

27 March 2009

Ms. Stephenie Fox
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International Federation of Accountants
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CANADA

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Ref: PSC/HvD/SS

Dear Ms. Fox,

Re: Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities:

- **The Objectives of Financial Reporting**
- **The Scope of Financial Reporting**
- **The Qualitative Characteristics of Information included in General Purpose Financial Reports**
- **The Reporting Entity**

- (1) FEE (Federation of European Accountants) is pleased to present its comments on this IPSASB Consultation Paper: Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: The Objectives of Financial Reporting, The Scope of Financial Reporting, The Qualitative Characteristics of Information included in General Purpose Financial Reports and The Reporting Entity.

Relationship with the IASB Conceptual Framework project

- (2) We welcome the work which the IPSASB is carrying out on developing a conceptual framework. This is very helpful at a time when there are concerns that developments in the IASB Framework may have the effect of making it more difficult to adapt or interpret for a public sector context. It will also provide a more complete context for the conceptual work which the Board has already progressed on issues such as Non-Exchange Transactions and Social Policy Obligations.
- (3) Against this background we agree with IPSASB that the public sector Framework should not simply interpret the IASB Framework. Nevertheless, we would note that the IPSASB Framework may prove very helpful in interpreting IAS/IFRS, as a starting point for development of IPSAS.

- (4) We would also note that there are clear advantages to maintaining alignment with the IASB Framework where this is possible and appropriate. Comparable financial reporting can be expected to have benefits arising from:
- mutual intelligibility between economic sectors which transact trillions of dollars of business with each other
 - skills transfer between public and private sector
 - transfer of good practice between sectors

Focus and scope of the public sector Framework

- (5) We agree that the primary focus of the IPSASB Conceptual Framework should be on public sector entities which operate, at least in part, for the benefit of the public. Those government bodies which operate purely for profit can use private sector focussed conceptual frameworks with little or no adaptation.
- (6) We also agree that it is very important to broaden the Framework to cover matters which go beyond the current focus on financial statements. The Board has already made proposals on financial reporting on social benefits, and has proposed a project on long-term fiscal sustainability reporting. While it remains to be seen whether standards or other internationally applicable guidance can be developed in these areas, these are important issues which should be properly explored.

Responses to the Request for Comment

- (7) Our responses to the Request for Comment are attached as an Appendix to this letter. These include general comments on each chapter of the Consultation Paper, and specific commentary on the Preliminary Views.

For further information on this letter, please contact Ms. Saskia Slomp from the FEE Secretariat.

Yours sincerely



Hans van Damme
President

Introduction and Executive Summary

This explanatory material:

- describes the purpose and applicability of the IPSASB Framework in general terms, and refers to the work carried out by the International Accounting Standards Board (IASB) and US Financial Accounting Standards Board (FASB) in reviewing their frameworks.
- explains that the IASB framework is a useful starting point, but that the objective of the IPSASB framework should not be simply to interpret the IASB framework for the public sector.
- explains the intention to develop the Framework primarily for public sector enterprises other than profit-seeking Government Business Enterprises (GBEs).
- encourages public sector entities to adopt the accrual basis of accounting, while acknowledging that many use cash based accounting, which will be considered later in the Framework consultation.
- sets out an intention to minimize divergence from statistical financial reporting by governments when developing the IPSASB Framework.
- explains that the Framework is being developed in four phases, that the Board will issue Consultation Papers for each phase, followed by an Exposure Draft of the full accrual IPSASB Framework.
- provides an executive summary of the current Consultation Paper for Phase 1 of the Framework Project.

Comments on the Introduction and Executive Summary

We agree that the Framework should not simply interpret the IASB Framework. Nevertheless, the IPSASB Framework may prove very helpful in interpreting IAS/IFRS, as a starting point for development of IPSASs.

We would note that there are clear advantages to maintaining alignment with the IASB Framework where this is possible and appropriate. Comparability of financial reporting can have benefits in terms of mutual intelligibility between economic sectors which transact trillions of dollars of business with each other, skills transfer, and transfer of good practice.

We agree that the primary focus of the IPSASB Conceptual Framework should be on public sector entities which operate, at least in part, for the benefit of the public. Those government bodies which operate purely for profit can use private sector focussed conceptual frameworks with little or no adaptation

Chapter 1 The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities

This chapter:

- describes the role of the Framework as enabling consistent standard setting based on a coherent set of relevant concepts, assisting efficient standards development through a common conceptual basis, and the opportunities for increased accountability and transparency.
- sets out Preliminary View 1 on the Authority of the Framework
- discusses the applicability of the Framework as mainly focused on Government Business Enterprises
- sets out Preliminary View 2 on the type of General Purpose Financial Reports on which the Framework should provide guidance.
- discusses Differential Reporting by different classes or types of entity, and concludes that this is a matter to be considered during standards development rather than in the IPSASB Conceptual Framework

Comments on Chapter 1

We agree broadly with all of the above points. Comments on the Preliminary Views are set out below:

IPSASB Preliminary View 1 - The Authority of the IPSASB Framework

The IPSASB Framework will not establish new authoritative requirements for financial reporting by public sector entities that adopt IPSASs, nor will it override the Requirements of existing IPSASs.

In selecting accounting policies to deal with circumstances not dealt with in IPSASs or other guidance issued by the IPSASB, public sector entities will refer to, and consider the applicability of the definitions, recognition criteria, measurement principles, and other concepts identified in the IPSASB Framework.

We agree with Preliminary View 1. The IPSASB Framework will be the starting point for developing all new standards, and for the interpretation of standards in circumstance not dealt with in IPSASs. However, it should not override the requirements of standards which have already been issued. This is particularly clear for standards developed after the framework has been established, but should also apply to those developed beforehand.

The appropriate way to change financial reporting standards is by following due process.

We suggest that the Exposure Draft should make it clear that the Framework is the principled basis for setting IPSASs in the future.

IPSASB Preliminary View 2 - General Purpose Financial Reports (GPFRs)

GPFRs are financial reports intended to meet the common information needs of a potentially wide range of users who are unable to demand the preparation of financial reports tailored to meet their specific information needs.

We agree with this proposal, which we note is similar to the discussion of general purpose financial reporting in the IASB Conceptual Framework Exposure Draft on the Objective of Financial Reporting.

Both the IASB and the IPSASB are considering the wider concept of financial reporting, public sector aspects of which are helpfully illustrated in the diagram at Figure 1. This wider consideration may have implications for the scope of the Framework, discussed in Chapter 3.

Chapter 2 The Objectives of Financial Reporting

This chapter

- discusses the many potential users of financial reporting
- sets out Preliminary View 3 which provides a more compact description of the users designed to help focus on their common information needs
- discusses the information needs of users, and the common information needs of user groups
- sets out Preliminary View 4 which proposes objectives of financial reporting
- discusses the limitations of GPFRs

Comments on Chapter 2

We agree with the comprehensive discussion of users and user needs set out in this Chapter. Comments on the Preliminary Views are set out below:

IPSASB Preliminary View 3 - The Users of GPFRs

As a mechanism for focusing on their common information needs, the potential users of GPFRs of public sector entities are identified as:

- recipients of services or their representatives;
- providers of resources or their representatives; and
- other parties, including special interest groups and their representatives.

The legislature is a major user of GPFRs. It acts in the interest of members of the community, whether as recipients of services, providers of resources, or citizens with an interest in, or need for, particular services or activities.

We agree that these are helpful and appropriate groupings, and that it is also important to consider the role of the legislature acting in the interest of other users.

Furthermore, we would observe that in representative democracies there are many who consider that the primary user group is the electorate, and that the elective process should in general persuade the legislature will act in their interest. We recognize that the IPSASB framing may be helpful in covering other forms of government.

In addition, we would suggest that the legislature is often the main user which is engaged with the financial reporting process. When revisiting these matters in the Exposure Draft, we suggest that the presentation in the Preliminary View is reversed, noting the role of the legislature, and that they represent the three groupings outlined above.

IPSASB Preliminary View 4 - The Objectives of Financial Reporting

The objectives of financial reporting by public sector entities are to provide information about the reporting entity useful to users of GPFRs for:

- accountability purposes; and
- for making resource allocation, political and social decisions.

We strongly agree with the inclusion of accountability and decision usefulness objectives.

We consider that accountability is primary, and using this term helpfully draws attention to the requirement to 'report' on the stewardship of public resources. We also consider that it is useful to use a different term to stewardship to signal the special character of public sector reporting in this regard.

Having said this, we consider that it is also essential to have a decision usefulness objective, for two main reasons:

- (1) in holding government accountable, decision useful information helps determine whether the government has acted with propriety, in accordance with its stated aims, and in a manner generally conducive to economic, efficient and effective use of resources
- (2) retaining a link to decision usefulness will enable IPSASB to develop financial reporting which promotes mutual intelligibility between the public sector and other economic sectors.

In this discussion it is important to recognize the limitations of financial reporting, and we agree with the comments in Chapter 2 which explain that financial reporting cannot be expected to provide all the information which users might require for accountability purposes.

In particular, while we consider that economic, efficient and effective use of resources is a key concern of public sector managers and accountants, it is less clear that this lends itself to a standardised reporting treatment, and we would note that many jurisdictions approach these issues through assessment and oversight bodies rather than standardised reporting. (Other matters relating to the scope of *standard setting* are discussed later in our comments on the scope of financial reporting).

Chapter 3 The Scope of Financial Reporting

This chapter discusses the scope of financial reporting in terms of economic resources, compliance, service delivery, prospective financial information and other information, and material which seeks to explain the financial information.

A view on all of these matters is set out in Preliminary View 5, and the need for the scope of financial reporting to evolve is set out in Preliminary View 6.

Comments on Chapter 3

We agree with the discussion of scope. Comments on the Preliminary Views are set out below:

IPSASB Preliminary View 5 - The Scope of Financial Reporting

The scope of financial reporting encompasses the provision of financial and non-financial information about:

- economic resources of the reporting entity at the reporting date and claims to those resources;
- the effect of transactions, other events, and activities that change the economic resources of the reporting entity and claims to those resources during the reporting period, including cash inflows and outflows and financial performance;
- the reporting entity's compliance with relevant legislation or regulation and legally adopted or approved budgets used to justify the raising of monies from taxpayers and ratepayers;
- the reporting entity's achievement of its service delivery objectives; and
- prospective financial and other information about the reporting entity's future service delivery activities and objectives, and the resources necessary to support those activities.

It also encompasses explanatory material about: (a) the major factors underlying the financial performance of the entity, the achievement of its service delivery and other objectives and the factors which are likely to influence its performance in the future; and (b) the assumptions underlying and major uncertainties affecting the information included in GPFRs.

We agree with the proposed scope. Many of these matters are already part of the public sector financial reporting landscape.

We agree that the potential scope is very broad, and we are glad to see acknowledgement at 3.21 that the inclusion of matters within the scope of financial reporting does not mean that it is inevitable that an IPSASs will be developed to direct reporting on the matter.

We strongly agree that information presented in financial statements and their notes should remain at the core of financial reporting. However, we assume the Board will in some cases make use of the wider scope, for example

- in considering matters relating to government budgets; and
- in considering explanatory material such as that considered in the for-profit context in the IASB Discussion Paper on Management Commentary.

In going beyond the implied framework under which standards are currently developed, we suggest that there will also be a need to develop or use other forms of authoritative pronouncement, including non-mandatory guidance, or standards which allow for a great deal of flexibility and tailoring to the circumstances of the reporting entity.

There are also implications for the types of audit and assurance regimes that can be applied to such wider financial reporting.

IPSASB Preliminary View 6 - Evolution of the Scope of Financial Reporting

The scope of financial reporting should evolve in response to users' information needs, consistent with the objectives of financial reporting.

We agree that the scope of financial reporting should evolve in response to user need.

Chapter 4 The Qualitative Characteristics of Information Included in GPFRs

This chapter discusses the qualitative characteristics of information included in public sector GPFRs. Specific consideration is given to some public sector issues, mainly by reference to the different objectives of public sector financial reporting.

The discussion refers to IASB's recent consideration of qualitative characteristics. The IASB exposure draft suggests that relevance and faithful representation are 'fundamental' characteristics of financial information while comparability, verifiability, timeliness and understandability are 'enhancing' characteristics. Materiality and cost are 'pervasive constraints'.

Chapter 4 differs from the IASB approach by giving equal prominence to each of the characteristics. It also differs from the IASB proposals in that it articulates the balance between characteristics as a pervasive constraint.

The above matters are encompassed in Preliminary View 7.

Comments on Chapter 4

Much of the discussion would appear to be relevant to any discussion of financial reporting. Comments on Preliminary View 7 are set out below:

IPSASB Preliminary View 7 - The Qualitative Characteristics of Information Included in GPFRs

The qualitative characteristics of information included in GPFRs of public sector entities are:

- relevance, which encompasses confirmatory value, predictive value, or both;
- faithful representation, which is attained when depiction of economic or other phenomena is complete, neutral, and free from material error;
- understandability;
- timeliness;
- comparability; and
- verifiability (including supportability).

Constraints on financial reporting are materiality, cost, and the balance between the qualitative characteristics.

We agree with the proposed qualitative characteristics and constraints on financial reporting.

We note that these are not the same as current proposals for the IASB Conceptual Framework. However, it is not clear to us that this makes a significant difference to the application of the qualitative characteristics.

Chapter 5 - Characteristics of a Reporting Entity

This chapter discusses the characteristics of public sector reporting entities. It proposes that the Framework should not identify which entities or group entities are reported upon, but will identify the characteristics which they are likely to possess.

The proposals for a definition of a reporting entity are quite flexible, reflecting the fact that governments may use a variety of institutional and administrative approaches to the organization of their activities. It suggests that the key signal is that it is reasonable to expect users to need information in General Purpose Financial Reports for accountability or decision making purposes.

The proposals for a definition of a group reporting entity are mainly framed for the purpose of defining 'whole of government' group reporting entities. Chapter 5 explains that IPSASB have considered defining group boundaries in terms of control, risk and rewards, oversight and other approaches. Thereafter it refers to the May 2008 IASB Discussion Paper on this subject, and suggests that a similar approach to the IASB proposals should be used:

- defining the group boundary by reference to control; and
- defining control in terms of 'power' and 'benefit'

Key aspects of the reporting entity and group reporting entity are set out in Preliminary Views 8 and 9.

Comment on Chapter 5

Chapter 5 addresses important differences in the way in which public sector operations may be organised and reported upon, and allows for flexibility in entity definition which is linked to achieving the objective of public sector financial reporting for an appropriate group of users.

Our comments on Preliminary View 8 and Preliminary View 9 are set out below.

IPSASB Preliminary View 8 – Characteristics of a Reporting Entity

The key characteristic of a reporting entity is the existence of users who are dependant on GPFs of the entity for information for accountability purposes, and for making resource allocation, political, and social decisions.

A public sector reporting entity may be an entity with a separate legal identity or other organisational structure or arrangement.

We agree with the above analysis. It provides sufficient flexibility to accommodate the many approaches which governments may use to organize their activities, which also often reflects a view that they often define functional or organizational boundaries specifically to support accountability to government and other stakeholders, and to inform funding and other decisions.

IPSASB Preliminary View 9 – The Composition of a Group Reporting Entity

A group reporting entity will comprise the government (or other public sector entity) and other entities when the government (or other public sector entity):

- has the power to govern the strategic financing and operating policies of the other entities (a “power criterion”); and
- can benefit from the activities of the other entities, or is exposed to a financial burden that can arise as a result of the operations or actions of those entities; and can use its power to increase, maintain, or protect the amount of those benefits, or maintain, reduce, or otherwise influence the financial burden that may arise as a result of the operations or actions of those entities (a “benefit or financial burden/loss” criterion).

We agree that this is a sensible approach on the basis of which to develop guidance for group entities, although in practice we would note that some jurisdictions will require financial reports to be produced for group entities on a basis more akin to that set out in Preliminary View 8, to support accountability and decision making.

Considering the specific matter of whole of government entities, we accept that the control based approach is more applicable, although again, in practice some flexibility may be required in practice.