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

Dear Ms Fox

**IPSASB Exposure Draft *Key Characteristics of the Public Sector with Potential Implications for Financial Reporting***

The Australian Accounting Standards Board (AASB) is pleased to provide its comments on the above named Exposure Draft (ED).

**General Comments**

The AASB's comments are provided in the context of its fundamental view (expressed in its recent submissions on other IPSASB Conceptual Framework consultation documents) that the IPSASB and IASB Conceptual Frameworks should be complementary, where any differences are limited to those necessary to deal with different economic phenomena or with economic phenomena that are much more pervasive in one sector than the other. Therefore, it would be important to explain why any of the key characteristics warrants a difference between the Frameworks.

The AASB is concerned that the ED does not clearly explain the implications of the key characteristics for the IPSASB's draft Conceptual Framework or link those characteristics to proposals in other IPSASB Conceptual Framework consultation documents. Therefore, the ED's purpose is unclear. If the key characteristics were not fully meshed with the draft Conceptual Framework, there is a risk that some of them might become, in substance, alternative concepts used in the development of IPSASs.

The AASB also notes that a number of the key characteristics are not unique to the public sector. Examples of these characteristics are discussed in Appendices A and B to this submission.

**Specific Comments**

The AASB's responses to the specific matters for comment in the ED are set out in Appendices A and B.

Comments by AASB staff on other aspects of the ED, including editorial suggestions, are set out in Appendix C.

If you have any queries regarding matters in this submission, please contact me or Jim Paul (jpaul@aaasb.gov.au).

Yours sincerely,

A handwritten signature in black ink, appearing to read 'K M Stevenson', written in a cursive style.

Kevin M. Stevenson  
*Chairman and CEO*

## APPENDIX A

### AASB's Comments on the Specific Matters for Comment on the ED

#### Specific Matter for Comment 1

Do you agree that this document provides useful background information on the key characteristics of the public sector and identifies some potential implications of those key characteristics for financial reporting? If not, please indicate how you would modify the document.

#### Unclear purpose

The AASB agrees that the ED provides some useful background on the key characteristics of the public sector and their potential implications. However, the AASB is concerned that the ED does not clearly explain the implications of the key characteristics for the IPSASB's draft Conceptual Framework or link those characteristics to proposals in other IPSASB Conceptual Framework consultation documents. Therefore, the ED's purpose is unclear.

In respect of the concern above, the AASB notes that recent IPSASB Conceptual Framework consultation documents discuss the implications of:

- (a) the holding of property, plant and equipment primarily to provide goods and services, rather than to generate net cash inflows (referred to in paragraph 4.1 of the ED);
- (b) the longevity of public sector entities and the very long time horizons for their service delivery programs (referred to in paragraphs 6.1 – 6.6 of the ED);
- (c) the regulatory role of government (referred to in paragraphs 7.1 – 7.2 of the ED);  
and
- (d) the power of governments to grant rights to natural resources and licences to act in a certain manner (referred to in paragraph 8.1 of the ED).

However, those implications are not clearly reflected in this ED. For example, in the third sentence of paragraph 7.2, obtuse references are made to the implications of public sector entities' regulatory responsibilities for the determination of the reporting entity and the scope of financial reporting. It would be more helpful to state those implications directly. For example, it is difficult to glean why regulatory responsibilities should affect the scope of financial reporting, as some might argue that regulation is one of the services that public sector entities provide (and therefore that regulation would simply be the subject of any disclosures about service performance).

In addition, the implications of other key characteristics identified in the ED appear not to be discussed at all in the recent IPSASB Conceptual Framework consultation documents. For example, whilst the ED notes that a significant proportion of transactions of not-for-profit public sector entities are 'non-exchange', neither the ED nor the IPSASB Conceptual

Framework consultation documents explain why different accounting principles should apply to ‘exchange’ and ‘non-exchange’ transactions. For instance:

- (a) paragraph 2.6 of the ED does not explain the implications of transfers with conditions being essentially non-exchange; and
- (b) paragraph 2.7 notes that income from non-exchange transactions has implications for the definitions of assets and liabilities, without saying what those implications are.

As mentioned in its submission on the IPSASB’s Conceptual Framework Consultation Paper *Elements and Recognition in Financial Statements*, the AASB considers the issue of whether to distinguish exchange and non-exchange transactions to be a standards-level issue only, and that the terms ‘exchange’ and ‘non-exchange’ should not (and need not) be used in the IPSASB Conceptual Framework.

### **Overstated distinctions**

The AASB notes that a number of the key characteristics identified are not specific to not-for-profit public sector entities. For example:

- (a) paragraph 1.4 (third sentence) comments that, unlike with most private sector entities, the future existence of public sector entities is not dependent on the generation of profits. Paragraphs 6.1 (fourth sentence) and 6.5 (second sentence) comment that governments and sub-national entities that encounter severe financial difficulties cease to exist only very rarely or may be restructured (with some service delivery responsibilities transferred to other entities). However:
  - (i) the viability of any entity, whether in the public sector or private sector, depends on its ability to generate net cash inflows. The tipping point for ceasing to be viable will depend on the circumstances; regardless of its sector, an entity may remain viable, with a reduced capacity to provide goods and services, despite incurring losses in some periods. Public sector entities with taxing powers might be more capable than other entities to generate sufficient cash inflows, but this does not obviate the need to generate cash inflows and does not justify the statement in the first sentence of paragraph 6.5 that going concern has generally been less relevant in the public sector than in the private sector. Even taxing powers do not guarantee that sufficient taxes will be generated, as individuals and businesses may relocate or change their affairs to avoid paying those taxes, or simply be incapable of paying sufficient taxes to meet the government’s needs; and
  - (ii) given that both the IASB and IPSASB Conceptual Frameworks are being developed for financial statements prepared under the going concern assumption (while noting that this assumption may be inappropriate for some entities), the focus on the continued existence of public sector entities (vis-à-vis private sector entities) seems less appropriate than a focus on a reduced capacity to provide goods and services (e.g., whether the chosen measurement model would provide useful information for assessing that capacity). Since such reductions can occur in the public and private sectors,

it is not clear that the asserted longevity of public sector entities has financial reporting implications (specifically, for the content of the IPSASB Conceptual Framework and IPSASs);

- (b) the basis for the assertion implicit in paragraph 2.3 that information about service performance is not relevant in respect of a private sector for-profit entity is unclear, particularly because most of the information needs itemised in paragraph 2.3 of the ED are similar or equivalent to information needs of users of financial reports of for-profit entities. In particular:
- (i) only paragraph 2.3(d) has no private sector (for-profit) equivalent—and it is only a reformulation of the universal issue covered in paragraph 2.3(c); and
  - (ii) the only other identified information need particularly affecting the public sector is information about restricted-use resources [referred to in paragraph 2.3(f)], the existence of which would generally be more prevalent in the public sector than the for-profit private sector;

(An analysis of whether the information needs set out in sub-paragraphs (a) – (f) of paragraph 2.3 are public-sector-specific is set out in Appendix B.)

- (c) in relation to paragraph 4.2, various private sector businesses (such as constructors, mining companies, manufacturers and utility operators such as power companies) also have a significant proportion of assets that are specialised and traded in limited markets. The third sentence acknowledges this point, but notes these characteristics of assets are more pervasive in the public sector and have potential implications for measurement. In that regard:
- (i) the AASB does not consider these characteristics of assets to be sufficiently infrequent in the private sector to justify treating them as public-sector-specific; and
  - (ii) the AASB notes that, for statistical convergence or regulatory reasons, public sector entities in some jurisdictions are required to regularly remeasure their property, plant and equipment (unlike private sector entities). However, the AASB does not consider jurisdiction-specific regulatory and other factors should be emphasised in the IPSASB's Conceptual Framework or related documents;
- (d) the second sentence of paragraph 5.1 does not acknowledge that private sector businesses are often responsible for the protection and preservation of historical buildings they occupy;
- (e) the first sentence of paragraph 6.1 does not identify a public-sector-specific characteristic. Various private sector businesses (e.g., banks) have existed for many generations and may continue to exist for a very long time;<sup>1</sup> and
- (f) in relation to paragraph 6.2, restructurings of private sector businesses are also commonplace. The implications of public sector entities generally providing

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<sup>1</sup> See also the AASB's comment regarding paragraph 6.1, on page 3 above.

different services than private sector businesses (alluded to in the second sentence) are not explained.

The AASB recommends integrating the discussion of the key characteristics (and their implications for financial reporting) with the other components of the IPSASB's draft Conceptual Framework, and removing overstatements of the public-sector-specific nature of the key characteristics identified.

**Specific Matter for Comment 2**

Do you agree that this document should be included as part of the IPSASB's literature? If you agree, where do you think the material in this document should be located:

- (a) As part of the Conceptual Framework;
- (b) As a separate section of the *Handbook of International Public Sector Accounting Pronouncements*; or
- (c) Elsewhere with some other status – please specify?

Because the ED's objective is unclear, the best location of its proposed material is difficult to assess.

As mentioned in its comments on Specific Matter for Comment 1, the AASB recommends that the IPSASB integrates its discussion of the key characteristics (and their implications for financial reporting) with the other components of its draft Conceptual Framework. If the IPSASB did this, it would not be particularly important whether, and if so where, the Key Characteristics were repeated elsewhere within IPSASB literature (e.g., as a compendium or other educational material).

## APPENDIX B

### **Analysis of Whether the Information Needs in Paragraph 2.3 are Public-Sector-Specific**

- 2.3(a) Users of financial statements of any entity are interested in whether an entity operates in an efficient and effective manner. Given that many for-profit private sector entities provide services to customers, the reference to providing services also does not indicate a sector-specific difference. Whilst public sector not-for-profit entities and private sector for-profit entities would generally have different objectives for providing services, both types of entity would aim to do so efficiently and effectively. For these reasons, paragraph 2.3(a) does not appear to identify a sector-specific issue.
- 2.3(b) Users of financial statements of any entity would be interested in how an entity financed its activities and met its cash requirements. Therefore, paragraph 2.3(b) does not identify a sector-specific issue.
- 2.3(c) Except for its reference to ‘taxation’ (which is only an example of the revenues being referred to), paragraph 2.3(c) does not identify a sector-specific issue. Users of financial statements of any entity providing services would be interested in whether current-period revenues covered the cost of providing current-period services.
- 2.3(d) Whether part of the burden of paying for current services is shifted to future-year taxpayers has no private sector (for-profit) equivalent. However, it is only a reformulation of the universal issue covered in paragraph 2.3(c). In other words, the same financial information would be provided to meet the objectives in paragraphs 2.3(c) and 2.3(d). Therefore, paragraph 2.3(d) does not identify a public-sector-specific need for different information than that reported by a private sector for-profit entity.
- 2.3(e) Whether a service provider is a public sector not-for-profit entity or a private sector for-profit entity, information about changes in its ability to provide services would be useful to users of its financial statements. The fact that providing services is a primary objective of public sector entities but arguably only a means to an end (generating net cash inflows) for private sector for-profit entities does not affect the relevance of the information in either sector. For example:
- (a) in both sectors, an entity recognises its resources (stores of service potential) and not future cash inflows (except those to which it is presently entitled); and
  - (b) if a private sector for-profit entity’s capacity to provide services diminishes, so does its capacity to generate net cash inflows.

Therefore, paragraph 2.3(e) does not identify a sector-specific issue.

2.3(f) Restrictions over the use of resources arise for some private-sector for-profit entities in relation to borrowing covenants, prudential oversight or heritage-listed features of occupied buildings. However, such restrictions would generally be more prevalent in the public sector than the for-profit private sector. Therefore, the issue in paragraph 2.3(f) could be viewed as a public-sector-specific issue.

## APPENDIX C

### AASB Staff's Comments on Other Aspects of the ED

#### Noteworthy Issues

Paragraphs	Comment
3.2	<p>AASB staff do not support the comment in the first sentence that, historically, the budget has been more important than the financial statements of public sector entities. Undoubtedly, the budget has been given more prominence by public sector entities and in public discourse. However, that does not mean the budget is more important. In many jurisdictions, financial statements have been prepared on a cash basis or modified accrual basis, and it is unsurprising that financial statements that do not report all of an entity's resources and obligations have been given less attention than budgets. In addition, some governments might prefer to emphasise budgets, rather than financial statements that reflect outcomes against budgets (either explicitly through budget-to-actual reporting, or implicitly). Reasons such as these do not make the budget more important than financial statements. AASB staff think the relative importance of the budget and financial statements is a value judgement that the IPSASB should not comment on in its Conceptual Framework or related documents.</p> <p>To reinforce the comments above on the first sentence, AASB staff note that the third sentence says the approved budget is the primary method by which the government's management is held financially accountable. We think a published budget cannot of itself enable users to hold an entity to account—the financial statements are also needed for this purpose. This is acknowledged in the first sentence of paragraph 3.3. Therefore, we think it is inappropriate to refer to approved budgets as having primacy over financial statements. Furthermore, we note that the budget basis adopted will affect the potential effectiveness of a budget as an accountability tool.</p>
3.3	<p>The first sentence (with its reference to assessing “actual spending against budget estimates”) seems biased toward cash budgeting. AASB staff think IPSASB documents should not be slanted against accrual budgeting in the public sector, even if unintentionally. Therefore, we suggest replacing “spending” with a more neutral word like “outcomes”.</p>

Paragraphs	Comment
6.3	<p>AASB staff think the second sentence does not logically follow on from the first. The difficulty of determining whether social benefit programs<sup>2</sup> give rise to ‘obligations’ that meet the definition of a liability does not arise from the long-term nature of those ‘obligations’ (for example, environmental restoration obligations might not be settled for many years, but that does not cause doubt about whether they are liabilities).</p> <p>AASB staff think it is an overstatement for the fourth sentence to indicate the issue of whether the power to tax is an asset <u>arises</u> from the dependence of social benefits provision on future tax flows. We think that whether the power to tax is an asset is a separate (albeit related) issue from whether social benefit ‘obligations’ are liabilities.</p>
6.6	<p>AASB staff think an important reason why prospective financial information about long-term programs of public sector entities might be particularly useful is that many entities do not recognise social benefit ‘obligations’ as liabilities and, accordingly, information about such ‘obligations’ is not provided in statements of financial position. Therefore, we think the argument in this paragraph should be made specifically in respect of social benefit programs, and not as a general comparison between the need for prospective financial information in the public and private sectors.</p>

### Editorial Comments

Paragraphs	Comment
1.3	<p>In relation to the first sentence, AASB staff suggest inserting “, entities within those governments” after “local government units”.</p>
1.4	<p>In relation to the first sentence, AASB staff suggest avoiding the publicly debated issue of whether public sector entities contribute to wealth generation, by replacing “wealth generation” with the more neutral “economic activity”.</p> <p>The relevance of the fourth sentence to the IPSASB Conceptual Framework is unclear to us. We question whether the sentence should be retained.</p>
2.1	<p>In the fourth sentence, “approximately equally value” should be “approximately equal value”.</p> <p>In the fifth sentence, last line, “approximately” should be inserted between “receiving” and “equal value in exchange”.</p>

<sup>2</sup> ‘Social benefits’ are not referred to by name in paragraphs 6.3 and 6.6, but implicitly seem to be referred to.

Paragraphs	Comment
2.2	AASB staff suggest inserting “, such as the payment of taxes” at the end of the first sentence. This would acknowledge that, whilst ‘non-exchange transactions’ are more limited in the private sector, particular non-exchange transactions of private sector entities may be significant in amount.
6.5	The second sentence seems to repeat the second sentence of paragraph 6.2.
7.1, 7.2	<p>Whereas the first sentence of paragraph 7.1 refers to governments’ “powers to regulate”, the first sentence of paragraph 7.2 refers to “regulatory responsibilities” (but not “powers”). AASB staff suggest adding a reference to “regulatory powers” in the first sentence of paragraph 7.2.</p> <p>We found confusing the reference to “protect the population from certain risks that would not be conveyed through pricing mechanisms” in the third sentence of paragraph 7.1, and suggest clarifying it.</p>