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Dear Stephenie

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**

Introduction

- 1 The ASB welcomes the publication by IPSASB of the Consultation Paper on the Conceptual Framework for Public Sector Entities. We believe this initiative is timely and can be expected to lead to significant improvements in the financial reporting of public sector entities. We agree with many of the conclusions in the paper.
- 2 As you are aware, the ASB has published an Interpretation of its Statement of Principles for Public Benefit Entities (the SOPBE). In developing the comments in this letter we have reconsidered the issues rather than merely repeating the position adopted in the SOPBE. It is, of course, important that the scope of the documents differ in that the IPSASB Framework will address reporting by public sector entities, whereas the SOPBE also includes private sector public benefit entities.

Scope

- 3 We welcome the statement that ‘Information presented in financial statements and their notes remains at the core of financial reporting’ (paragraph 3.22 of the Consultation Paper). However, we are concerned that the Consultation Paper takes a very broad view of the boundaries of financial reporting and the potential users of General Purpose Financial Reports (GPFRs). There is a risk that, by attempting to be too broad in scope, the Framework will not be as useful as it would be if its scope were more clearly defined. The wide scope of the Consultation Paper makes it difficult to appraise whether its proposals are appropriate for the wide range of information to which it applies.
- 4 We expand on this difficulty below under “Objectives” and “Qualitative Characteristics” and then suggest under “Developing the Framework” how the approach to the project might be refined to meet this concern.

Objectives

- 5 We agree that, particularly in the public sector, the notion of ‘accountability’ should form part of the objective of financial reporting. In our view, accountability emphasises the provision of information on the events that have occurred in the reporting period; that is, historical information. In contrast, decision-usefulness implies a focus on the future because rational decisions can only be made on the basis of future prospects. Despite this apparent divergence, there is a very significant overlap between accountability and decision-usefulness as:
 - Information prepared for accountability purposes necessarily includes information on the financial position at the end of the period: that information will be heavily influenced by projections of the future.
 - Information on future events is usually incomplete and the most relevant basis for an assessment of the future is often an account of past events.
- 6 We therefore agree that both accountability and decision-usefulness should form part of the objectives of financial reporting. That said, it is probable that the relative emphasis between them varies depending on the nature of the report concerned. One might take the view, for example, that accountability suggests financial statements should report the actual outturn on pension scheme assets but that in the Management Commentary an expected return measure could be reported because it is thought to be a more appropriate basis for decision making. IPSASB should consider whether this potential difference in emphasis should be acknowledged in the Framework.

Qualitative characteristics

- 7 It is not clear that the qualitative characteristics that are appropriate for financial statements are equally appropriate for all the information within the proposed scope of the Consultation Paper. This is illustrated by the acknowledgement in paragraph 4.28 of the Consultation Paper that the quality of 'verifiability' is often referred to as 'supportability' in the context of qualitative and prospective information: this seems to be more than merely a difference in terminology. Another example: it is unclear how the quality of 'faithful representation' may be applied to prospective financial information, which is not part of financial statements but is part of wider financial reporting.
- 8 In our response to the IASB Exposure Draft on this matter, we argued against the replacement of the qualitative characteristic of "reliability" with "faithful representation". In our view, reliability is particularly important in the context of the financial statements and less so in other forms of financial reporting. That said, we acknowledge that IPSASB is attempting to conform with the IASB Exposure Draft. Assuming the IASB retain the Exposure Draft position, it is our view that, in the absence of compelling public sector reasons, the advantages of alignment are greater than the improvements that would be secured by IPSASB using reliability.
- 9 The IASB's Discussion Paper on 'Management Commentary' (authored by the staff of partner standard-setters and others) discusses the qualitative characteristics that are appropriate for Management Commentary and also discusses 'placement criteria' that may assist in determining where information may be placed in a financial report.

Developing the Framework

- 10 We think that in the later phases of the Conceptual Framework project, the wide scope will give rise to great difficulties, for example we presume that the definition of assets and liabilities will provide a suitable foundation for financial statements but will not embrace all that will be reported elsewhere in financial reports. Similarly, the material on measurement will consider the issue in the context of financial statements and we note that the Project Brief envisages that paper (e) (elements) will also be addressed specifically in the context of financial statements.
- 11 We believe that IPSASB should consider developing a Framework in two stages that focuses initially on financial statements (including the notes) and then address how it might apply to other kinds of financial reporting. This will enable a robust framework to be developed for financial statements, but will also highlight their limitations and hence show the need for other kinds of information. Although this would differ from the sequencing adopted by the IASB in its Framework project, we believe it is likely to result in a higher quality product and would hope that differences could be resolved as the IPSASB and IASB Frameworks develop.

12 Our suggestion is not premised on the view that financial statements are more important than other elements of financial reporting, but rather on the desirability for a clear delineation between the two. Financial statements and other parts of financial reporting are both vitally important and complementary, but there are significant differences between them. At a general level, financial statements are, for good reason, bounded by conventions and constraints that limit what they can deal with: other parts of financial reporting seek to provide information beyond the bounds of these limitations, including information on process, performance, policy and programmes, and in so doing enhance the usefulness of financial reporting.

13 The Appendix to this letter sets out our views on each of the preliminary views in the Consultation Paper. We are pleased to support IPSASB in the development of the Paper and look forward to continuing to contribute to its work on the Framework.

14 Because it covers much of the same ground as the Consultation Paper, we have attached a copy of our response to the IASB Exposure Draft '*An improved Conceptual Framework for Financial Reporting – Chapter 1 The Objective of Financial Reporting, and Chapter 2 Qualitative Characteristics and Constraints on Decision-useful Financial Reporting Information*'. If you require any further information please contact me or Alan O'Connor (a.oconnor@frc-asb.org.uk or telephone +44 (0)20 7492 2421).

Yours sincerely



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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.

- 1.1 We agree. IPSASs are inevitably more specific than the Framework, and it would therefore be undesirable to allow the Framework to be used as authority to depart from an IPSAS.
- 1.2 We note the approach suggested in paragraph 1.5 for conflicts between an IPSAS and the Framework. Whilst IPSASB should be alert for departures between the Framework and standards, we agree that it would not be reasonable for IPSASB to respond to all possible conflicts.

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.

- 2.1 We agree that GPFRs should seek to meet the demands of users who are unable to demand the preparation of financial reports, and that it is useful for the Framework to differentiate GPFRs from specialised reports.

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.

- 3.1 Whilst we agree that financial reporting should seek to satisfy many of the information needs of a variety of users, the relative emphasis between different groups will vary in differing cases. As regards the financial statements, we would suggest greater emphasis upon providers of resources would provide a helpful focus for standard setting and the further development of the Framework. Recipients of services will often be more interested in information accompanying the financial statements.
- 3.2 We would hope that the reference to “common information needs” in the preliminary view is not intended to imply that information that is required by some, but not all, users need not be provided.

- 3.3 Whilst we agree that some of the information in GPFs may be useful to special interest groups, it is not clear to us that the information needs of such groups is always a relevant consideration for financial reporting.
- 3.4 We also agree that, although it may also have the authority to demand certain information that might be deemed specific purpose, the legislature is a major user of general purpose financial reports.

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.*
- 4.1 As stated in our covering letter, we believe that providing information for accountability (or stewardship) purposes is part of the objectives of financial reporting, and that it is particularly relevant in the case of the public sector. We therefore support the specific inclusion of accountability as a complement to decision-usefulness. The emphasis given to these two aspects may not always be the same and, in our view, accountability is particularly important in the context of financial statements.

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.

- 5.1 By setting out a very broad range of information, it is not clear that the Consultation Paper's discussion of this preliminary view is very useful. Its usefulness would be greatly enhanced if the scope of the various parts of financial reporting were identified separately. In broad terms, it would seem that the first two bullets would relate to financial statements and that most of the last two bullets (and the closing paragraph on explanatory material) would primarily be met by other parts of financial reporting.
- 5.2 We agree that non-financial information is important in the public sector. However, we believe such information should not be included in the financial statements.

- 5.3 Information to allow a comparison between budgets and outturn is a legitimate aspiration for financial reporting. However, the third bullet suggests that financial reporting provides information about compliance with a much wider set of legislation or regulation, and we question whether this is appropriate.

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.

- 6.1 We agree with this view.

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.

- 7.1 We refer in paragraph 8 of the covering letter to our concerns about the replacement of the qualitative characteristic “reliability” with “faithful representation”. This point is also discussed in the attached letter responding to the IASB Exposure Draft. However, as explained in the covering letter, assuming the IASB retain the Exposure Draft position, we think IPSASB should align with the IASB and use the term faithful representation.
- 7.2 We believe the IPSASB Framework should provide additional emphasis on the significance of materiality based on the “context and nature” of an item as this is likely to be a common and significant feature in the accounts of public sector entities.

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.

- 8.1 We agree that a key characteristic of a reporting entity is the existence of users who are dependent on general purpose financial reports, although the proposed broad range of potential users identified in preliminary view 3 raises the question of whether it is necessary for the proposed Framework to direct which entities should report.
- 8.2 We also believe the preliminary view would be more helpful if it identified some other, more neutral, criteria for a reporting entity, such as the existence of separately identifiable transactions, assets and other economic events that make an entity accountable to users and that can be economically impacted by users' decisions. A

further criterion could be having separate management accountable for the activities of the entity.

- 8.3 We also consider that it may be helpful for the Framework to explain that, in addition to reporting entities, data may also be presented for specific “activities”, such as the collection of taxation revenues or for a number of reporting entities within a sector, such as housing or health. Although accounting standards may provide guidance in such a case, the resulting statement would not be GPFRs if it did not relate to a reporting entity.

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).*
- 9.1 We agree the composition of a group reporting entity should be determined by controlling entity model and agree with the two criteria put forward in the preliminary view. We also agree with the need to demonstrate that both these criteria apply.