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Ms Stephenie Fox
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Dear Ms Fox

IPSASB CONSULTATION PAPER: CONCEPTUAL FRAMEWORK FOR GENERAL PURPOSE FINANCIAL REPORTING BY PUBLIC SECTOR ENTITIES

The Heads of Treasuries Accounting and Reporting Advisory Committee is responding to the IPSASB's invitation to comment on the International Public Sector Accounting Standards Board's Consultation Paper: *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*.

HoTARAC members have divergent views regarding the need for the development of a separate public sector conceptual framework for the public sector.

Some HoTARAC members believe that the development of a separate framework, not based on the IASB Framework, is contrary to the long term convergence between the IPSASB and IASB requirements as it will make future convergence more difficult and time consuming. By having a separate IPSASB project on the Conceptual Framework, the IPSASB may also risk losing the discipline of rigorously analysing and justifying departures from the IFRS, which is present in the IPSASB's approach to individual IFRSs. The importance of this is reflected in the IPSASB's document Process for Reviewing and Modifying IASB Documents.

Other HoTARAC members view the nature and operation of the public sector differently from that of the for-profit sector, particularly in areas of accountability and stewardship. Hence, this alternate view considers there is a need for the IPSASB to develop a separate conceptual framework for the public sector which reflects the differences between the public sector and for-profit sector, rather than aiming for exact convergence between the IASB and IPSASB Conceptual Frameworks. On this basis, an IPSASB Conceptual Framework may be a good tool for the AASB to use in the future in developing Aus paragraphs for the public sector.

Despite these differing views, HoTARAC has agreed, based on its review to date, the following comments with respect to the Preliminary Views contained in the IPSASB Consultation Paper (refer to Attachment 1).

HoTARAC will continue to monitor and provide comment on the work being undertaken by the IPSASB as content is released for comment.

Yours sincerely

D W Challen
CHAIR
HEADS OF TREASURIES ACCOUNTING AND REPORTING ADVISORY COMMITTEE

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Encl

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Attachment 1

IPSASB Consultation Paper

Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities

HoTARAC Response

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.

Comment

HoTARAC supports this preliminary view as it is consistent with the current Australian Accounting Standards Board Framework which states that the framework is not an Australian Accounting Standard and does not define standards for measurement or disclosure.

However, HoTARAC notes that the IPSASB Framework Project is not simply interpreting the IASB Framework to the public sector, but rather developing a public sector conceptual framework that makes explicit the definitions, principles, etc that underpin the IPSAS. This is different from the approach to many of the IPSAS, which are based on IFRS and draw on IASB's definitions etc that underlie the IASB Framework. As a consequence, the proposed IPSASB Framework approach may be inconsistent with some of the IPSAS, which are implicitly based on the IASB Framework, and could be interpreted to represent a fundamental change in approach that could promote divergence rather than convergence with IFRS.

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.

Comment

HoTARAC supports the statement of providing information to meet the common information needs of a wide range of users. However, Preliminary View 2 could be strengthened by clarifying and identifying what information needs GPFRs are to satisfy.

Paragraph 1.13 of the Conceptual Framework states that GPFRs include, but are broader than, financial statements and their notes as currently dealt with in IPSAS. The Conceptual Framework is highlighting that GPFRs may provide information about the past, present and the future that is useful to users. This may include prospective financial and other information and non-financial information about the achievement of the entities service delivery objectives. Further, the Conceptual Framework mentions that information the GPFRs may provide will develop and evolve in response to a number of factors, including the changing operating environment and users needs for relevant information about new and innovative transactions. HoTARAC also believes that this broad framework will mean it is possible that not all GPFR will address all of these facets in the same report. In other words, not all GPFRs will be consistent in their coverage.

When considering this breadth of reporting, there will need to be consideration of the parameters placed on annual disclosure of such information in the financial statements to ensure they can be faithfully represented, and verifiable (auditable).

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.

Comment

HoTARAC provisionally supports Preliminary View 3, however, it believes that in defining users of GPFRs the following should be further considered:

- the term “legislature” is too broad and should be replaced by “Parliament”;
- reference should be made to “goods and services”, not just services, and other recipients that would “otherwise benefit from the activities of the government”; and
- in respect to the term “other parties, including special interest groups and their representatives” this category appears too broad. It would be preferable for the Framework to include the specific parties who are users of GPFRs such as regulators and oversight bodies etc.

An alternative approach held by a minority of HoTARAC members would be to use “resource providers” as a proxy for all three user groups, which would represent the public sector equivalent to the IASB’s proposed primary user group of “capital providers”. The advantage of this approach is that it would promote convergence with the IASB’s proposed Framework. If a user group is identified in this way for the public sector, it should exclude “recipients of goods and services”, as it could be argued that the primary purpose of the financial report is not to address customer needs (in the public or for-profit sectors). However, other HoTARAC members believe that a disadvantage of using the term “resource providers” is that it may be too broad to describe all users of GPFRs.

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*
- *making resource allocation, political and social decisions.*

Comment

HoTARAC believes that the proposed Objectives of Financial Reporting need to be researched further to determine how they will be met and the impact they will have on the alignment of IPSAS statements with those proposed under IFRS. In respect to the latter, a minority of HoTARAC members have suggested that differences between the two frameworks could be minimised, without significant effect, by encompassing “political and social decisions” as part of “accountability”.

Accountability is discussed from the perspective of demonstrating that the public sector entity has achieved its performance objectives and is therefore still performance based. This is a different focus from the IASB, where performance is based on the profit made from the use of assets and how this is attributed to shareholders. However, while information can be made available to users, it is up to those users to determine management accountability rather than for this to be included explicitly in the GPFRs. Further, it would be nearly impossible to generically define accountability as each jurisdiction has different accountabilities and legal frameworks.

HoTARAC believes that stewardship and accountability are two distinct concepts and the IPSASB should discuss the stewardship of resources separately from accountability.

It is suggested that further consideration be given to the following matters identified within paragraph 2.22, namely:

- anticipated future service delivery activities and objectives of the entity - including information about their anticipated cost and the amount and sources of the resources that will be allocated to their provision;
- prospective financial and other information useful in assessing the sustainability of government operations and programs - and at what level; and
- explanatory information to support assessments of the efficiency and effectiveness of operations - and to place in context financial and other information about the compliance and service delivery achievements of the entity during the reporting period and the entity's future plans, objectives and anticipated resource needs.

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, cash 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.

Comment

HoTARAC does not support including prospective information and information regarding achievement of service delivery objectives in financial statements and notes. However, if the IPSASB believes that this type of information is included in the scope of a financial reporting framework, HoTARAC believes that it needs to differentiate between the audited financial statements and the unaudited annual reporting information (or financial reporting information outside of the financial statements). For example, at present, prospective management information and information about service delivery objectives generally does not form part of the audited financial statements.

In respect to the auditing of information HoTARAC believes that there are some issues that need further consideration, as follows:

- Auditing of information:
  - should the provision of service delivery achievements be mandated in the financial statements and audited, or should it, partially or wholly, be in the general section of annual reports?
  - there will also be a need to differentiate between the audited financial statements and the unaudited annual reporting information.
- the practicability and cost versus benefit of capturing, collating and reporting this information, in particular:
  - do users have the capacity to request it anyway by other mechanisms such as Freedom of Information requests; and
  - the ability of this information to be faithfully represented and verifiable to facilitate auditor sign-off?

Some of the difficulties in auditing such information may encompass:

- due to the short term nature of the Australian and other jurisdictions which have an elected parliamentary cycle, there would need to be a limitation on how far into the future this information is projected;
- the degree of detail provided in the information and the type of information could have audit implications when projected into the future; and
- if budgets are to form the basis of this information, then the projected time period may need to be limited to the budget timeframes.

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.

Comment

HoTARAC supports this view, as long as the scope is based on an open and transparent consultation process. However, it is important to bear in mind that it is not realistic or desirable to envisage such reports as providing all information that is useful for accountability and decision making purposes. Therefore, it is best to limit non-financial and prospective information that may form part of a general purpose financial report to information best communicated in financial reports.

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 achieving an appropriate balance between the qualitative characteristics.

Comment

HoTARAC supports this view, noting that, with the exception of the omission of the distinction between "fundamental" and "enhancing" characteristics, the qualitative characteristics are identical to the proposed IASB Framework. Further, the proposed characteristics are also consistent with the current AASB Framework, namely understandability, relevance, reliability and comparability - these characteristics are limited by timeliness, materiality and cost/benefit. It is suggested that IPSASB gives consideration to including substance over form as a characteristic.

In respect to the distinction between "fundamental" and "enhancing" characteristics its omission does not appear to be well justified. It is important that the IASB Framework should only be departed from where there is a public sector-specific justification.

Preliminary View 8 - Characteristics of a Reporting Entity

The key characteristic of a reporting entity is 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.

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

Comment

This view is cautiously supported by HoTARAC. However, the IPSASB's proposed definition of a public sector entity could potentially increase the number of reporting entities within each jurisdiction and also increase the number of consolidated financial statements being prepared.

Further, the basis of the reporting entity discussion primarily revolves around the presence of users for general purpose statements and does not address the issue of the resources available to the entity, its size or the relevance of preparing full financials for some entities. As a consequence, the Conceptual Framework needs to recognise that GPFR may not be appropriate for all public sector entities and the jurisdiction is responsible for deciding which entities prepare them.

Consideration needs to be given to the fact that in some circumstances a restricted or differential form of GPFR or even a special report may be adequate to meet the objectives.

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).*

Comment

The group reporting entity concept is not supported by HoTARAC in its current form.

The application of the IPSASB group reporting entity concept in Australia may have a major impact on what entities are consolidated into whole-of-government reporting entities. The term "govern" does not necessarily mean "control". Further the word "govern" could be inferred to mean regulate, which could cause problems. Although the section on the reporting entity does not specifically refer to regulation, the question of regulation versus control should be considered. Regulate has several possible interpretations, including legislate or restrict or control. As such, the group reporting entity scope is very broad and could potentially capture some non-government organisations.

To define what entities fit within the group it is necessary to determine at what level enabling legislation and financial legislation applicable to some of these entities demonstrates their power to govern strategic financing and operating policies of an entity.

For example, in Australia, local governments are constitutionally recognised as a separate and independent tier of government and as a consequence are not consolidated into their State's whole-of-government financial statements even though the State concerned is responsible for their enabling legislation.

If the legislation is sufficient to fulfil the power criterion and a State government has guaranteed a loan facility for the local government for no fee, that State would be exposed to the risk of a financial burden as well. Such a scenario raises the question of whether this could be a trigger for local governments to be consolidated in the States whole-of-government financial statements.

An alternative to using the word "govern" could be to replace it with the word "direct". This would avoid any possible confusion and would bring the basis for determining the composition of the group reporting entity closer to the IASB proposal and promote convergence.

HoTARAC further suggests that the IPSASB should take the International Monetary Fund Institutional Structures (General Government Sector, Public Financial Corporations, Public Non-Financial Corporations) into account in setting a reporting entity.

It is also unclear why the IPSASB has amended the IASB working definition of control by changing the reference to reducing "the amount or incidence of losses" to a reference to "financial burden". Although some HoTARAC members support the change, others have concern as it is not clear why being exposed to a financial burden that can arise as a result of the operations or actions of another entity would not be encompassed by benefiting from the activities of that entity. As a consequence, further information from IPSASB on the reasoning for the change would be appreciated.