

**Meeting:** International Public Sector Accounting Standards Board

**Meeting Location:** Toronto, Canada

**Meeting Date:** June 13–16, 2023

# Agenda Item 14

For:

Approval

Discussion

Information

## DIFFERENTIAL REPORTING

<b>Project summary</b>	[To be determined after June 2023 – The 2021 IPSASB Mid-Period Work Program proposed that this project would enable the IPSASB to explore the characteristics of less complex public sector entities, and the appropriate financial reporting approaches and guidance that could be applied by such entities.]	
<b>Project staff lead</b>	<ul style="list-style-type: none"> <li>Eileen Zhou, Principal</li> </ul>	
<b>Task Force</b>	<ul style="list-style-type: none"> <li>Claudia Beier, IPSASB Member (Task Force Chair)</li> <li>[Task Force members will be added after June 2023, once the objective and direction of the project have been agreed upon.]</li> </ul>	
<b>Meeting objectives</b> <b>Project management</b>	<b>Topic</b>	<b>Agenda Item</b>
	<a href="#">Project Roadmap</a>	<a href="#">14.1.1</a>
	<a href="#">Instructions up to Previous Meeting</a>	<a href="#">14.1.2</a>
	<a href="#">Decisions up to Previous Meeting</a>	<a href="#">14.1.3</a>
<b>Decisions required at this meeting</b>	<a href="#">Whether an International Differential Reporting Model is Consistent with the Conceptual Framework</a>	<a href="#">14.2.1</a>
	<a href="#">Determining the Direction of the Differential Reporting Project</a>	<a href="#">14.2.2</a>
<b>Other supporting items</b>	<a href="#">Supporting Document: Illustrative Decision Tree</a>	<a href="#">14.3.1</a>

**DIFFERENTIAL REPORTING:  
PROJECT ROADMAP**

<b>Meeting</b>	<b>Completed Actions or Discussions / Planned Actions or Discussions:</b>
	1. [To be determined after June 2023.]

**INSTRUCTIONS UP TO PREVIOUS MEETING**

<b>Meeting</b>	<b>Instruction</b>	<b>Actioned</b>
	1. No instructions to date.	1. n/a

**DECISIONS UP TO PREVIOUS MEETING**

<b>Meeting</b>	<b>Decision</b>	<b>BC Reference</b>
March 2022	1. The IPSASB decided, based on responses to the Mid-Period Work Program Consultation, to add the exploration of a differential reporting model to the work program starting with a research and scoping phase.	1. n/a

## Whether an International Differential Reporting Model is Consistent with the Conceptual Framework

### Question

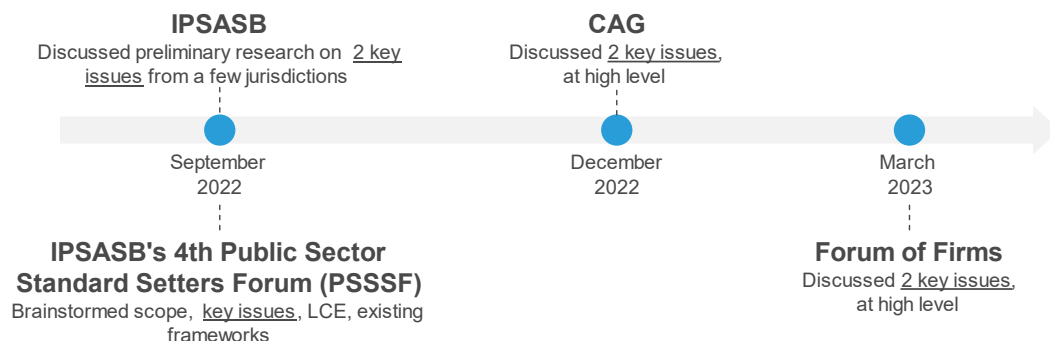
1. Does the IPSASB agree that a standard-setting solution (i.e., the development of an international differential reporting model) would not be consistent with the IPSASB's *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (Conceptual Framework)?

### Recommendation

2. Staff recommend that the IPSASB not pursue a standard-setting solution. This is because a standard-setting solution would not be conceptually consistent with the Conceptual Framework and may pose a reputational risk for the IPSASB.

### Background

3. The IPSAS literature includes a single set of accruals based standards for all entities in the public sector. Constituents often highlight that public sector entities vary substantially within and across jurisdictions in terms of size, complexity, capacity, and other variables. A “one size fits all” approach has been noted as an application challenge in certain jurisdictions and for certain public sector entities.
4. Responses to the [2021 Mid-Period Work Program Consultation](#) and feedback from regional roundtables prompted the IPSASB to add a project on differential reporting to its work program in March 2022. The intention of this project was to explore the:
  - (a) Characteristics of ‘less complex public sector entities’<sup>1</sup>, and
  - (b) Appropriate financial reporting approaches and guidance that may be applied by such entities.
5. Since then, the IPSASB and staff have discussed these two issues with members, the CAG, and constituents<sup>2</sup> as part of the initial research and scoping activities. This paper considers feedback received to date in the conceptual context (i.e., the IPSASB’s Conceptual Framework) to help the IPSASB determine how to proceed in the project (see illustrative decision tree in [Agenda Item 14.3.1](#)).



<sup>1</sup> 'Less complex public sector entities' is not a defined term in IPSAS. If the IPSASB pursues a standard-setting solution in this project, it will need to consider whether to use a defined term to identify entities that would be eligible to apply the differential reporting model.

<sup>2</sup> Discussions have included public sector representatives from approximately 40 countries in a variety of functions, including preparers, auditors, academics, parliamentarians, standard setters, and others at the IPSASB's 2022 Public Sector Standard Setters Forum (PSSSF), and various global representatives from audit firms at the 2023 Forum of Firms events.

## Analysis

6. Discussions during initial research and scoping activities have emphasized that any international differential reporting model the IPSASB may develop should be aligned with its Conceptual Framework.

### *'Public Accountability' in the Public Sector*

7. In the private sector, the International Accounting Standards Board (IASB) uses 'public accountability' to determine whether or not entities are eligible to apply their differential reporting model, *IFRS for SMEs* ([Appendix 1](#)). The IASB continues to receive constituent feedback on what constitutes public accountability and how it should be applied in practice, and recently proposed additional guidance in its Exposure Draft, *Third Edition of the IFRS for SMEs Accounting Standard*.<sup>3</sup>
8. As noted in the IPSASB's Conceptual Framework, public sector entities are inherently publicly accountable:
- (a) The primary objective of most public sector entities is to deliver services to the public (Conceptual Framework Preface 2). Governments and other public sector entities raise resources from taxpayers, donors, lenders, and other resource providers to use in the provision of services to citizens and other service recipients (Chapter 2.3); and
  - (b) Governments and other public sector entities are accountable to resource providers (Preface 7). Public sector entities are accountable for their management and use of resources to those that provide them with resources, and to those that depend on them to use those resources to deliver necessary services. Those that provide the resources and receive, or expect to receive, the resources also require information as input for decision-making purposes (Chapter 2.3).
9. Thus, public accountability would not be appropriate as an eligibility criterion to permit application of simplified reporting requirements by public sector entities. This conclusion is consistent with feedback from CAG members and public sector constituents, who unanimously agreed that public accountability would not be a useful criterion in the public sector.<sup>4</sup> These discussions also foreshadowed more fundamental issues if the IPSASB committed to developing an international differential reporting model for the public sector.

### *Inconsistency with the IPSASB's Conceptual Framework*

10. As presented in Chapter 2 of the IPSASB's Conceptual Framework:
- (a) The **objectives of financial reporting** by public sector entities are:
    - (i) To provide information about the entity that is useful to users of general purpose financial reports (GPFs) for accountability purposes and for decision-making purposes; and
    - (ii) Determined by reference to the users of GPFs and their information needs;
  - (b) The **primary users** of GPFs are service recipients (e.g., citizens) and resource providers, and their respective representatives; and

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<sup>3</sup> *IFRS for SMEs*, first issued in 2009, can only be applied by entities without public accountability. The IASB's Exposure Draft is part of its second comprehensive review of *IFRS for SMEs*. The comment period closed in March 2023. The IASB's review of responses is still ongoing.

<sup>4</sup> Respondents shared alternative ideas that may be used to identify entities that could benefit from a potential international differential reporting model. See in [Appendix 2](#).

- (c) Governments and public sector entities **are accountable** to those that provide them with resources, and to those that depend on them to use resources to deliver services.
11. For consistency with its Conceptual Framework, any financial reporting guidance the IPSASB develops should be consistent with the financial reporting objectives for primary users of public sector entities.
12. However, an international differential reporting model, which by its nature is a standard-setting solution intended to provide simplified accounting requirements for certain entities, may conflict with the objective of financial reporting by public sector entities. Service recipients and resource providers often depend on this information to ensure that public sector entities are appropriately delivering services, thereby discharging their accountability obligations, to the public (Chapter 2.8). Simplified recognition, measurement, and/or disclosure requirements may impede on the quality and completeness of information provided to the users of GPFRs in the public sector, and thus would not meet their information needs as outlined in the Conceptual Framework.

*Potential Reputational Risk*

13. The development of a standard-setting solution, in the form of an international differential reporting model, may pose a potential reputational risk.
14. Other international standard setters have noted challenges in clearly defining the entities eligible for their differential models, which impact the ability to obtain maximum value from such solutions.
15. Public sector constituents have also hinted at similar challenges if the IPSASB decides to develop a standard-setting solution (see details in [Appendix 2](#)):
- (a) A standard-setting solution may require the IPSASB to use a characteristic/criterion other than 'public accountability' to determine whether an entity is permitted to apply any international differential reporting model the IPSASB may develop.
- (b) However, no specific characteristic/criterion that is sufficiently pervasive and objective for the global public sector has emerged as a frontrunner. Rather, preliminary feedback indicates that it may be difficult to identify a characteristic/criterion (or set) that would be sensible for every jurisdiction, as each jurisdiction can vary substantially. This indicates that solutions at the jurisdictional level may be more appropriate.
16. Effectively identifying the eligible entity in a principled manner is an integral step to creating a standard-setting solution that appropriately addresses needs, and thereby be widely adopted by the entities for which it was developed. This challenge would need to be addressed before the IPSASB can consider other challenges in developing an international differential reporting model (see [Agenda Item 14.2.2](#) for further details).
17. Some CAG members have shared views on this potential reputational risk. Although a new stand-alone standard that provides simplified requirements may be an opportunity for the IPSASB to increase appetite towards full IPSAS, there is a risk that some entities may apply the simplified model when they should apply full IPSAS<sup>5</sup>. Some CAG members advised that any decisions on this project should preserve the credibility of, and momentum towards, full IPSAS, and be conceptually consistent

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<sup>5</sup> This risk is similar to the risk noted with Cash Basis IPSAS, where some jurisdictions have adopted the Cash Basis IPSAS and not moved towards accrual IPSAS

with the Framework and existing IPSAS literature. (See [Appendix 1](#) for additional CAG advice, which highlights other complexities of a standard-setting solution.)

*Next Steps*

18. Based on the above analysis, staff are of the view that a standard setting solution, specifically the development of an international differential reporting model that is inconsistent with the IPSASB's Conceptual Framework would:
  - (a) Impair the ability of the financial statements of public sector entities to provide useful information for accountability and decision making; and
  - (b) Pose a significant reputational risk for an international standard setting board.
19. In the following paper, [Agenda Item 14.2.2](#), staff provide further analysis to support the IPSASB in determining the direction for this project, and how it can address the public need that originally prompted constituent interest in an international differential reporting model.

**Decision Required**

20. Does the IPSASB agree with the staff [recommendation](#)?



## **APPENDIX 1: ADDITIONAL DETAILS**

### [Private Sector] IFRS for SMEs

1. *IFRS for SMEs* was first issued by the IASB in July 2009, and later reissued in 2015. It is not an International Financial Reporting Standard (IFRS); rather, it is a self-contained standard that is designed to meet the needs and capabilities of SMEs.
2. Paragraphs 1.1–1.7 of *IFRS for SMEs* provides the details of entities for which this standard is intended to apply. As a summary, it is intended for use by small and medium-sized entities (SME). A SME is described as those entities that:
  - (a) Do not have public accountability; and
  - (b) Publish general purpose financial statements for external users.
3. An entity has public accountability if:
  - (a) Its debt or equity instruments are traded in a public market or it is in the process of issuing such instruments for trading in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets); or
  - (b) It holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses (most banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks would meet this second criterion).

### [Public Sector] Additional Advice from CAG Members

4. At its December 2022 meeting, CAG members provided additional advice for the IPSASB to consider if it pursues a standard-setting solution in this project:
  - (a) Leverage existing IPSAS work;
    - (i) Consider any solution in the context of the IPSASB's existing work (the Conceptual Framework, materiality, applicability of IPSAS, Cash Basis IPSAS, etc.);
    - (ii) Ensure any outputs are consistent in principles with the existing IPSAS; and
  - (b) If the IPSASB decides to proceed with a standard-setting solution (developing an international differential reporting model):
    - (i) Either be dynamic, or use objective clear thresholds, in defining the eligible entity;
    - (ii) Consider providing jurisdictions the ability to set their own thresholds as it is unlikely to identify a characteristic that is sufficiently pervasive for the global public sector; and
    - (iii) Consider whether a separate standard is necessary, as it can be resource intensive and difficult to maintain.

**APPENDIX 2: SUMMARY OF PRELIMINARY CONSTITUENT FEEDBACK**

1. The IPSASB and staff began preliminary research and discussions in September 2022 with CAG members and public sector constituents. One of the key issues discussed was how to identify entities that should be eligible to apply a potential international differential reporting model in the public sector. The following table summarizes various ideas and views shared during brainstorming sessions and discussions:

Potential Characteristic/Criterion	Type	Preliminary Views (Constituent or Staff)
<b>Public accountability</b>	Qualitative	May not be useful in public sector, as all public sector entities would be publicly accountable
<b>Transaction complexity or types</b>	Qualitative	May not be objective / comparable across jurisdictions
<b>Entity size or turnover</b>	Quantitative	
<b>Materiality</b>	Quantitative	
<b>Thresholds (based on \$ or %)</b>	Quantitative	
<b>Volume or type of external users</b>	Quantitative	
<b>Nature or directive of entity</b>	Qualitative	
<b>Risk profile</b>	Qualitative	

2. The discussions have yielded a few key themes, which suggest at feasibility challenges in the public sector:
  - (a) **Difficulty identifying jurisdiction-agnostic characteristic(s):** It will be difficult to identify a characteristic, or set of characteristics, that would be sensible for every jurisdiction, as each jurisdiction can vary substantially. For example, a % of GDP may be appropriate in a stable economy, but not in an economy with substantial fluctuations. Allowing jurisdictions to make their own determination, based on their own needs, may be more realistic and appropriate;
  - (b) **Application challenges already exist at the jurisdictional level:** Certain jurisdictions have already considered and implemented certain characteristics deemed appropriate for their jurisdiction, such as absolute thresholds (e.g., expenditures) or entity metrics (e.g., size or turnover), and still face challenges at their own jurisdictional level; and
  - (c) **Carefully consider what a characteristic is meant to communicate:** Certain characteristics may not be indicative of a need for simplified accounting guidance in lieu of full IPSAS compliance. For example:
    - (i) The complexity of an entity’s transactions does not necessarily warrant a simpler accounting model (in lieu of full IPSAS). In contrast, an entity with less complex transactions would not need to apply the more complex IPSAS; and
    - (ii) The size of an entity does not necessarily warrant a simpler accounting model (in lieu of full IPSAS). Rather, the size of an entity may be a proxy for the level of resource and capacity available for an entity to achieve compliance with accounting requirements.

## Determining the Direction of the Differential Reporting Project

### Question

1. Does the IPSASB agree that a non-standard-setting solution would more pragmatically and effectively address the public need?

### Recommendation

2. Staff recommend that, in lieu of a standard-setting solution, the IPSASB should provide other forms of guidance, as it better addresses the public need. If supported, staff will provide proposals in Q3.

### Background

3. The challenges faced by 'less complex public sector entities' in adopting the full IPSAS and benefiting from accrual accounting are not new. This has generated interest in finding an international solution, such as a differential reporting model, that could help entities unlock the benefits of accrual accounting without potentially substantial costs of full IPSAS. This had prompted the IPSASB to propose adding a differential reporting project in three separate consultations, prior to the 2021 Mid-Period Work Program Consultation. The IPSASB received limited constituent support during those three consultations, so the IPSASB had decided against adding the project (see [Appendix 1](#)).
4. The increased support for a differential reporting project in the recent 2021 Consultation may, in part, be a reflection of the substantial progress the IPSASB has made in the past few years. This project may have risen in relative importance as the IPSASB finished delivering on other major technical projects to address gaps in IPSAS literature, which constituents had considered more urgent.
5. [Agenda Item 14.2.1](#) proposed that a standard-setting solution is not appropriate, conceptually, and may pose a reputational risk. In this paper, staff reflects holistically on the public need and how the IPSASB can address that public need, to determine alternative approaches for this project.

### Analysis

#### *Reflecting on the Public Need*

6. The [International Public Financial Accountability Index: 2021 Status Report](#) forecasted an increasing shift by governments from cash to accrual reporting over the next decade.<sup>6</sup> This increased shift to accruals will also come with a parallel increased interest in, and application of, IPSAS.
7. Most public sector entities face potentially significant challenges to implementing full IPSAS and seek support from various sources to address these challenges. The challenges to IPSAS implementation include:
  - (i) *Resource limitations* (e.g., costs of implementation, costs of ongoing reporting requirements, availability of accounting IT systems, etc.);
  - (ii) *Capacity limitations* (e.g., availability of skilled and qualified accounting personnel to meet financial reporting requirements in a timely manner, underdeveloped accounting and auditing profession and available training, etc.); and

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<sup>6</sup> The [International Public Financial Accountability Index: 2021 Status Report](#) noted that the number of jurisdictions reporting on accrual in 2020 was 30%. The percentage is forecasted to reach 50% by 2025 and projected to surpass 70% by 2030.

- (b) Resource and capacity limitations magnify other challenges an entity may face in understanding and applying the accounting requirements in full accrual-based IPSAS to generate accurate and comprehensive data for decision-making and effective public financial management.

*How the IPSASB can Address the Public Need*

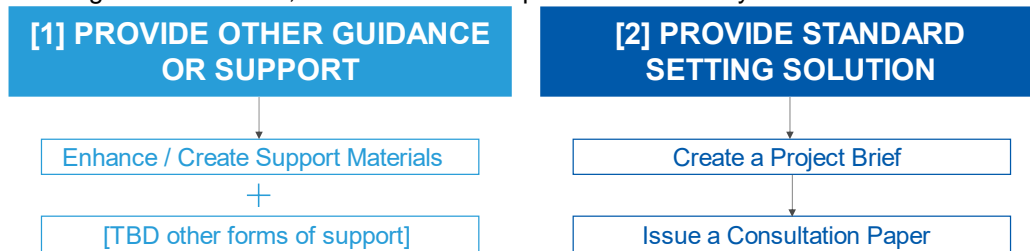
8. The IPSASB develops accounting standards and guidance for use by public sector entities. To achieve its Strategic Objective<sup>7</sup>, the IPSASB Strategy commits the Board to (1) developing and maintaining IPSAS and other high-quality financial reporting guidance for the public sector, and (2) raising awareness of IPSAS and the benefits of accrual adoption.
9. Staff considered how activities within the remit of the IPSASB can help entities overcome the barriers in paragraph 7:

Challenge	IPSASB’s Potential Role / Support
<p><b>Resource and capacity limitations</b> are independent from any complexity in an entity’s transactions and the accounting and reporting of such transactions. Rather, resource and capacity limitations may prevent an entity from appropriately accounting for its transactions effectively and correctly.</p>	<p><b>[Non-standard-setting support]</b> These challenges cannot be eliminated by developing a new or simplified accounting standard. Rather, they could be better addressed through broader development programs. The IPSASB can participate in, and support such initiatives, by partnering with IFAC, local professional accountancy organizations, development banks, and aid organizations. This approach could include joint work to enhance or supplement existing resources (such as IFAC’s <a href="#">Pathways to Accrual</a>, and be developed through feedback with the IPSASB and international stakeholders).</p>
<p><b>Appropriate application of the IPSAS requirements</b> can be impacted by the complexity of an entity’s transactions, and the above limitations. Complex transactions require application of more complex accounting principles to appropriately reflect the transaction’s substance.</p>	<p><b>[Standard-setting or non-standard setting support]</b> This challenge could be mitigated by developing simplified accounting guidance (recognition, measurement, and/or disclosure). However, the analysis in <a href="#">Agenda Item 14.2.1</a> highlighted that this approach poses a different set of challenges, and is not necessarily the only, nor best, solution. The IPSASB could also provide implementation and application guidance, supplemented by an entity’s own resource and capacity building, independently or in partnership with other organizations.</p>

<sup>7</sup> The IPSASB’s [Strategic Objective](#) is to strengthen public financial management (PFM) globally through increasing adoption of accrual-based IPSAS.

*Considering the IPSASB's Options*

10. Considering the public need, the IPSASB's role and reputation as the international public sector accounting standard setter, the IPSASB could proceed in two ways:



11. Both options have benefits and challenges:

- (a) **[Option 1]** would enable the IPSASB to produce feasible and practical output(s) to support the public need in a timely manner, that remain(s) conceptually consistent with its Conceptual Framework and suite of IPSAS. This option more directly addresses the issues that prompted constituent interest in a potential international differential reporting model, is consistent with feedback received from certain jurisdictions, and would allow the IPSASB to build on existing work.
- (i) Other guidance or support could be in the form of application materials or guides to complement existing materials (e.g., Pathways to Accrual, Staff Q&As on Materiality, Cash Basis IPSAS, etc.). Non-standard support can also be provided by any Implementation Groups that the IPSASB may be set up in the future.
- (ii) However, as noted in paragraph 9, any other guidance or support would likely require collaboration with other organizations and be implemented in conjunction with other tools and resources for public sector entities to derive the maximum value and benefits of accrual accounting.
- (b) **[Option 2]** would involve the IPSASB developing an international differential reporting model (with simplified recognition, measurement, and/or disclosure requirements), similar to the IASB's initiatives.
- (i) However, the analysis in [Agenda Item 14.2.1](#) and in this paper highlighted the substantial issues and challenges, and potential reputational risk related to developing an international differential reporting model.
- (ii) The above analysis has also noted that standard-setting is not necessarily the most appropriate way to address the public need identified.

*Considering the Options*

12. The output of the project should address the core issue raised by constituents as effectively as possible. Considering the public need, the IPSASB's role and reputation in the public sector, and CAG member advice, staff are of the view that Option 1 would be the better option because it:
- (a) Provides a pragmatic solution, given the conceptual and practical challenges highlighted in both agenda papers; and
- (b) Addresses the need for support with capacity and resources, and;

- (c) Avoids the potential technical and reputational issues associated with a standard-setting approach.
13. Thus, Option 1 is better from a public interest perspective as it addresses the public need identified in a conceptually consistent and pragmatic way. Option 1 is aligned with advice and feedback from the public sector representatives, as it allows jurisdictions to develop their own approaches, as each knows their own environment and capabilities best.
14. However, if the IPSASB proceeds with Option 2, the Board will need to further consider how it could:
- (a) Create an international differential reporting model that is separate from its existing Conceptual Framework but maintains the IPSASB's credibility in the international public sector;
  - (b) Tackle the feasibility challenges around developing an international differential reporting model, given the user needs of public sector entities; and
  - (c) Continue to encourage entities to transition to full IPSAS.

*Next Steps*

15. Depending on the IPSASB's decision on this paper, staff will provide the following in Q3:
- (a) Additional analysis or details on specific outputs under the selected option; and
  - (b) Proposed project timeline.

**Decision Required**

16. Does the IPSASB agree with the staff [recommendation](#)?

## **APPENDIX 1: DETAILS ON PAST CONSULTATIONS**

### High-Level Summary: Feedback on Past Consultations

1. Prior to its 2021 Mid-Period Work Program Consultation, the IPSASB had proposed a project on differential reporting in three other separate consultations (2012-2018):
  - (a) The [IPSASB Consultation on Work Program 2013-2014](#), where only 2 of 38 respondents listed the project as high priority (see [March 2013](#) Agenda Item 10.1);
  - (b) The [IPSASB Strategy Consultation 2015-2019 & Work Program Consultation 2015-2019](#), where only 4 of 32 respondents referenced the project, indicating low urgency (see [September 2014](#) Agenda Item 4.1); and
  - (c) The [IPSASB Proposed Strategy and Work Plan 2019-2023](#), where only 17 of 53 respondents agreed with adding this project (see [September 2018](#) Agenda Item 10.2.5).
2. A majority of respondents to the 2021 Mid-Period Work Program Consultation agreed with the two major projects proposed (of which one was Differential Reporting). However, staff note that only 16% of participants at the regional round tables considered Differential Reporting as the most important issue to address (see [March 2022](#) Agenda Item 5.3.1).
3. The **feasibility** of an international standard setting solution to address this issue remains a prominent concern in the responses to all four consultations since 2012, as well as in recent discussions at IPSASB and CAG meetings, and other outreach events. While participants generally acknowledged the potential benefits of an international differential reporting model, they often questioned whether an international solution was achievable, or whether the need was better addressed at the jurisdictional level by national standard setters to achieve a more pragmatic domestic solution.

## Supporting Document: Illustrative Decision Tree

The following is a high-level illustration of the considerations and decisions proposed in this Agenda Item.

