

Our ref: AASP\Responses\090402 SC0113

Stephenie Fox
Technical Director
International Public Sector Accounting Standards Board
International Federation of Accountants
277 Wellington Street, 4th Floor
Toronto, Ontario M5V 3H2
CANADA

2 April 2009

Dear Stephenie Fox

Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities:

- **The objectives of financial reporting**
- **The scope of financial reporting**
- **The qualitative characteristics of information included in general purpose financial reports**
- **The reporting entity**

- 1 We are pleased to be able to present comments on this IPSASB Consultation Paper. The development of this response has been co-ordinated by CIPFA, seeking to bring together a range of views from the United Kingdom, including other UK accountancy bodies, public sector practitioners, and other stakeholders in public sector financial reporting. A list of those who provided their views is provided at Annex A.
- 2 Those listed at Annex A have considerable experience of commenting on financial reporting over several decades, including more recent consultations on conceptual framework related projects such as
 - the UK Statement of Principles for Financial Reporting
 - the Interpretation for Public Benefit Entities, which extended that framework to cover public benefit entities
 - the IASB Conceptual Framework project Discussion Papers and Exposure Drafts, and other IASB related consultations with a significant conceptual element such as the Canadian Accounting Standards Board discussion paper on measurement
 - IPSASB consultations with a significant conceptual element, such as the recent consultation paper on Social Benefits

General Comments

- 3 A sound conceptual framework is vital to the development of principles based financial reporting standards, regardless of sector, and we would see benefits in a sector neutral framework which covered profit-seeking enterprises, public sector

bodies and wider public benefit entities. However, while international standards are increasingly being adopted in all economic sectors, a single conceptual framework underpinning a single set of financial reporting standards is not a realistic expectation at present.

- 4 We therefore welcome the work which the IPSASB is carrying out on developing a conceptual framework for public sector financial reporting. This is very helpful when there are concerns that developments in the IASB framework may have the effect of making it more difficult to adapt or interpret International Financial Reporting Standards (IFRS) for a public sector context. This important work is timely, and may lead to significant improvements in public sector financial reporting.
- 5 We are also very supportive of IPSASB's project to develop a suite of IFRS converged IPSASs on relevant issues, using an approach which, in addition to making helpful terminological changes and refocusing examples, might be seen as interpreting the relevant IAS or IFRS as if had been prepared under an overarching framework applicable to all economic sectors.
- 6 Against this background we agree with IPSASB that the public sector Framework should not simply *interpret* the IASB framework. However we would also note that there are very substantial advantages to maintaining alignment with the IASB framework where this is possible and appropriate. Comparable financial reporting can be expected to have benefits arising from
 - better comparability and mutual intelligibility between economic sectors which transact trillions of dollars of business with each other
 - skills transfer between public and private sector
 - transfer of good practice between sectors
- 7 We therefore support the inclusion in this paper of the Comparison of IPSASB Preliminary Views with Current IASB Proposals/Preliminary Views (Attachment 1). The consultation paper also notes that concepts underlying statistical financial reporting will be considered in developing the IPSASB Framework, and that the Board is committed to minimizing divergence from statistical financial reporting models. We suggest that the eventual Exposure Draft of the IPSASB framework should include a comparison with relevant aspects of statistical financial reporting models.
- 8 We also agree that the primary focus of the IPSASB Conceptual Framework should be on public sector entities which operate, at least in part, for the benefit of the public. We would note that some public sector entities operating mainly for public benefit may need to include Government Business Enterprises in their consolidated financial statements.

Scope of the Framework

- 9 The Framework sets out a potentially very broad scope, covering matters which go significantly beyond the current focus on financial statements.
- 10 We welcome the paper's reassurance that financial statements should remain at the core of financial reporting. However, contributors to this response expressed

a variety of concerns arising from the proposals to broaden the Framework, with two main themes:

- The paper may not be sufficiently clear in setting out the current proposed scope of the Framework, and this makes it difficult to evaluate related material in other Chapters
- Several UK stakeholders have significant concerns over the broader application of conceptual work mainly developed in the context of financial statements (for example, Qualitative Characteristics)

11 We note that Chapter 3 explains that the broadening of the scope will not necessarily be reflected in IPSASs on all matters within that scope, and this provides some reassurance that the Board will exercise caution in carrying out development work on broader scope matters. However, in the light of the concerns noted above, we suggest that the Framework either needs to be developed in stages, or the Board needs to provide greater clarity over the applicability of individual concepts to GPFS and GPFR information respectively.

Other Matters

12 Comments on other Preliminary Views are set out in Annex B. Key points from these include

The Users of GFPRs

We support consideration of wide categories of users, but suggest that it might be helpful for standard setting purposes to assign some priority to the resource provider perspective. When considering the use of limited resources, the resource provider perspective will provide a helpful focus even to citizens who are not taxpayers and who have not provided resources in other ways.

We also suggest that the reference to “special interest groups” is unnecessary, and might result in undue emphasis being accorded to the needs of these users.

The Objectives of Financial Reporting

We strongly support the inclusion of an accountability objective. Accountability has a special status within public sector reporting generally and financial reporting in particular, and it would be helpful if this were further emphasized in the explanatory material which accompanies the Preliminary View. A variety of views were expressed on the relative importance which should be attached to the two objectives within the Preliminary View, which are detailed in Annex B.

13 I hope these comments are helpful contributions to the development of the conceptual framework.

Steven Cain
Policy and Technical Directorate, CIPFA
Tel +44 (0)20 7543 5794
steven.cain@cipfa.org

Consultation with and Contributions from UK Stakeholders in Public Sector Financial Reporting

Comments from the following have been incorporated into this response.

Accounting Standards Board (ASB)

Chartered Institute of Management Accountants (CIMA)

Chartered Institute of Public Finance and Accountancy (CIPFA)

Financial Reporting Advisory Board (FRAB)

Institute of Chartered Accountants in England and Wales (ICAEW)

Institute of Chartered Accountants of Scotland (ICAS)

Local Authority (Scotland) Accounts Advisory Committee (LASAAC)

National Audit Office (NAO)

Wales Audit Office (WAO)

Richard Laughlin, Professor of Accounting at Kings College London

A draft response to the IPSASB Conceptual Framework Group 1 paper was drawn to the attention of IFAC member bodies based in the United Kingdom and other key UK stakeholders in public sector financial reporting. This and other explanatory material was also published and made available for comment on the CIPFA website.

Some of the contributors listed above have written separately to IPSASB, to provide responses which highlight their distinctive views, which may differ in emphasis and detail from the combined response. Professor Laughlin has also provided an article developing his ideas on the objectives of public sector financial reporting (published in *Public Money and Management* Volume 28, No 4, August 2008)

RESPONSE TO MATTERS RAISED IN THE REQUEST FOR COMMENT

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.

We agree. The Framework should not override the requirements of standards which have already been issued, but should be the starting point for interpretation or development of financial reporting in circumstances not dealt with in IPSASs.

The Framework will also inform consideration of which IPSAS standards are most in need of updating or revision, and will inform the development of exposure drafts with amended or new requirements.

We note that the Board has developed Guidelines for Modifying IASB Documents, and that in that document, consistency with the developing IPSASB framework is first in the list of contextual factors which inform consideration of whether IPSASB pronouncements should include departures from IASB standards requirements. We suggest that the Framework should include a clear statement that it will also be the starting point for development of any IPSASs on public sector issues which might not be based on IASB standards.

RESPONSE TO MATTERS RAISED IN THE REQUEST FOR COMMENT

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.

We agree that general purpose financial reporting as defined in Preliminary View 2 provides an appropriate and helpful focus for the IPSASB Framework, and the standards and guidance that may be developed using the Framework.

The distinction made between general purpose financial reporting and special purpose financial reporting is consistent with that used by the IASB in their framework, and in the standards developed by the International Auditing and Assurance Standards Board (IAASB) in their discussion of reporting frameworks under financial statements and other reporting might be carried out, and be subject to audit under International Standards on Auditing (ISAs)

Most of the potential 'customers' for IPSASs and other pronouncements will be governments who may be in a position to demand that specific reports are produced, but choose to develop or use general purpose reporting to meet the information needs of a wider range of users.

In many jurisdictions including the United Kingdom, a key role of public sector financial reporting is that it provides a basis for reporting of financial 'performance' against legally authorized budgets. We consider that it would be helpful if the explanatory material in the IPSASB Conceptual Framework could refer to this important aspect of public sector financial reporting, although we do not suggest that it should be highlighted in the preliminary view. We recognize that the budgetary reporting currently carried out by governments may constitute general purpose or special purpose financial reporting, or a mixture of both.

RESPONSE TO MATTERS RAISED IN THE REQUEST FOR COMMENT

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.

We broadly agree with the discussion of users in Chapter 2 of this IPSASB Consultation Paper, but we have some detailed comments on the groups identified in the Preliminary View.

UK stakeholders have considered this matter in successive UK consultations on the ASB Statement of Principles: Interpretation for Public Benefit Entities. In line with 2.4(a) of the IPSASB paper, the ASB identified 'present and potential funders and financial supporters' as the primary user group, suggesting that information which was useful to this grouping would also serve the needs of other users. UK respondents to that consultation generally agreed that 'funders and financial supporters' was a good starting point, but that consideration should also be given to the needs of other stakeholders including service recipients.

In reviewing this matter again for this consultation, comments included the following

- the inclusion of 'service recipients' and 'other parties' within potential users helpfully bring into consideration the needs of these other stakeholders
- the description of users does not refer to 'citizens' as an overarching stakeholder category. While it is clear from the supporting material that 'service recipients' is intended to encompass all citizens, it might be helpful if this were more clearly signposted in the Preliminary View.
- it would be helpful if the Preliminary View put more emphasis on the resource provider perspective, as this will often provide a useful focus for the needs of all users.
- The reference to 'special interest groups' may have the effect of putting too much emphasis on these users, whose needs are already served inasmuch as they represent service recipients, resource providers or both of these

It was also agreed that the legislature was a major user of general purpose financial reporting, notwithstanding the fact that they may also be in a position to request specific information.

RESPONSE TO MATTERS RAISED IN THE REQUEST FOR COMMENT

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 GPFs for:

- accountability purposes; and
- for making resource allocation, political and social decisions.

We strongly agree that the Framework objectives need to reflect on the usefulness of information for both accountability purposes and decision making.

Using the term “accountability” helpfully draws attention to the requirement to report on the stewardship of public resources. It may also be helpful to use a different term to stewardship to signal the special character of public sector reporting in this regard.

‘Decision usefulness’ is also essential, and in many contexts it overlaps with and complements the accountability objective.

Some UK contributors stressed the relatedness of the two objectives; inasmuch as accountability is characterized in terms of historical information, and decision-usefulness reflects on future prospects

- consideration of future prospects is substantially embedded in the assessment of the historical position at the end of a financial reporting period
- in practice, information on future prospects is mainly informed by past events

Other UK contributors took a contrasting position, suggesting that the main objective of financial reporting is accountability or stewardship, and that decision-usefulness (except inasmuch as it supported accountability) was less important.

One UK contributor suggested that Preliminary View 4 has the effect of presenting accountability and decision-usefulness as sub-components of a single objective, and that it would be better if they were more clearly presented as separate objectives.

Inasmuch as there is a clear and agreed UK view, it is that the objectives proposed by IPSASB distinguish between accountability and decision-usefulness, and this avoids some of the very significant concerns expressed in relation to the 2006 IASB Discussion Paper, which set out a single resource allocation decision-usefulness objective.

RESPONSE TO MATTERS RAISED IN THE REQUEST FOR COMMENT

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 GPFs.

As noted in the covering letter, all UK contributors to this response expressed reservations about the proposed broad scope, or suggested that clarification or restriction of the scope would be needed.

Comments and suggestions included

- that the Framework should be initially restricted to financial statements, and extended to wider forms of reporting after further development
- that the potentially different verifiability characteristics of 'broader scope' information raised audit and assurance issues
- requests for more clarity on the nature of prospective information which might be attached to financial statements.

Several respondents also expressed very similar concerns to the IASB, when responding to its proposals to extend the scope of the IASB framework from financial statements to financial reporting without further clarification or discussion.

Having made these observations, we agree that all of the matters set out in the Preliminary View are legitimate matters for public sector reporting and are related to financial reporting. There are several areas in which there may be scope for IPSASB to play a constructive role through the development of standardized approaches to including such material in general purpose financial reports.

RESPONSE TO MATTERS RAISED IN THE REQUEST FOR COMMENT

In going beyond the framework for financial statements, we suggest that there may also be a need to develop or use other forms of authoritative pronouncement, including non-mandatory guidance and educational material, or standards which allow for a great deal of flexibility and tailoring to the circumstances of the reporting entity.

Based on these UK views, we suggest that the Board should adopt one of two approaches going forward:

- The development of the Framework could be carried out in (at least) two stages, with initial development mainly focusing on financial statements. This would have the advantage of keeping to a more well-established and better understood body of discussion and theory from which to develop a public sector framework. Under this approach the IPSASB would need to consider how conceptual issues for 'broader scope' projects such as Long-Term Fiscal Sustainability Reporting should be addressed.
- Alternatively the Framework might develop using a broader scope, but with greater clarity over the applicability of individual concepts to GPFS and GPFR information respectively, and might for example parallel the IASB framework proposals. This would have the advantage of maintaining alignment with the IASB framework, but as noted in the comments on Preliminary View 7, we would have some concerns over the applicability of the Qualitative Characteristics. IPSASB might need subsequently to redeliberate this aspect of the Framework taking account of issues arising from future IASB work on management commentary.

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.

We agree that the scope of financial reporting should evolve in response to user need.

RESPONSE TO MATTERS RAISED IN THE REQUEST FOR COMMENT

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.

The proposed qualitative characteristics are similar, but not identical, to those articulated in recent proposals for the IASB Conceptual Framework, on which several of the bodies at Annex A provided formal responses.

Key concerns articulated in response to the IASB consultations were that

- it is unlikely that qualitative characteristics which are appropriate for financial statements are equally appropriate for the wider categories of information envisaged by the IASB framework. The ASB commented specifically on the problems encountered by the standard setter teams which developed the IASB Discussion Paper on Management Commentary.
- the replacement of the qualitative characteristic of “reliability” with “faithful representation” raises problems in the context of financial statements

We suggest the first of these points may cause difficulties in applying the proposed IPSASB Framework. This will need to be addressed through applying one of the approaches discussed in the response to Preliminary View 5. Regardless of whether broader financial reporting remains within the scope of the Framework, further consideration of qualitative characteristics may be required in connection with broader scope projects such as Long Term Financial Sustainability Reporting.

On the second point, we acknowledge that the IPSASB is seeking to maintain alignment with the IASB framework as articulated in the 2008 Exposure Draft, and in this case we agree that the advantages of alignment are greater than the improvements that would be secured by IPSASB using “reliability”.

In addition, we suggest that the Framework should provide additional emphasis on the significance of materiality based on the “context and nature” of financial reporting. This is a significant aspect of the accountability discussion in the United Kingdom, and we expect it will be a common and significant feature in other jurisdictions.

RESPONSE TO MATTERS RAISED IN THE REQUEST FOR COMMENT

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.

We agree with the above analysis. It provides sufficient flexibility to accommodate the many approaches which governments may use to organize their activities, and which in some cases may reflect functional or organizational boundaries specifically designed to support accountability to government and other stakeholders (as described in Preliminary View 3), and to inform funding and other decisions.

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).

We agree that this is a sensible approach on the basis of which to develop guidance for group entities, although we would note that some jurisdictions will require financial reports to be produced for group entities on a basis more akin to that set out in Preliminary View 8, to support accountability and decision making.

Considering the specific matter of whole of government entities, we accept that the control based approach is more applicable, although again, some flexibility may be required in practice. For example, based on a review of the discussion in Chapter 9, UK commentators from Scotland and Wales suggested that the power and benefit criteria would not provide a basis for the inclusion of Scottish and Welsh entity information within Whole of Government Accounts which the UK government plans to publish. For some whole of government groups it may be necessary to consider other principles based approaches to providing coherent reporting on economic substance.