Comments on the "Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities" Discussion Paper as issued by the IPSASB in September 2008

by

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Introduction

1. The decision to develop a conceptual framework is welcomed, even if overdue! Many issues and problems relating to IPSAS can be resolved if working within an appropriate framework. As such the Discussion Document is an important step forwards.

2. The comments below are written based on experience of working primarily with national governments The perception is that IPSAS are written mainly from the perspective of sub-national levels of government and public sector agencies, and do not adequately reflect the external influences and pressures facing national governments.

The authority of the Framework (preliminary view 1)

3. The starting point should be a definition of a "Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities". One definition is that a conceptual framework of accounting "seeks to identify the nature, subject, purpose and broad content of general-purpose financial reporting and the qualitative characteristics that financial information should possess"[1].

4. But can you have a conceptual framework for financial reporting distinct from a conceptual framework for financial reporting separate from the framework for public sector entity accounting itself? Surely accounting is one of the outcomes of the accounting system?

5. Hence, building on the above definition, it is suggested for Preliminary view 1

> *Preliminary view 1: The "Conceptual Framework for Public sector Entity Financial Reporting" is part of the overall accounting conceptual framework for such entities. Within this broader context the Financial Reporting Framework defines the nature, subject, purpose and broad content of general-purpose financial reporting and the qualitative characteristics that financial information should possess.*
>
> *Hence all new IPSAS must be consistent with the Conceptual Framework and existing IPSAS reviewed to ensure consistency.*

[1] Deegan and Unerman "Financial Accounting Theory" McGraw hill 2005

General Purpose Financial reports (preliminary view 2)

6. Under the agency concept of government, the government is the agent of the people (or civil society). As such civil society has the right to demand from government reports on various matters. GPFRs should be a key element of that reporting framework.

7. As such civil society by definition can demand other reports on governance. But it chooses to require the production of GPFRs. That requirement may be articulated by law, e.g. legislation requiring local government GPFRs, or administratively, e.g. the production of whole of government GPFRs.

8. The concept that users are only interested in GPFRs if they do not have access to other information is **not** accepted. As an analogy company management is very interested in their GPFRs even though they have access to internal information, because such reports are produced according to standards and externally verified.

9. Hence wording proposed for Preliminary view 2 is:

> *Preliminary view 2: GPFRs are financial reports intended for members of civil society who have an actual or potential interest in the reporting entity*

The users of GPFRs (preliminary view 3)

10. As indicated above the primary users must be civil society, or the sub-set affected by a specific public sector entity. Legislators are users as elected representatives of civil society. Similarly there may be other groups representing specific elements of civil society, but their authority always comes from civil society.

11. There will also be external users, e.g. multilateral agencies such as the IMF, other governments, corporations extending across several countries, interest groups extending across several countries. In the case of sub-national entities the central government will have a legitimate interest.

> *Preliminary view 3: the primary users of GPFRs are members of civil society who have an actual or potential interest in the reporting entity. In addition users may include external parties with a legitimate interest, e.g. multilateral agencies, other governments, suppliers, creditor and other interest groups.*

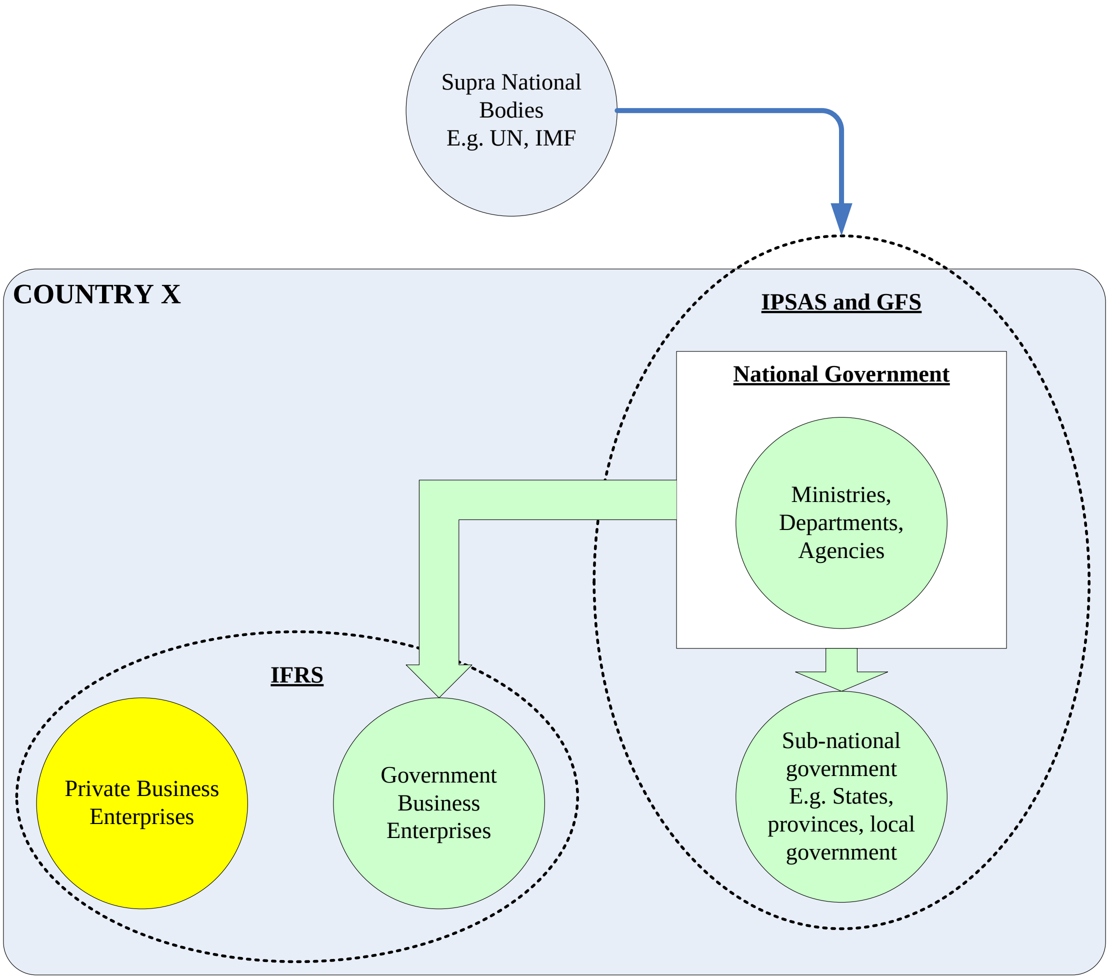
A relevant digression - the IMF GFS

12. On page 4 the Discussion Paper refers to “Statistical Financial Reporting Models”. It is assumed this refers particularly the UN System of National Accounts (SNA) and the IMF Government Finance Statistics (GFS) 2001. The GFS has been designed to be consistent with the SNA. The Eurostat system is also consistent with the SNA, but does not include the detailed financial information required by GFS; the latter is therefore applicable to all countries.

13. It is suggested that the Discussion Paper understates the significance of such systems; in fact the IMF GFS is the dominant international comparative reporting model for national government financial information.

14. This is because in any country the dominant public sector entity is the national Government. All other public sector entities are sub-sets of the national government with varying degrees of autonomy. This and the relationship to commercial entities is summarised in Figure 1 below.

Figure 1: Entity Relationships



15. Thus, though the Discussion Document does not specifically define public sector entities (see comments below), it is clear the IPSAS and GFS are concerned with substantially an identical set of such public sector entities.

16. It is also clear that the GFS by providing standards for international comparison on government financial information should be an important driver of financial reporting - at least as important as IFRS. In particular GFS:

- Prescribes a standard Classification Of the Functions Of Government - COFOG - consistent with SNA. In the design of budget classifications and chart of accounts it is an essential requirement that they comply with, or at least can be bridged to, the COFOG classifications.
- The GFS also prescribes economic expenditure and revenue classifications which again governments need to be able to comply with so as to be able to produce the fiscal tables required for GFS reporting
- GFS also defines and classifies capital expenditure and lending flows.

17. On the other hand GFS does not lead to a set of auditable financial statements.

18. The IPSASB has produced a documents "International Public Sector Accounting Standards (IPSASs) and Statistical Bases of Financial Reporting: An Analysis of Differences and Recommendations for Convergence". It is suggested that the

development of a Conceptual Framework should - indeed must - be used to identify any conceptual differences with the GFS reporting model.

19. It would appear that differences between GFS and IPSAS arise as a result of:

    i) A different perspective - the GFS approach is from the perspective of economists in a financial institution not accountants, and

    ii) A different purpose - the GFS does not lead to general purpose financial statements, but rather to a set of fiscal tables for international comparison.

20. If the issue of GFS/IPSAS convergence alone could be addressed through the conceptual framework it would be a great service to governments and their advisers struggling to design budget and accounting systems which are both IPSAS and GFS compliant.

The objectives of GPFRs (preliminary view 4

21. For a privately owned entity the GPFRs have four objectives:

    i) An indication of the capacity to pay dividends

    ii) An indication of the capacity to pay tax

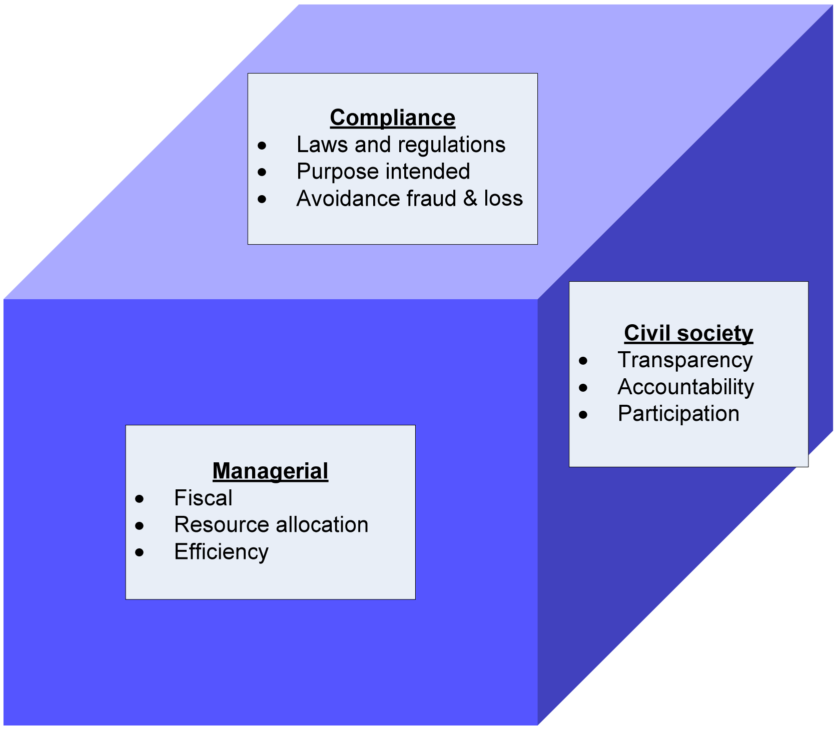
    iii) Information enabling an assessment of solvency

    iv) A report on the use of shareholder funds

22. For a public sector entity (i) and (ii) above are irrelevant. It is hoped that solvency (iii) will not be an issue, though there may be special circumstances and of course in the current environment the issue of solvency of national government may be an issue. Point (iv) is very relevant, but surely there are other reasons? The Discussion Paper suggests resource allocation, political and social decisions, but really a broader perspective is required of the purpose of public financial management.

23. The analysis below is based primarily on a national government and uses a broad concept of accounting to include the whole financial management cycle. However, most of the concepts are equally applicable to other levels of public sector entity. It is suggested that government accounting purpose has at least three dimensions - managerial, compliance and linkage to civil society, as represented in the diagram in Figure 2 below and explained in the following text.

Figure 2: The purpose of government accounting



24. The three dimensions and their relevance to GPFRs are summarised in the matrix below. For completeness the relevance of IMF GFS fiscal table information is also included

Title	**Description**	**Extent to which addressed by:**	
		IPSAS compliant GPFRs	**IMF GFS**
Managerial Dimensions[2]			
Fiscal	Managing government activities within fiscal (tax and borrowing) limits as prescribed by policy makers	GPFRs provide information to analyse fiscal outcomes but no specific requirement on the analysis of debt and debt flows	GFS has specific requirements for analysis of both debt balances and debt flows which enables useful analysis
Resource allocation	Allocating fiscal resources in accordance with strategic priorities	GPFRs provide some information on resource allocation but no standard classification system or level of detail	Compliance with GFS provides detailed and standardised analysis using COFOG and economic analysis

[2] Sanjay Pradhan and Jose Edgardo L. Campos, *Budgetary Institutions and Expenditure Outcomes: Binding Governments to Fiscal Performance*. Washington, D.C.: Policy Research Working Paper #1416, World Bank (1996)

Title	Description	Extent to which addressed by:	
		IPSAS compliant GPFRs	**IMF GFS**
Efficiency	Managing the raising of funds so as to as achieve maximum efficiency or value for money. This purpose has many sub-components, e.g. minimising transaction costs, treasury management, value for money.	No measure of efficiency available	No measure of efficiency
Compliance dimension			
Compliance with laws and regulations	Operating within the constitutional, legal and regulatory framework of government	GPFRs should disclose any material failures.	GFS does not address the issue of compliance
Purpose intended	Ensuring public money is used for the purpose intended as defined in the budget	The GPFRs comparison with budget should provide this information.	GFS does not require a comparison with budget.
Avoidance of fraud and loss	The negative, but important, objective of ensuring that the risk of fraud and other losses is minimised	GPFRs should disclose any material fraud or loss	GFS does not address the issue of fraud or loss
Civil Society			
Transparency	Making information available to civil society in a manner that meets the needs of different groups	GPFRs are designed to provide information to users	Fiscal tables usually only produced at national government level, so too highly aggregated to provide useful information
Accountability	Ensuring politicians and officials are made accountable for their actions	GPFRs and the audit report thereon are a key element of accountability	GFS is not designed to address accountability
Participation	Using financial management as a tool to enable civil society groups to participate in policy issues, resource allocation and accountability.	GPFRs may provide information for participation, but otherwise do not directly address this issue of participation	As above, information may be to aggregated to facilitate participation

25. Based on this analysis it is suggested that GPFRs should provide historic information on:

- Entity fiscal management, particularly borrowing s and contingent liabilities
- Resource allocations by the entity preferably using standardised and informative classifications

- Compliance with laws and regulations identifying any material failures
- The extent to which public money was used for the purpose intended by caparison with budget allocations
- Identification of any material frauds or losses
- The financial transactions of the entity so as to support transparency, enable accountability and to facilitate civil society participation in the process of governance.

26. A suggested wording for Preliminary view 4 is:

Preliminary view 4: the objective of GPFRs is to provide information about the reporting entity in terms of fiscal management, resource allocation, compliance, material frauds or losses in manner to facilitate transparency, accountability and civil society participation in governance of the entity.

Scope of financial reporting (preliminary view 5)

27. The scope of the financial statements follows on from the objectives above. Using the bullet points in the discussion draft:

- Agreed
- Agreed - conditional claims are important and should be specified
- Agreed - subject tot the test of materiality
- See comments below on last two bullet points.

28. The last two bullet points suggest the scope of financial statements should include service delivery objectives, activities and achievements. However, these are not considered appropriate as part of the financial statements for a number of reasons:

- The information is clearly not financial and requires subjective decisions on objectives, activities and achievements
- Evidence shows how difficult it is to set objectives that meaningfully measure an entities performance, and indeed how such objectives can lead to sub-optimal behaviour by officials
- The objectives are in part political and may change over time.

29. At most the Conceptual Framework should allow for non-financial information, but it should not be specific as to the form and content of such information.

30. On the other hand it is considered there is strong case for bringing the analytic requirements of the GPFRs into line with the GFS analysis, e.g.

- Adoption of the COFOG as required analysis
- Adoption of the GFS economic, capital and debt analysis.

31. This should not be an imposition on reporting entities because governments are trying to bring their reporting into line with the new GFS analytic structure. It would be a move to convergence between GFS and IPSAS, minimise duplication of efforts and make the GFS analysis more credible by making it part of the GPFRs and hence subject to audit.

32. Hence the alternative Preliminary view 5 is as follows:

Preliminary view 5: Scope of financial reporting:

- *economic resources of the reporting entity at the reporting date and claims to those resources using international standards for analysis of such information;*
- *the effect of transactions, other events, and activities that change the economic resources of the reporting entity and claims to those resources (including contingent claims) during the reporting period, including cash inflows and outflows and financial performance using international standards for analysis of such information;*
- *the reporting entity's compliance with relevant legislation or regulation (subject to the test of materiality of disclosure) and legally adopted or approved budgets used to justify the raising of monies from taxpayers and ratepayers;*
- *non-financial information on the value for money delivered by the entity;*

Evolution of the scope of GPFRs (Preliminary view 6)

33. This is supported as allowing for future developments.

Qualitative characteristics (Preliminary view 7)

34. This preliminary view is supported.

The reporting entity (Preliminary views 8)

35. The Discussion Paper does not define the reporting entity but instead refers to a reporting entity being defined by "*the existence of users who are dependant on GPFRs of the entity for information for accountability purposes, and for making resource allocation, political, and social decisions*".

36. As an aside it is hoped no one makes "resource allocation, political and social decisions" based on historic accounting information! Such decisions are about the future; at best historic information can only be used as a guide to estimate the future impact of decision alternatives.

37. The move away from any rigid definition of the reporting entity and towards a definition based on user need is supported. However, it is suggested that:

- Users need not be "dependent" on GPRS; civil society has a right to require GPRS from government entities and does not need the test of dependence.
- For the same reason it is not necessary to define the purpose for which GPRS are required.
- Whilst the idea of a definition based on user needs is supported, it must additionally be recognised that where an entity is created by law and that entity handles public money, then there should be an automatic requirement for GPRS.

> *Preliminary view 8 - There should be two tests either of which is sufficient to identify a reporting entity:*
>
> *i)* *Either users who require GPFRs for information or accountability purposes, or*
>
> ii) *The existence of an entity defined by law which receives, holds or spends public money.*

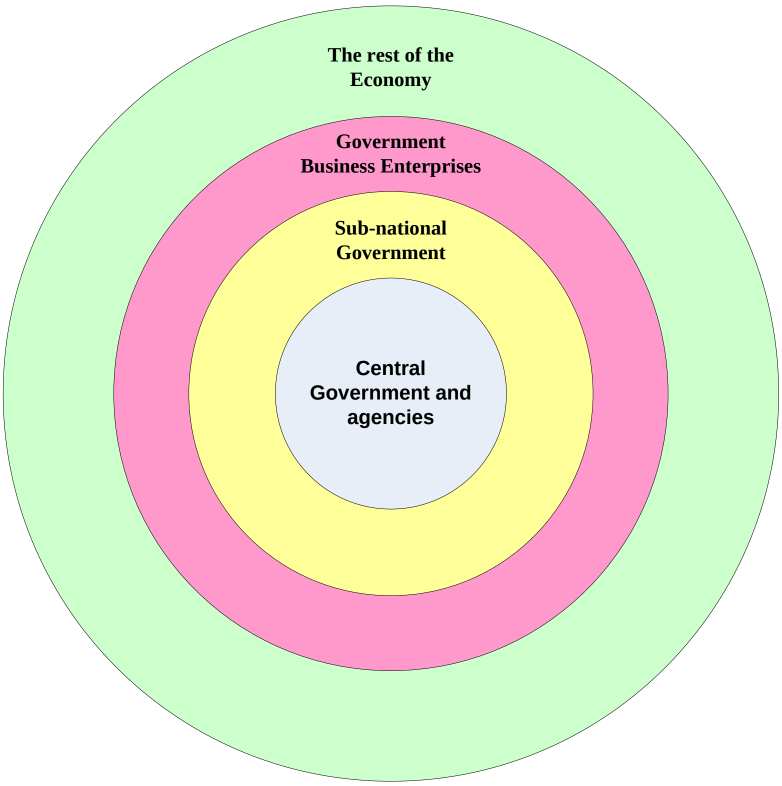
The Group reporting entity (Preliminary view 9)

38. The problem with the definition in Preliminary View 9 is the concept of control at a national government level. Both in theory and in practice the national government as the embodiment of the "will of the people" has complete authority to control anything and everything within a country.

39. Practical evidence of this has been dramatically provided over very recent history by the ability and willingness of national governments to take control of private sector banks and dictate their actions and policies. There are no constraints on the authority of a government other than the constitution.

40. In fact government can be seen as a series of concentric circles moving from central government to the whole economy, as illustrated in Figure 3 below.

Figure 3: The parameters of government

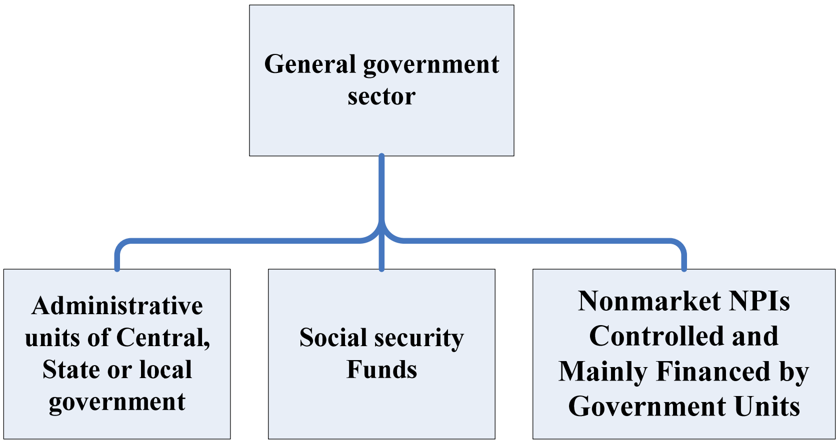


41. The breadth of government creates real problems of defining contingent liabilities. For example, again recently, it has become apparent that a national government has a moral liability for the savings of citizens in privately owned banks - yet it has never before been suggested that private bank liabilities should be treated as a contingent liability of government.

42. The above examples indicate the inadequacy of the concept of control when used to define the parameters for national governments. In fact there is no real entity of national government; it may be defined as anywhere within the group of concentric circles above for different purposes.

43. Hence it is suggested that a more pragmatic definition of government is required. The IMF GFS definition is summarised in the diagram from the GFS Manual in Figure 4 below.

Figure 4: GFS definition of the government sector



Key: NPI -Nonmarket Non-profit Institutions

44. This seems an adequate and reasonably comprehensive definition and we would suggest that the definition of the public sector uses this framework for the definition of national governments. For groupings below the level of national government the concept of control is regarded as appropriate.

Preliminary view 9: The general government sector for financial reporting is defined to include:

- *Administrative units of Central, State or local government*
- *Social security Funds*
- *Nonmarket Non Profit Institution s Controlled and Mainly Financed by Government Units*

At sub-national level the concept of control as set out in Preliminary view 9 can be used

For supra national groupings the groups own definition of its composition and parameters should be used if GPFRs are required

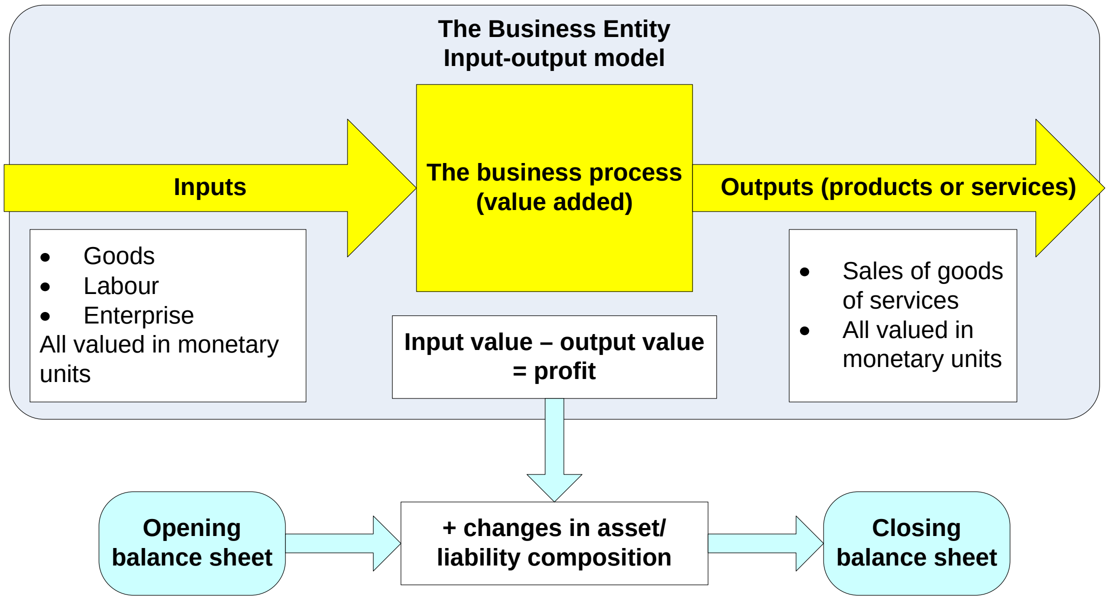
What is lacking from the discussion document - a conceptual model

45. The Discussion Document addresses a number of important issues that are part of a conceptual framework, but never actually seeks to identify such a framework. Yet what is needed is an all embracing model of the relationships in Public Financial Management.

A digression: the conceptual model for commercial accounting

46. As an example, the accounting model for commercial entities provides a universal input-output model for all types of business as illustrated in Figure 5 below.

Figure 5: The commercial accounting model

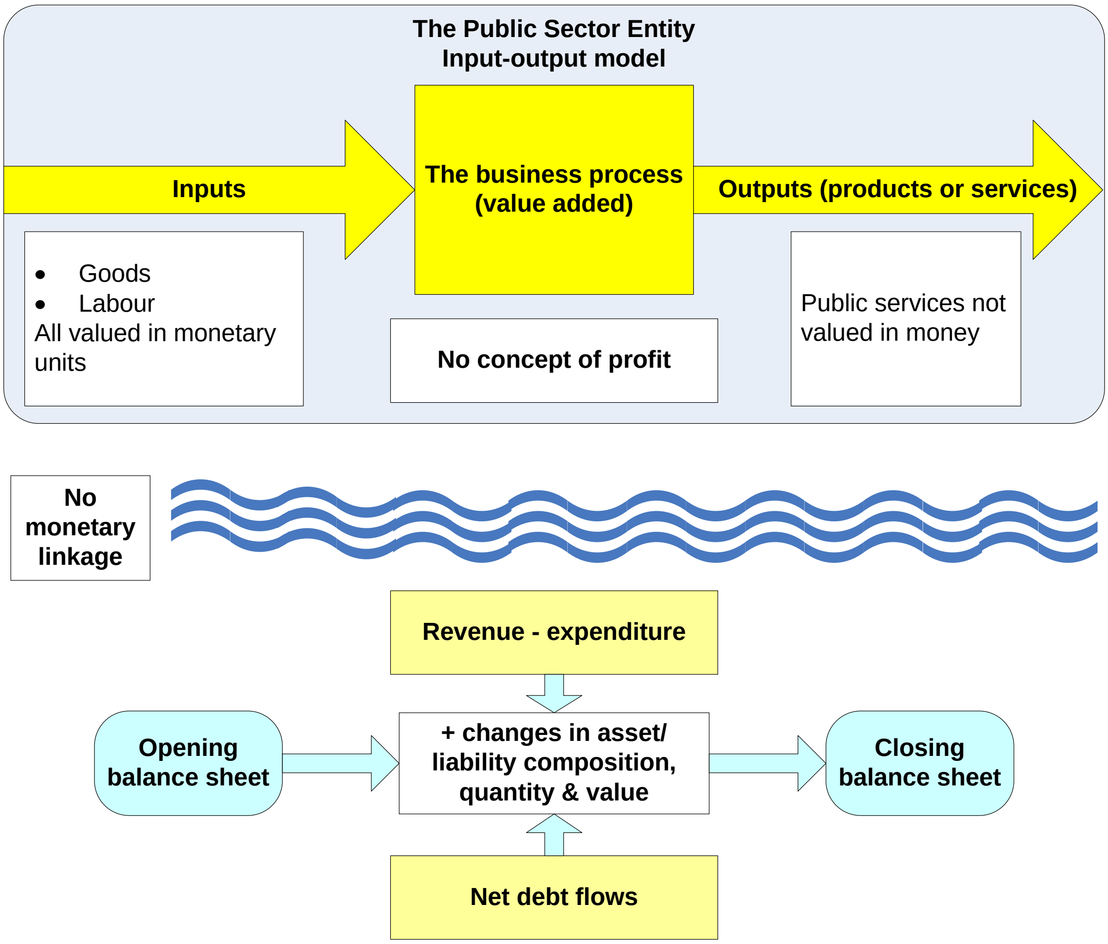


47. The accounting model has achieved dominance in the commercial sector because it because it is a universal model of all types of business enterprises which identifies one key performance indicator - profit.

Applying the commercial accounting model to the public sector

48. Unfortunately the above model cannot be applied to public sector entities because outputs are service delivery, usually provided free at the point of delivery, and hence not valued in money units. This there is a fracture in the model.

Figure 6: Public sector accounting model



49. Thus for the public sector entity (government or otherwise) there is no direct linkage between the input-output model and financial accounting model - because outputs of service deliveries are generally provided free and are not easily monetized.

50. Output, or performance budgeting, has been an attempt to link monetary inputs with non-monetary outputs. But this has practical problems:

- The physical measures vary between and within organisations according to the type of activities
- Physical measures cannot be converted to any single scale so as to enable comparison across and within entities
- Physical measures must always be selected form a range of possible measures, and the measures selected must be biased according to the political goals. Hence they are not an independent selection.

51. The Discussion Paper does not consider this issue; .but can there be a conceptual framework without such consideration?