

THE
INSTITUTE OF
CHARTERED
ACCOUNTANTS
OF SCOTLAND



Response from
The Institute of Chartered Accountants of Scotland to
the International Public Sector Accounting Standards Board

CONCEPTUAL FRAMEWORK EXPOSURE DRAFT

15 June 2011

INTRODUCTION AND KEY POINTS

Introduction

The Public Sector Committee of The Institute of Chartered Accountants of Scotland (ICAS) welcomes the opportunity to comment on the International Public Sector Accounting Standards Board's (IPSASB's) exposure draft on the Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities. The Public Sector Committee is a broad based committee of ICAS members with representation from across the public services.

The Institute's Charter requires its Committees to act primarily in the public interest, and our responses to consultations are therefore intended to place the general public interest first. Our Charter also requires us to represent our members' views and to protect their interests, but in the rare cases where these are at odds with the public interest, it is the public interest which must be paramount.

Key points

- The draft Conceptual Framework does not distinguish sufficiently between the components of general purpose financial statements (GPFs) and accompanying management commentary, or equivalent material. We believe that there are differences between the qualitative characteristics of the material which should be included in GPFs and accompanying narrative commentary. Therefore, it is important that the Conceptual Framework provides clarification on the content of both of these components of general purpose financial reports (GPFs) and sets out the qualitative characteristics for both elements.
- Paragraphs 2.24 and 2.25 of the exposure draft are headed up 'narrative reports' although there is material in paragraphs 2.19 to 2.23 (on compliance with budget, service delivery achievements, prospective financial and non-financial information) which we would normally envisage being included within the management commentary. We believe that the Conceptual Framework should specify which items of content are outside the scope of GPFs as the IASB has done through the publication, in 2010, of its 'Conceptual Framework for Financial Reporting' and separately published 'Practice Statement on Management Commentary'.
- The positive assurance on the GPFs of public sector entities, provided by auditors in their audit reports, is an importance aspect of the overall governance arrangements of jurisdictions across the world. However, this level of assurance is not extended to the narrative commentaries which accompany GPFs and International Standards on Auditing, which apply in many jurisdictions, are not designed to enable the auditor to give positive assurance on this material. Therefore, from the perspective of the overall arrangements for both the preparation and scrutiny of GPFs and accompanying narrative commentary, it is important that the IPSASB provide clarity on how it intends the Conceptual Framework to apply to these two distinct components of GPFs.

- As the Conceptual Framework is intended to be a high level document, we believe it would be helpful if the IPSASB could develop a one page summary covering the key principles contained within the more detailed Framework. We believe that this would make the Conceptual Framework more accessible to accounts' preparers. Looking ahead to the development of new International Public Sector Accounting Standards (IPSASs) and the revision of existing IPSASs, following the finalisation of the Conceptual Framework, we would welcome the inclusion within the commentary accompanying IPSASs, details of how the Conceptual Framework had influenced their development.
- We believe that the Conceptual Framework should be as consistent as possible with the IASB's Conceptual Framework and its Practice Statement on Management Commentary. Therefore, we would also welcome the publication by the IPSASB of any key differences between its Conceptual Framework and the IASB's material, with explanations for these differences. This would provide users of GPFs prepared by public sector entities, particularly those more familiar with private sector practice, with a better understanding of public sector entity reporting.

Our comments on the specific matters for comment are set out in the following section of our submission.

COMMENTS ON THE EXPOSURE DRAFT

Specific matters for comment

Specific matter for comment 1

Do you agree with the material on the role, authority and scope of the Conceptual Framework?

Comments

Role

The role of the Conceptual Framework set out in paragraph 1.1, of chapter 1, of the exposure draft is appropriately described, including its role in relation to non-authoritative guidance.

Authority

The statement in paragraph 1.2 on the authority of the framework needs strengthening. While we agree that the Conceptual Framework should not override IPSASs which have been issued following due process, ultimately the Conceptual Framework should be at the top of the hierarchy of concepts upon which other principles are based: this is fundamental to the development of principles-based financial reporting standards. Therefore, we would welcome the inclusion of a statement similar to that included within the section on 'Purpose and status' within the IASB's 'Conceptual Framework for Financial Reporting' (2010) which clarifies that:

"The Board recognises that in a limited number of cases there may be a conflict between the Conceptual Framework and an IFRS. In those cases where there is a conflict, the requirements of the IFRS will prevail over those of the Conceptual Framework. As, however, the Board will be guided by the Conceptual Framework in the development of future IFRSs and in its review of existing IFRSs, the number of cases of conflict between the Conceptual Framework and IFRS will diminish through time."

Scope

We broadly agree with the material in paragraph 1.5 to 1.7 on the scope of financial reporting. However, we believe that further refinement is required of the material within chapter 2 (paragraphs 2.14 to 2.26) to distinguish between information which should be contained within GPFs and information contained in the management commentary, or equivalent, which accompanies those statements.

In the UK, departmental resource accounts, which are prepared in accordance with EU adopted IFRS, include a statement of parliamentary supply. This statement reports on a department's compliance with the budget approved by the relevant parliament or assembly. Therefore, we appreciate that where budgets have been specifically agreed by a legislature and fall within statute that it is appropriate to include compliance with budget information within GPFs rather than the management commentary.

The sub-heading 'Service delivery achievements' is worded in a way that could be interpreted as the entity only having to report on those objectives which it has actually achieved. We believe the issue here is about service performance rather than achievement and would welcome greater precision in the wording within this paragraph (2.21).

Other comments

The basis for conclusions defines and refers to special purpose financial reports. We understand that the Conceptual Framework and accompanying standards and guidance are designed for GPFs and that this material may be used or adapted for the preparation of special purpose financial reports. However, we would welcome the inclusion of a paragraph which positively defines special purpose financial reports and their status in relation to the Conceptual Framework within chapter 1 on the Role and Authority of the Conceptual Framework and the Scope of General Purpose Financial Reporting. We believe that this would be helpful to users of the Conceptual Framework.

Specific matter for comment 2

Do you agree with the material on the objectives of financial reporting by public sector entities and the primary users of general purpose financial reports of public sector entities and their information needs?

Comments

We support the emphasis given to the objective of accountability included within the Conceptual Framework. We also support the identification of a primary user group within the Conceptual Framework and support the definition of primary users as service recipients and their representatives and resource providers and their representatives.

Our comments on the information provided by GPFs are included within our comments on scope within specific matter for comment 1.

Specific matter for comment 3

Do you agree with the material on qualitative characteristics of, and constraints on, information included in general purpose financial reports 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 general purpose financial reports or as an entity-specific component of relevance?*

Comments

We welcome the broad alignment of the qualitative characteristics of, and constraints on, general purpose financial reports of public sector entities with those of the IASB's Conceptual Framework for financial reporting. However, we have the following comments to make on the IPSASB's approach:

- We support the term 'faithful representation' on the basis that its use is consistent with the approach taken by the IASB. In our response to the consultation draft, which preceded this exposure draft, we set out our preference for 'reliability' over 'faithful representation'. However, our overarching consideration in supporting 'faithful representation' is consistency with the IASB's Conceptual Framework.
- We note that the IPSASB has not followed the convention followed by the IASB's Conceptual Framework in distinguishing fundamental qualitative characteristics (relevance and faithful representation) from enhancing qualitative characteristics. We would prefer that the IASB's approach is followed.
- Prospective financial and non-financial information features in chapter 2 of the exposure draft within information provided by general purpose financial reports. We do not believe that prospective information is capable of complying with all qualitative characteristics of financial reporting and support the approach set out by the IASB towards forward looking information in its 'Practice Statement on Management Commentary'.

Under the heading 'Principles', the Practice Statement says:

"Management should present commentary that is consistent with the following principles:
(a) to provide management's views of the entity's performance, position and progress; and
(b) to supplement and complement information presented in the financial statements.
(paragraph 12)

In aligning with those principles management commentary should include:

- (c) forward looking information; and
- (d) Information which possesses the qualitative characteristics described in the Conceptual Framework for Financial Reporting. (paragraph 13)"

Political and parliamentary processes are a constraint on prospective information and public sector entities will need to explain any assumptions used to prepare such information included within GPFs, in particular the management commentary.

- With regard to the approach towards materiality, we would favour the classification of materiality as a specific component of relevance rather than a constraint on information. We are not convinced by the material in the basis of conclusions for treating materiality as a constraint.

Specific matter for comment 4

Do you agree with the material on 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?

Comments

Paragraph 4.1, of chapter 4, states that: “A public sector reporting entity is a government or other public sector organisation, program or identifiable activity that prepares general purpose financial reports.”

This definition of a reporting entity is self-referring. If this is an intentional aspect of the Conceptual Framework then we recommend that a statement is made to clarify this intention. However, if the self-referring definition is unintended then we recommend that paragraph 4.1 is amended so that it is not self-referring.

If the objective of chapter 4 is to define the reporting entity for the purpose of establishing whether the entity should prepare a GPFR, then the fact that an entity prepares a GPFR is not a factor which defines the entity; it prepares a GPFR because it is identified as being an entity.

We understand the difficulties in defining the characteristics of the group reporting entity and welcome the recognition within paragraph 4.13 that operational and implementation issues which arise in different jurisdictions are a factor in determining whole of government and other public sector groupings. However, legislative issues may also arise in different jurisdictions which impact on the identification of the group reporting entity. We also recommend that the Conceptual Framework recognises that the authority and capacity to direct the activities of another entity as described in the draft Conceptual Framework may be overridden by operational, implementation and legislative issues in different jurisdictions.

Another issue which the IPSASB may wish to refer to in the final Conceptual Framework published on completion of Phase 1 is the treatment arm's length bodies (ALBs) within the group accounts. ALBs are sometimes established by public sector bodies to deliver a particular function but they are themselves not public bodies. As non-profit-making bodies, ALBs are not Government Business Enterprises (GBEs). However, like GBEs they would not be required to comply with IPSASs and would comply with another suitable accounting framework. In the UK, ALBs take a number of forms, for example, an ALB can be a Limited Liability Partnership (LLP) or a Trust. Public sector bodies preparing group accounts will need to be able to determine whether or not ALBs should be treated as a group component.

Other comments

The accruals basis of accounting

We believe that the description of the accrual basis of accounting, on page 3 of the exposure draft, should be developed further by explaining what is meant by ‘occurrence’. There may be descriptions of the accrual basis of accounting elsewhere which the IPSASB can draw on.

Of relevance to ‘occurrence’ are:

- for revenue recognition, determining when the right to consideration arises; and
- for the recognition of expenditure, the existence of an obligation.

We would also welcome the inclusion within the accrual basis of accounting material on how the use of fair values impacts on the basis of accounting.