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Technical Director  
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Dear Sir or Madam

## **Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities**

The Audit Commission welcomes the opportunity to comment on the consultation paper, "Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities".

The Audit Commission is an independent watchdog, driving economy, efficiency and effectiveness in local public services in England to deliver better outcomes for everyone. Our work across local government, health, housing, community safety and fire and rescue services means that we have a unique perspective. We promote value for money for taxpayers, auditing the £200 billion spent by 11,000 local public bodies. As a force for improvement, we work in partnership to assess local public services and make practical recommendations for promoting a better quality of life for local people.

### **The Commission's Response**

The Commission strongly supports the Board's move to create an over-arching conceptual framework from which future IPSASs will be developed. We also welcome the move to relate this framework to the IASB Framework as applicable for the public sector. Our key comments are as follows:

1. The overall scope of the document appears to cover information over and above that typically included in public sector financial statements. Whilst there is undoubtedly a need to establish some form of framework for such information, we believe that this should be developed separately to this Conceptual Framework.
2. We strongly believe that the users of General Purpose Financial Reports (GPFRs) should be defined more narrowly, to comprise 'funders and financial supporters'. To include groups wider than this would impose too great a burden on reporting entities to try to identify, and then to meet, the needs of all such groups.

3. As a framework that will underpin future IPSASs, we believe the framework should address the tension between accounting at historical cost and at fair value and clarify the primacy of one concept over the other. Our preference is that current cost accounting should have primacy as it results in better information about the stewardship of resources.
4. In many instances, terms used in the framework need to be defined more clearly in order to be better understood and applied in practice. In many cases this simply requires clarification that the information covered is financial in nature.

Our detailed comments on each of the Preliminary Views are included in the attached Annex.

Yours faithfully

A handwritten signature in black ink that reads "Stephen R. R. Warren". The signature is written in a cursive style. To the right of the signature is a vertical red line.

Steve Warren  
Head of Professional Standards

### **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.*

#### **Response**

We agree with this view.

### **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.*

#### **Response**

In our response to the IASB conceptual framework consultation we stated that generic users for all sectors could be defined as 'funders and financial supporters'. A more detailed consideration of this definition is given below on Preliminary View 3. We believe that the framework should specify that GPFRs are intended to meet the 'common *financial* information needs' of those users, as opposed to the potentially wide category of 'common information needs'. Wider non-financial information over and above that which aids the understanding of the entity's finances will need to be clearly defined and will, therefore, require a significant amount of additional research and consultation. Consequently, we believe that it should be outside the scope of the framework at this stage so that publication of the framework is not unnecessarily delayed.

### **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.*

#### **Response**

As discussed above, we believe that users of GPFRs should be defined as 'funders and financial supporters'.

In the UK, the Treasury issues a Financial Reporting Manual (FReM). In this document, users of UK public sector GPFRs are identified and examples of key users are given, being:

- Parliament, including relevant Select Committees;
- the relevant authority;
- the entity's management board;
- the entity's audit committee; and
- the taxpayer.

In our view, 'funders and financial supporters' covers all of the users detailed above and ensures that GPFRs are sufficiently focused on key users.

We also believe that the third group of users (other parties, including special interest groups and their representatives) is potentially dangerous as it will create a definition that is too broad. It would be difficult to make any judgement as to what such a wide group of users might be interested in.

We agree that whilst some of the information included in GPFRs will be useful for special interest groups, we do not support the view that the requirements of such groups should be considered when deciding the content of GPFRs. The requirements of such groups will be represented by the legislature.

#### **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.*

#### **Response**

In the Commission's view, one of the key objectives for financial reporting in the public sector is demonstrating good stewardship of public funds and this should be given equal status as decision-usefulness. We feel that the objective of 'accountability' in the Preliminary View should be replaced by 'stewardship', or further defined to clearly include stewardship, recognising the public sector organisations' accountability for the proper stewardship of funds raised by compulsory taxation.

The second objective should in our view be amended to clarify that the objective is for *informing* rather than *making* resource allocation decisions. Financial reporting will be one source of

information used by decision makers. Therefore, while financial reporting will inform those decisions it will not, of itself, enable decision makers to make those decisions on resource allocation.

In addition, in our view the first sentence should be redrafted to make it clear that the objectives are to provide *financial* information about the reporting entity rather than just generic information. We believe this is important in clarifying the nature and purpose of financial reporting.

## **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.*

### **Response**

We agree with the first two bullet points of the scope. These broadly accord with the traditional concept of the content of financial statements

The third bullet point potentially covers a wide range of indicators and targets, many with no clear link to the reporting on the finances of the reporting body. This point would be better framed if it related only to the reporting of performance against financial targets required by relevant legislative and regulatory frameworks.

The fourth bullet point should be constrained to the reporting of financial elements of service delivery objectives as in our view this conceptual framework should not at this stage seek to cover aspects of non-financial reporting.

In our view the fifth bullet point similarly needs constraining to only cover the *financial* aspects of future activities and objectives.

## **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.*

### **Response**

We agree with this view although feel that 'as necessary' should be added after 'evolve'. We believe that this will address concerns that users' information needs may not always be consistent with the objectives of financial reporting.

## **IPSASB Preliminary View 7 - The Qualitative Characteristics of Information Included in GPFs**

*The qualitative characteristics of information included in GPFs 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*

### **Response**

We note that this framework mirrors the characteristics identified in the IASB Conceptual Framework including the characteristic of 'faithful representation'. In our response to the IASB consultation we stressed that faithful representation was not a term that would be readily understood by the users of GPFs and that reliability would be more readily understood. We continue to hold that view.

We think that the framework needs to address the tension between accounting at historical cost and at fair value and, in the absence of specific accounting standards in an area, clarify the primacy of one concept over the other. Our preference is that current cost accounting should have primacy as it results in better information about the stewardship of resources.

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We support the view expressed on the remaining qualitative characteristics of information included in GPFs.

## **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 organizational structure or arrangement.*

## **Response**

We would prefer to see the conceptual framework broadly describe a reporting entity as a circumscribed area of economic activity of interest to funders and financial supporters, to make the definition more specific.

The Commission agrees that the definition of a reporting entity should not be limited to bodies that are structured as legal entities. In the United Kingdom, we are aware of a number of public benefit entities that are not constituted as legal entities but which consume resources in the delivery of their activities and services. As we believe that stewardship should be an objective of financial reporting, it is important that those bodies not constituted as legal entities do prepare financial reports to provide the necessary level of accountability.

## **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).*

## **Response**

The Commission believes that the control (or power) criterion should be the starting point for defining the group reporting entity.

We believe the reference to “government” in the first sentence is superfluous and the framework needs only to refer to public sector entities. There will be many circumstances where public sector entities will enter into group reporting arrangements and, in our view, there will be no difference between the recognition and reporting requirements of those public sector bodies and the government.