurers of last resort. In these instances, governments are often unable to transfer risk to the private sector through reinsurance, as a private insurer may be unwilling to provide insurance or may demand an excessive premium.

**Financial Reporting Implications:**

As noted in the ED, the absence of markets and the specialisation of assets may have implication for the measurement of assets (4.2). Specifically, in assessing the present value of service concession arrangements and other infrastructure projects valuation may differ between private and public sector entity depending on who controls the assets due to the use of income valuation techniques where entities are using different discount rates. Assets created under these arrangements are usually highly specialised with no active markets;
consequently, determination of fair value will usually be achieved by using the income or
depreciated replacement cost valuation method as a proxy to market value.

The impact of different public and private sector asset valuations may be justified if an
operating capacity concept of capital (as discussed in the Consultation Paper Conceptual
Framework for General Purpose Financial Reporting by Public Sector Entities:
Measurement of Assets and Liabilities) is employed so public sector valuations are more
linked to entry prices and entity specific valuation inputs.

The lack of a secondary market for the government insurance and government guarantees
may complicate the valuation of such obligations. Disclosure in these circumstances may
default to the contingencies’ schedule, making this schedule a critical component of the
financial statements.

3. Government as regulator

Governments usually have extensive regulatory powers and may use these to control price
and service delivery.

A government may control the market for a service by being a monopoly producer and using
its regulatory power to exclude others from the market (for example, by operating a postal
service). This is particularly the case in less developed countries, where governments may
also be the sole provider of public transport, telecommunications, banking, water, gas, and
electricity services. A government may also influence market behaviour by regulating prices
and standards of service delivery or by subsidising certain industries.

Financial Reporting Implications:

The exercise of a government’s regulatory power over assets operated by other entities may
result in confusion in determining who has control of the asset, particularly where a rights-
based criteria is applied. Generally, governments have regulatory power over many areas of a
country’s economy. This should not result in the government controlling assets of entities
within the various economic sectors.

HoTARAC reiterates its comments from the submission on the consultation paper
Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities:
Elements and Recognition in Financial Statements on the importance of distinguishing
between a government’s right to benefit from the economic benefits embodied in an asset
(control of an asset) and the rights the government obtains through its regulatory role.

Other comments

In addition, HoTARAC recommends that the ED be amended to take into account decisions
made in finalising IPSASB’s Conceptual Framework.

For example, paragraph 8.1 states that it is unclear whether rights to natural resources give
rise to assets. HoTARAC notes this issue also relates to Specific Matter for Comment 4 in the
Phase 2 consultation paper Conceptual Framework for General Purpose Financial Reporting
by Public Sector Entities: Elements and Recognition in Financial Statements on the
classification of public sector entity rights and powers as assets. Responses to that question in the Phase 2 consultation paper, and resulting deliberations by the IPSASB on this matter may provide the basis for a more definitive view.

**Inclusion of GBEs in scope**

HoTARAC notes that, contrary to the scope of existing IPSASs and the IPSASB’s proposed Conceptual Framework, the scope of this exposure draft appears to include Government Business Enterprises (GBEs) – refer to paragraph 1.3 in the exposure draft. Given the characteristics of GBEs are more consistent with private sector for-profit entities, HoTARAC strongly recommends that the IPSASB clarify its intentions about dealing with GBEs, and be consistent throughout all its pronouncements. In this regard, HoTARAC does not support GBEs adopting accounting treatments that differ from the private sector International Accounting Standards Board’s pronouncements.

**Statistical Bases of Accounting**

As mentioned above, a minority of HoTARAC members disagreed that statistical accounting is a key characteristic of the public sector. These HoTARAC members argue statistical information is also collected in relation to private sector entities. Further, these HoTARAC members believe that, in particular, at an individual public sector entity level, the statistical bases of accounting is irrelevant, given that its purpose relates only to macro economic analysis at a general government sector or whole of government level. In contrast, such HoTARAC members believe that the statistical bases of accounting should only be considered once it has been determined that a different disclosure, presentation, recognition or measurement requirement is appropriate for the public sector. This is consistent with the approach adopted in Australia in the document Process for modifying IFRSs for PBE/NFP: http://www.aasb.gov.au/admin/file/content102/c3/Mar_2010_Agenda_paper_B7.6_Process_for_modifying_IFRSs_for_PBE_NFP.pdf

**Editorial**

HoTARAC recommends that section 5, ‘Responsibility for National and Local Heritage’ includes some acknowledgement that, in some jurisdictions, state governments and other sub national units have responsibility for heritage assets. HoTARAC suggests the heading be modified to ‘Responsibility for Heritage’, without specifying a level of government.

**Specific Matter for Comment 2**

Do you agree that this document should be included as part of the IPSASB’s 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?
HoTARAC members agreed that the ED should examine the implications of the public sector key characteristics on financial reporting and IPSASB’s Conceptual Framework. Once these implications are considered, HoTARAC strongly supports the inclusion of this document in IPSASB’s Conceptual Framework.

Reasons for the document to be included in the Conceptual Framework (Majority HoTARAC view)

A majority of HoTARAC members strongly agree with the view that the document should be part of the Conceptual Framework if it assists in developing the key concepts underlying financial reporting and differentiates between public and private sector financial reporting. As noted above, if the document is to be included as part of the Conceptual Framework, HoTARAC recommends there be a clear correlation between the financial reporting implications raised in the ED and the matters covered in IPSASB’s Conceptual Framework.

Reasons for the document not to be included in the Conceptual Framework (Minority HoTARAC view)

A minority of HoTARAC members suggested that a more appropriate location for this would be as a supplement to the IPSASB document *Process for Reviewing and Modifying IASB documents*. These HoTARAC members believe that while the document may be an input into the Conceptual Framework (i.e. in guiding its development), it should not form part of the Conceptual Framework otherwise it could be deemed to be authoritative guidance. Rather, the Conceptual Framework is, in part, an output of considering the key characteristics document, rather than the document forming part of the framework itself.

Instead, the document could form part of or be used to supplement or enhance the IPSASB document *Process for Reviewing and Modifying IASB documents*. That is, the document may be relevant in identifying key characteristics of the public sector, which impact on transactions and user needs, and which may justify departures from the private sector IASB’s Framework and Accounting Standards.

For example, the Australian Accounting Standards Board (AASB) document *Process for modifying IFRSs for PBE/NFP* identifies the following factors as being relevant when considering user needs and assessing whether a departure from International Financial Reporting Standards (IFRS) may be warranted:

- Nature of transactions, events and circumstances and their impact on Public Benefit Entities (PBE)/Not For Profit entities (NFPs);
- Benefits to users of complying with IFRS; and
- Costs of complying with IFRS.

Consistent with HoTARAC’s comments on the draft IPSASB Conceptual Framework documents, HoTARAC believes that the IPSASB and IASB Conceptual Frameworks should be consistent, except to the extent that differences exist between the public and private sector which impact on transactions and user information needs. Therefore, on this basis, a minority of HoTARAC members believe that the most appropriate role for the ED is to assist in the process for identifying where such departures may be appropriate.