

Development of a Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities

COMMENTS ON THE EXPOSURE DRAFT ISSUED BY IPSASB/IFAC IN OCTOBER 2008

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1. Our expectations

Some of us attended the FEE/European Commission conference in Brussels on October 23rd, 2008, where we heard three distinguished members of IPSASB explain that future IPSAS will be developed based on IFRS at a rather rapid pace (one year from the release of a new IFRS to the publication of the corresponding IPSAS). In order to take the public sector's specificity into account, this process is to rest on a comprehensive conceptual Framework.

We are grateful that we are granted the opportunity to take part in the elaboration of this Framework, which we understand will be critical in the future.

Being sometimes confronted with barriers to change, we would find it useful to be able to refer to a commonly known and generally accepted document, focussing on the use of financial reporting and on keeping a balance between costs and benefits of financial reporting.

2. The objectives of the consultation

As one can read in the introduction to the Framework, the current public consultation "will (a) provide constituents with the opportunity to review and comment on components of the IPSASB Framework as they are developed, as well as the full exposure draft, and (b) allow each stage of project development to be informed by responses to prior consultation papers." (p. 4).

In this perspective, our comments will aim at:

- ☞ highlighting risks inherent to the formulation of the Consultation Paper
- ☞ drawing IPSASB's attention on sensitive issues which could become a matter of concern later on in the process.

3. Key questions on the Consultation Paper

The Consultation Paper raises seven key questions:

1. the links (or tension) between accounting and financial reporting
2. the identification of basic assumptions regarding the specificity of the Public Sector with respect to financial reporting
3. the neutrality of the Framework and recognition of diversity
4. the conflict between a principle-based approach and a rule-based reality
5. the borders of financial reporting with regards to non-financial information
6. the scope of the GPRS's released by business entities in the public sector
7. the opportunity to rely on IFRS in order to develop effective financial reporting

3.1. Public Financial Reporting vs. Public Accounting

Financial reporting differs from accounting. It has to do with public entities' duty in terms of accountability, and only makes sense if some stakeholders find it useful. Still, it must be connected with public accounting processes, which produce some inputs involved in the reporting process.

Public accounting being currently under reform in many countries throughout Europe, the links between the two should be made clearer (all the more that "IPSAS" stands for "International Public Sector **Accounting** Standards").

If not, the **link** between the two might become a **tension**, and financial reporting will grow as a burden in the view of public officers.

3.2. Public Sector's specificity

We haven't found a statement demonstrating a comprehensive view of the specificity of the public sector, based on the economic theory, for instance (cf. Musgrave's division of the functions of government between three branches).

Given this vision determines key assumptions regarding public financial reporting, it should be made explicit.

If not, the Framework might miss its objective to provide guidance on aspects which are not covered by an IPSAS (see Preliminary View # 1).

3.3. The question of the recognition of diversity

A Framework on financial reporting can be a very technical, thus neutral, document. Indeed, it reads that "The IPSASB Framework will (...) need to recognize the diversity of (a) underlying social and cultural traditions, (b) forms of government, and (c) service delivery mechanisms that exist in the many jurisdictions that may adopt IPSASs." (p. 3). An effort in this direction was certainly made.

Still, some explanations reveal that one major underlying assumption of the Framework is that public entities operate within a competitive environment, which happen not to be the case in all countries for all segments of the public sector.

What is more, we have the feeling that the Framework is focused mainly on product and service delivery, to the expense of the other two branches which are the distribution and stabilisation branches of public finance. These aspects are not properly covered if only tackled from the input side. This leads to an approach of public entities as « business likes » only, which could favour resistance to change in some administrations.

3.4. Principle-based approach vs. rule-based reality

Just like the IFRS Framework, the IPSASB Framework seems to be promoting a principle-based approach.

This approach might reveal conflicting with the rule-based approach that prevails in the European public administration. ESR 1995 is a regulation on economic accounts with a strong emphasis on public financial reporting.

Governments are bound to respect ESR 1995. How will administrations cope with the two ranges of standards?

This problem was identified in the introduction of the Consultation Framework (p. 4). In which part of the Framework is it handled?

3.5. Borders of GPFRs with regards to non-financial information

Figure 1 (p. 16) presents a classification of information needs relating to assessment of accountability and decision process.

The notes to the financial statements are integrated within GPFS (financial statements). Aren't they made redundant with additional information within GPFRs?

If not, what is the difference between other information outside GPFRs and additional information within GPFRs? For instance, an agency in charge with fostering employment has to issue statistics regarding unemployment. Are they considered to fall into the "additional information within GPFRs" category?

3.6. The scope of GPFRs released by business entities in the public sector

Under Paragraph 4.3, we find: *"These qualitative characteristics have been developed after considering the qualitative characteristics proposed in the IASB Framework ED "Objective and Qualitative Characteristics" (2008). However, they differ in some respects from those proposed by the IASB, because they (a) respond to the objectives of GPFRs of public sector entities, and (b) reflect a potentially broader scope of financial reporting than the IASB has currently identified."*

Thus, we can infer that the scope of financial reporting under IFRS is narrower than the under IPSAS.

When reading the introduction to the framework, we can read: *"The initial focus of the IASB-FASB joint project is on financial reporting by business entities in the private sector. In a later phase of the project, the applicability of the IASB Framework to financial reporting by not-for-profit entities in the private sector and business entities in the public sector will be considered. However, the IASB Framework will not apply to other public sector entities."*

In other terms, the IASB framework might apply to a number of public sector entities in the future - mainly those with a business objective.

Thus, there might be a discrepancy between the objectives settled by the framework applicable to business entities within the public sector (which would prepare GPFRs under IFRS) and their stakeholders' information needs and rights.

The same difficulty might arise concerning non-for-profit entities, which sometimes prove difficult to qualify as "public sector entities" or "private sector entities". Some actors try to use them strategically, in order to escape their duty in terms of reporting. This temptation is likely to grow if the qualitative characteristics appear to be lighter in one case than in the other.

3.7. Relevance of IFRS as a starting point for developing new IPSAS

IFRS failed to prevent or anticipate the financial crisis. Is it still appropriate to promote their transposition to the Public Sector?

4. Opinion on the preliminary views

Generally speaking, we find it easier to agree on the Preliminary Views than on their explanations.

<i>Preliminary View 1 - The Authority of the IPSASB Framework</i>	The IPSASB should take into account that the Framework will have no legal value unless a country or international organisation makes it enforceable
<i>Preliminary View 2 - General Purpose Financial Reports</i>	Given the diversity of functions and stakeholders, some common information needs might escape the scope of GPFRs, all the same.
<i>Preliminary View 3 - The Users of GPFRs</i>	<p>The three categories seem to reflect only one function of government: the allocation of resources which can also be viewed as a production function.</p> <p>What about the stakeholders interested in the other two branches, not only from the financing side, but also from the effectiveness side?</p> <p>Even GPFRs are targeted at stakeholders outside the organisation, it would be interesting to take its management into account, too.</p>
<i>Preliminary View 4- The Objectives of Financial Reporting</i>	In order to make these objectives more specific, it would be useful to limit the scope of financial reporting (in other terms, the Limitations of GPFRs deserve a preliminary view, as well).
<i>Preliminary View 5 - The Scope of Financial Reporting</i>	It seems that financial reports should cover all information needs, which cannot be the case. Financial reporting is not the sole way of meeting accountability duties.
<i>Preliminary View 6 - Evolution of the Scope of Financial Reporting</i>	
A preliminary view on the limitations should be added.	
<i>Preliminary View 7 - The Qualitative Characteristics of Information Included in GPFRs</i>	<p>Very useful.</p> <p>Why not endorse a hierarchy among qualitative characteristics? Isn't faithful representation more important than timeliness?</p> <p>Some pervasive constraints have been omitted (e.g.: strategic behaviour, assimilating the detention of information to power).</p>

<i>Preliminary View 8 - Characteristics of a Reporting Entity</i>	<p>This approach could make problem in terms of the stability and predictability of duties.</p> <p>The difference between GPFRs and Special Reports is not clear enough since a group can compel an entity to establish GPFRs based on its specific information needs.</p>
<i>Preliminary View 9 – The Composition of a Group Reporting Entity</i>	<p>Three ranges of questions:</p> <ul style="list-style-type: none"> ↳ about the power criterion: how to capture this criterion? Power is not always revealed. ↳ About the compatibility with regional regulations: what about ESR ↳ About the added value of financial reports embracing too many entities: some information might be diluted.

5. Additional comment

Translation into French: We checked some words, which appeared not to have been translated properly (e.g: “claims on resources” and “supportability”).

6. The authors of this contribution

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