KPMG IFRG Limited
8 Salisbury Square
London EC4Y 8BB
United Kingdom

Tel +44 (0)20 7694 8871
Fax +44 (0)20 7694 8429
mary.tokar@kpmgifrg.com

Ms Stephanie Fox
Technical Director
International Public Sector Accounting
Standards Board
International Federation of Accountants
277 Wellington Street West, 6th Floor
Toronto,
Ontario M5V 3H2
CANADA

Our ref MT/288
Contact Mary Tokar

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Dear Ms. Fox

Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities

Summary comments

We appreciate the opportunity to respond to the International Public Sector Accounting Standards Board's ('IPSASB' or the 'Board') Exposure Draft ('ED') titled *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*, dated December 2010. We have consulted within the KPMG network in respect of this letter, which represents the views of the KPMG network.

We strongly support the IPSASB's efforts to establish an international conceptual framework for general purpose financial reporting by public sector entities (the 'Framework'). The Framework is very important for the development of International Public Sector Accounting Standards ('IPSAS') that are consistent and forms the basis for the evolution to a more effective and efficient standards-setting process.

The Framework, once complete, together with relevant standards, could affect the general purpose financial reporting of national, state/provincial, and local governments and other public sector entities around the world for years to come. While this ED addresses only the first of four phases to the Framework, we believe it is a significant step toward its development.

While supportive of the development of the Framework, we have comments on the undertaking of the Framework project, as well as comments on specific matters addressed in the ED. These comments follow below.

Comments on the Framework Project

We acknowledge the need to approach the development of the Framework in phases as is the current approach being undertaken by the Board. However, we do not believe that the final result should be separate documents issued for each individual phase of the Framework. Instead, we believe one Conceptual Framework document, incorporating the complete Framework, should be issued. The Framework is a single project and a single document will make this clearer and easier for users to understand how the different aspects relate with each other and form part of the whole. Later phases of the Board's joint framework project may need to include amendments to parts of the Framework completed in previous phases.

We believe the complete Framework should therefore be exposed in proposal form for public comment prior to issuance in a final document. We believe the relationships between the concepts addressed in each phase of the Framework are sufficiently interdependent such that an opportunity to provide commentary should be provided once all phases are tentatively completed.

Within the Background section of the ED, it is stated that many IPSASs currently in issue are based on International Financial Reporting Standards ('IFRSs') to the extent that the requirements of those IFRSs are relevant to the public sector. Furthermore, it is the IPSASB's strategy to maintain the alignment of IPSASs with IFRSs where appropriate for the public sector. The Basis for Conclusions refers to the current International Accounting Standards Board ('IASB') Framework project. We believe it would be helpful to extend that discussion to identify where the IPSASB Framework has reached different conclusions to those reached within the IFRS Framework, so as to highlight to the users that there are differences between the two Frameworks. As an example, we note the IASB's distinction between fundamental and enhancing qualitative characteristics is discussed within the Basis of Conclusions of IPSASB's Framework, but is not highlighted as a difference with the IASB's Framework. We would encourage the IPSASB to be flexible during the development of its own Framework to react to changes that may arise from the IASB Framework project.

Specific matters for comment

The IPSASB stated they would particularly value comments on whether constituents agree with certain areas and we have structured our comments by reference to those matters for comment:

1. Role, authority and scope of the Conceptual Framework.

We agree with the role, authority and scope of the Framework. The scope of financial reporting is determined by the information needs of the primary users of General Purpose Financial Reports ('GPFR'). However, the Framework might better refer to either the 'common information' needs of primary users, which are finite, rather than simply the 'needs', which are hard to define and probably infinite.

We agree that the scope of the Framework should cover GPFR, which include much more comprehensive information than financial statements (and associated disclosure notes to those statements). We note, however, the practical requirements, for example around consistency of reporting and verifiability, that will need consideration as the Framework's intention to address non-financial qualitative and prospective information is included in GPFR. When IPSASB addresses these reporting requirements, we would expect such matters to be detailed in future guidance or standards that would introduce the reporting of service delivery and prospective information.

2. Objectives of financial reporting by public sector entities and the primary users of GPFRs of public sector entities and their information needs.

We agree with the Framework's comments regarding the Objectives, Users and Information needs of users of GPFR.

The ED discusses the information needs of users. We agree that certain information topics clearly fall within the scope of GPFR, namely: Financial Position, Financial Performance, Cash Flows, Compliance with Budget, and other narrative reports such as management commentary.

In order to respond to these user demands, the Framework includes within GPFR both financial *and non-financial information that covers 'service delivery activities,' 'plans and objectives for* service delivery in the future, including anticipated amounts and sources of the resources needed to support those plans and objectives' and 'narrative reports.' These additional elements broaden the scope of GPFR beyond the more narrow financial statement objectives.

The expansion of a public sector entity's GPFR to include other information is likely to impact the role and responsibility of the auditor. Currently, auditors are required under standards issued by the International Auditing and Assurance Standards Board (IAASB) to read the information in documents that contain the audited financial statements and the auditor's report and to report inconsistencies with the audited financial statements or material misstatements of fact in the other information, when such misstatements are identified by the auditor. If GPFR is expanded to include non-financial information such as service delivery or prospective financial reporting then auditors may be asked to provide some form of assurance on that information (see comments above). ISAE 3000, *Assurance Engagements,* is the generic international standard that would be the relevant when providing such assurance. In order to provide assurance, auditors require suitable criteria that they can use to evaluate the subject matter of the engagement. We encourage the IPSAS Board to liaise with the IAASB in terms of the type of criteria auditors would require in order to provide assurance and any additional guidance over that provide in ISAE 3000 that auditors may require for reporting on items such as service delivery and prospective financial information.

We would suggest, with the Framework's emphasis on reporting non-financial and prospective information within GPFR, that IPSASB includes guidance that reviews the issues surrounding the provision of forward looking and assumptive-based information, or explain that this will be detailed in the standards that introduce the reporting of service delivery and prospective information.

3. Qualitative characteristics of, and constraints on, information included in GPFRs of public sector entities. In particular, whether:

> **(a) "Faithful representation" rather than "reliability" should be used in the Conceptual Framework to describe the qualitative characteristic that is satisfied when the depiction of an economic or other phenomenon is complete, neutral, and free from material error; and**
>
> **(b) Materiality should be classified as a constraint on information that is included in GPFRs or as an entity-specific component of relevance.**

Faithful representation

We agree with the qualitative characteristics as depicted within the proposed Framework, and have no further comments on the use of 'Faithful Representation' as a characteristic for information included in GPFR.

Materiality

The issue of Materiality is described in the Framework as a constraint. We do not disagree with the inclusion of the concept of materiality in the Framework, but believe that materiality should be discussed in the context of the application of the Framework as each entity produces its own GPFR. Therefore, we believe materiality would be better described as an entity-specific aspect of relevance.

Timeliness

We note the Framework's comments that a lack of Timeliness makes information less useful. However, we believe that producing information, even if late, may be better for the users of information than giving no information at all or unreliable information. An auditor would not qualify an audit opinion because information is late, if that information remains robust and in compliance with authoritative standards. As such we might describe Timeliness as a constraint as well as an enhancing characteristic of information in GPFR, as the speed of provision of financial information may be a trade off with the reliability of that information.

Verifiability

The Framework, rightly, describes Verifiability as a quality of information that helps assure users that information in GPFRs faithfully represents the phenomena that it purports to represent. We agree with the inclusion of this characteristic in the Framework. However, we would raise the issue that the further the GPFR broadens its remit away from financial statement information, the more difficult it becomes for the information to meet this Verifiability characteristic.

The Framework states that the factors and circumstances that support opinions expressed or disclosures made should be 'transparent,' particularly with reference to prospective and non-financial qualitative information. The transparency as described should enable users of GPFR to form judgments about the appropriateness of those assumptions. We would welcome IPSASB guidance on what transparent means in the context of GPFR.

We believe that users will look to state auditors and external audit firms to opine over the financial statements included in GPFR, and also may expect some assurance regarding the reasonableness of assumptions utilized in the preparation of information, whether prospective or historic. We would therefore re-iterate that we would welcome guidance from IPSASB as to how the characteristic of verifiability relates to the wider information outside financial statements, as provided within the Framework's GPFR, upon which users may form their own judgments.

4. The basis on which a public sector reporting entity is identified and the circumstances in which an entity should be included in a group reporting entity.

We agree with the Framework's approach that adopts a principles-based view over the Reporting Entity and the Group Reporting Entity.

The ED states 'a public sector reporting entity may be….a program or activity without a separate legal identity.' Generally we agree that what constitutes a reporting entity should not be limited to those activities that are structured as legal entities. We also believe that a reporting entity could be a program or activity that is not within a separate (or single) legal entity. However, we note the practical accounting issues that exist when reporting entities do not align with a separate legal entity, specifically the allocation of assets, liabilities, revenues and costs that may relate more generally to a legal entity. As such, IPSASB may wish to issue guidance so as to assist preparers in identifying what constitutes a program or activity and/or how the boundaries should be drawn between one such program or activity and other programs / activities within the same legal entity.

We believe that the Board should include in the description of a reporting entity the concept that a reporting entity would not exclude economic activities that are controlled at the same or lower level within the group so as to prevent arbitrary carve-outs or combinations of legal entities. In this regard, a reporting entity could include one or more circumscribed programs or activities, each of which could be a reporting entity in its own right. We believe the concept that, the boundaries of a reporting entity generally should be determined in the first instance on the basis of control of an entity, is important and therefore should be addressed within the Framework.

The Group Reporting Entity is defined as the 'Authority and capacity to direct the activities of another entity, so as to benefit (and be exposed to the financial burden) from the activities of those entities.' We support the approach outlined in the Framework that directs the application of these Group Reporting principles down at the IPSAS levels. We note the relevant IPSASs will need clarity of definition over each of the Group Reporting Entity terms noted, being: 'authority', 'capacity', 'activities', 'benefits' and 'financial burden'.

Notwithstanding the application of Group Reporting principles within specific IPSAS standards, we also believe that the Framework might consider raising these Group Reporting Entity principles to a higher-level than currently described within the ED. IPSASB might consider that Group Reporting, per the Framework, should simply be defined as where accountability and decision making are undertaken. This would be consistent with the overall objectives of Financial Reporting noted earlier in the Framework.

KPMG appreciates the opportunity to respond to this ED. Please contact Archie Johnston at +1 604 527-3757, Peter Greenwood at +1 604 691 3187 or Mary Tokar at +44 207 694 8871 if you wish to discuss any of the issues in this letter.

Yours sincerely

KPMG IFRG Limited

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