

Meeting: International Public Sector Accounting
Standards Board

Meeting Location: Brussels, Belgium

Meeting Date: September 15-18, 2014

Agenda Item 2A

For:

☒ Approval

☒ Discussion

☐ Information

Preface to the Conceptual Framework

Objective of Agenda Item

1. The objective is to **approve** *The Preface to the Conceptual Framework for Financial Reporting* in principle for publication.

Material Presented

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|-------------------|---|
| Agenda Item 2A.1A | Draft, <i>The Preface to the Conceptual Framework for Financial Reporting (marked-up to show changes from the version circulated on July 8, 2014 meeting)</i> |
| Agenda Item 2A.1B | Draft, <i>The Preface to the Conceptual Framework for Financial Reporting (clean)</i> |

Action Requested

2. The IPSASB is asked to **approve** the *Preface to the Conceptual Framework for Financial Reporting* for publication.

Background

3. At the June meeting Members reviewed a version of the Preface that included a number of amendments from the version made available on the website as a Preliminary Board View in July 2013. Members directed that a number of further changes should be made and that the draft Preface should be circulated for views out-of session. A revised version was circulated on July 8, 2014. This version reflects further amendments as a result of comments received from Members, Observers and the Senior Adviser.

Key Issues

4. There are three key issues on which Staff seek directions prior to a page-by-page review of the document:
 - Use of term "compulsory" rather than "involuntary" in the section: *The Volume and Significance of Non-Exchange Transactions including Compulsory Transfers*;
 - Absence of discussion on public sector specific liabilities; and
 - References to consideration of GFS reporting guidelines in section: *Relationship to Statistical Reporting*.

Use of term "compulsory" rather than "involuntary" in the section: *The Volume and Significance of Non-Exchange Transactions including Compulsory Transfers*

5. At the June meeting Members directed that the term "involuntary" should be changed to "compulsory" in the title and subsequent text of the section: *The Volume and Significance of Non-Exchange Transactions including Compulsory Transfers*. Staff note that in Chapter 2 of the Framework, *Objectives and Users of General Purpose Financial Reporting*, the terms "voluntary" and "involuntary" (rather than "compulsory") are used to classify types of transfers and resource providers, for example i:
 - (a) The assertion in paragraph 2.9 that "taxpayers do not usually provide funds to the government or other public sector entity on a voluntary basis or as a result of an exchange transaction";
 - (b) Paragraph 2.26 refers to "Current and future generations of taxpayers and other involuntary resource providers who will provide the taxes and levies to fund the planned service delivery activities and related financial commitments"; and
 - (c) Paragraphs BC 2.29, 2.12, 2.16 and 2.18 use the term "involuntary."
6. Staff has no particular concerns with the use of "compulsory" rather than "involuntary" in this context given that the terms have similar, if not the same, meaning. However staff note that the term "compulsory" is not used in Chapter 2 and, on reflection, is concerned that introduction of the term at this stage may weaken the link to Chapter 2. Staff considers that "involuntary" harmonizes with the use of "voluntary" in Chapter 2 and, therefore, propose that the term "involuntary" is reinserted to replace 'compulsory'.

Matter for Consideration

1. The IPSASB is requested **to approve** the use of the term "involuntary" rather than "compulsory" in the title and section, *The Volume and Significance of Non-Exchange Transactions including Compulsory Transfers*.

Absence of discussion on public sector specific liabilities

7. In responding to the version circulated on July 8, a Member noted that while there is a section *The Nature and Purpose of Assets in the Public Sector*, the Preface does not discuss public sector specific liabilities. These include the items that are currently under consideration in the Public Sector Financial Instruments (PSFI) project, such as IMF Special Drawing Rights (SDRs) and Currency in Circulation.
8. Staff acknowledges that there is a lack of symmetry in the current structure of the Preface in that there is a section on assets but not a section on liabilities. Staff has some reservations about adding new material at this stage of the Preface's development. First, Staff is not aware of comments from constituents on this issue. Second, as has been pointed out in the PSFI project many of these instruments are relevant to a small number of entities, although, where relevant, the amounts are likely to be material. Third, there is still some discussion whether liabilities arise in some of these areas i.e., SDRs.
9. If it is decided that this area should be addressed Staff would favor the amendment of the title of the fourth section to *The Nature and Purpose of Assets in the Public Sector and Public Sector Liabilities*, and the insertion of two additional paragraphs, rather than the addition of a new section.

10. If such paragraphs are inserted draft text is shown below:

“Liabilities are incurred by government and other public sector entities to support service delivery objectives, rather than profit-seeking activities. Such liabilities may include loans on a non-commercial basis. Public sector entities also incur liabilities for a wide range of other purposes such as employee entitlements, and may incur liabilities in respect of their obligations for environmental protection and rehabilitation. Obligations may also arise in respect of public sector specific financial instruments such as the Special Drawing Rights of the International Monetary Fund and Currency in Circulation.

Whether these and other obligations incurred, or the undertakings of government and public sector entities, are liabilities that will be recognized in GPFRS and how they are measured will be determined by reference to the definition of a liability and recognition criteria in Chapters 5 and 6. Measurement is discussed in chapter 7.”

Matter for Consideration

2. The IPSASB is requested **to provide** a direction whether additional material on liabilities should be added to the current section on *The Nature and Purpose of Assets in the Public Sector* with a consequent amendment of the title.

References to consideration of GFS reporting guidelines in section: “Relationship to Statistical Reporting”

11. The section, “Relationship to Statistical Reporting” has been amended to reflect proposals from the Eurostat and IMF Statistical Affairs Division). Staff proposed that these changes are considered during the page-by-page review. This section concludes with paragraph 22 that explains:

In developing its *Conceptual Framework* and other literature the IPSASB has considered the objectives and requirements of statistical accounting guidance and the concepts that underpin them. The IPSASB has issued a Policy Paper, *Process for Considering GFS Reporting Guidelines during Development of IPSASs*, which sets out the IPSASB's process for considering GFS reporting guidelines during the development of IPSASs.

12. In the view of Staff if this paragraph is retained there is a case for inserting a similar paragraph on the relationship between IPSASB and the International Accounting Standards Board, given that the IPSASB has also monitored closely and considered the existing IASB Framework and proposals for its further development, and has in place an IFRS convergence process. However, Staff has a reservation that this final paragraph is more about operating procedures for the development of IPSASs, rather than the concepts in the Framework. Staff therefore proposes the deletion of this paragraph.

Matter for Consideration

3. The IPSASB is asked **to approve** deletion of paragraph 22.

Further Revisions

13. There are a number of further revisions to be considered in the page-by-page review:
- **Paragraph 4:** Some restructuring of the text and addition of a sentence that “general purpose financial reports (GPFRs) are the mechanism for providing information to users for

accountability and decision-making purposes” to confirm and make explicit the objectives of GPFRS as identified in Chapter 2 of the Framework.”

- **Paragraph 5:** Delete reference to “contributions” in the third sentence because it has a different usage in the third sentence than in the fourth sentence;
- **Paragraph 6:** Refinements to the text to indicate that “the source of funding of international organizations will generally be taxation”;
- **Paragraphs 7 and 8:** Minor editorials and a clarification of the role of the approved budget as a major component of the mechanisms by which the legislature (or equivalent) exercises oversight and constituents and their elected representatives hold the entity’s management financial accountable. This is intended to confirm the role of the approved budget and general purpose financial reporting in providing input for accountability and decision making;
- **Paragraphs 9-11:** Minor drafting changes;
- **Paragraphs 12-14:** Drafting changes intended to enhance the explanation of (i) long-term programs, and (ii) the nature and longevity of nation states; and
- **Paragraph 16:** Addition of cross-reference to Chapter 5.

Matter for Consideration

4. The IPSASB is requested to **approve** the above revisions, **identify** final revisions and **approve** the Preface for incorporation in the Framework.

The Preface to the Conceptual Framework for General Purpose Reporting by Public Sector Entities

Introduction

1. The purpose of this Preface is to highlight characteristics of the public sector that underpin the development of International Public Sector Accounting Standards (IPSASs) and Recommended Practice Guidelines (RPGs). The *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities (Conceptual Framework)* acknowledges and responds to these characteristics.
2. The public sector includes national, regional and local governments, and related governmental entities. It also includes international public sector organizations.
3. Governments generally have broad powers, including the ability to establish and enforce legal requirements, and to change them. Globally the public sector varies considerably in both its constitutional arrangements and its methods of operation. However, governance in the public sector generally involves the holding to account of the executive by a legislative body (or equivalent).
4. The primary objective of most public sector entities is to deliver services to the public, rather than to make profits and generate a return on equity to investors. Consequently the performance of such entities can be only partially evaluated by examination of financial position, financial performance and cash flows. Many entities are substantially financed by taxation ~~(or contributions)~~ or transfers from other entities, which are initially financed through taxation. Consequently the performance of such entities can be only partially evaluated by examination of financial position, financial performance and cash flows. General purpose financial reports (GPFRs) are the mechanism for providing information to users for accountability and decision-making purposes. Users of the general purpose financial reports (GPFRs) of public sector entities also need information to support assessments of such matters as:
 - Whether the entity provided its services to constituents in an efficient and effective manner;
 - The resources currently available for future expenditures, and to what extent there are restrictions or conditions attached to their use;
 - To what extent the burden on future-year taxpayers of paying for current services has changed; and
 - Whether the entity's ability to provide services improved or deteriorated compared with the previous year.

The Volume and Financial Significance of Non-Exchange Transactions including Compulsory Involuntary Transfers

5. In a non-exchange transaction, an entity receives value from another party without directly giving approximately equal value in exchange. Such transactions are common in the public sector. The level and quality of services received by an individual, or group of individuals, is not normally directly related to the level of taxes assessed~~contributions and taxes.~~ Depending on the provisions of the program, a an individual or group may have to pay a charge or fee and/or may have had to make specified contributions to access certain services. ~~Notwithstanding this characteristic~~However, such transactions are, generally, of a non-exchange nature, because the amount that an individual or group

of individuals obtains in benefits will not be approximately equal to the amount of any fees paid or contributions made by the individual or group. The ~~character~~ nature of non-exchange transactions may have an impact on how they, ~~and the resulting balances~~, are recognized, measured, and presented to best support assessments of the entity by service recipients and resource providers.

6. Taxation is a legally mandated ~~compulsory involuntary~~ transaction between individuals or entities and the government. Tax-raising powers can vary considerably between jurisdictions, particularly the relationship between the powers of the national government and those of sub-national governments and other public sector entities. International public sector entities are largely funded by transfers from national or regional governments. These may be governed by treaties and conventions or may be on a purely voluntary basis. The source of this funding will generally be taxation. The compulsory nature of taxes and transfers is one of the main reasons why Governments are accountable to resource providers, particular to those that provide resources through taxes and other involuntary transfers. The accountability objective of financial reporting, ~~which~~ is discussed in Chapter 2, ~~is important in the public sector.~~

The Importance of the Approved Budget

7. Most governments and other public sector entities prepare annual financial budgets typically covering the revenue to be raised and spending plans. In many jurisdictions there is a constitutional requirement to prepare and make publicly available a budget approved by the legislature (or equivalent). Legislation often defines the contents of that documentation. A government's approved budget is ~~the primary~~ an important method by which the legislature ~~(or equivalent)~~ exercises oversight and constituents and their elected representatives hold the entity's management financially accountable. The approved budget is often the basis for setting taxation levels, and is part of the process for obtaining legislative approval for spending.
8. Because of the approved budget's significance, information that enables users to compare actual spending, revenues and the resulting surplus or deficit with the ~~approved~~ budget facilitates an assessment of the extent to which a public sector entity has met its financial objectives. Such information promotes accountability and informs decision making in subsequent budgets. Reporting against budget is commonly the mechanism for demonstrating compliance with legal requirements relating to the public finances. The needs of users for budget information is discussed in Chapter 2.

The Nature and Purpose of Assets in the Public Sector

9. In the public sector, the primary reason for ~~holding operating~~ property, plant, and equipment and other assets is for their service potential rather than to generate cash flows¹. Because of the ~~nature of public sector service provision~~ types of services provided, a significant proportion of assets ~~deployed used~~ by public sector entities are specialized, for example roads and military assets. There may be a limited market for such assets and, even then, they may need considerable adaptation in order to be used by other operators. These factors ~~have implications for definitions of measurement bases~~ the measurement of such assets. Chapter 7 discusses measurement bases for assets.
10. Governments and other public sector entities may hold items that contribute to the historical and cultural character of a nation or region (for example, art treasures, historical buildings, and other artifacts). They may also be responsible for national parks and other areas of natural significance

¹ Many public sector assets will generate cash flows, but this is often not the main reason for operating them.

with native flora and fauna. Such items and areas are not generally held for sale, even if markets exist. Rather, governments and public sector entities have a responsibility to preserve and maintain them for current and future generations.

11. Governments often have powers over natural and other resources such as mineral reserves, water, fishing grounds, ~~and~~ forests and the electromagnetic spectrum. These powers allow governments to grant licenses for the use of such resources or to obtain royalties and taxes from their use. ~~Governments may also create new rights, e.g., over the electromagnetic spectrum.~~ The definition of an asset and recognition criteria for assets are discussed in Chapters 5 and 6.

The Longevity of the Public Sector and the Nature of Public Sector Programs

- ~~12. Interpretation Assessments~~ of the going concern principle that underpins the preparation of the financial statements needs to reflect public sector circumstances. ~~Because of sovereign powers, particularly the power to tax, net financial position is not the only indicator of whether a national government can meet its obligations as they fall due.~~

- ~~13.12. Governments have sovereign powers to tax. There are two further reasons why going concern has been difficult to interpret. The first reason is that m~~Many public sector programs are long term and the ability to meet commitments depends upon future taxation and contributions. Many commitments arising from public sector programs and powers to levy future taxation do not meet the definitions of a liability ~~in Chapter 5 and the power to levy future taxation does not meet the definition of~~ and an asset in Chapter 5. Such commitments and powers are therefore not recognized in the financial statements.

- ~~14.13.~~ Consequently the statement of financial performance and statement of financial position cannot provide all the information that users need on long-term programs, particularly those delivering social benefits. Reports on the long-term sustainability of key programs are therefore relevant to assessments of accountability by service recipients and resource providers. The financial consequences of many decisions will have an impact many years or even decades into the future, so GPFRs containing prospective financial information on the long-term sustainability of an entity's finances, covering lengthy time horizons, are necessary for accountability and decision-making purposes as stated in Chapter 2.

- ~~15.14. The second reason is t~~The nature and longevity of nation states and institutions is also central to assessments of going concern. ~~While~~Although political control may change regularly, nation states have very long existences. While they may encounter severe financial difficulties and may default on sovereign debt obligations nation states continue to exist. If sub-national entities get into financial difficulties, national governments might act as lenders of last resort or provide large scale guarantees. The main service delivery commitments of sub-national entities may continue to be funded by a higher level of government. Sub-national entities may also be amalgamated. In other cases public sector entities that are unable to meet their liabilities as they fall due may continue to exist by restructuring their operations.

The Regulatory Role of Public Sector Entities

- ~~16.15.~~ Many governments and other public sector entities have powers to regulate entities operating in certain sectors of the economy, either directly or through specifically created agencies. The underlying public policy rationale for regulation is to safeguard the public interest, in accordance with

specified public policy objectives. Regulatory intervention can also occur where there are market imperfections or market failure for particular services, or to mitigate against factors such as pollution, the impact of which is not transmitted through pricing. Such regulatory activities are carried out in accordance with legal processes.

17.16. Governments may also regulate themselves and other public sector entities. Judgment may be necessary to determine whether such regulations create rights of, and obligations on, public sector entities that require recognition as assets and liabilities, or whether the public sector entity's ability to amend such regulations has an impact on how such rights and obligations should be accounted for. Chapter 5 considers rights and obligations.

Relationship to Statistical Reporting

18.17. Many governments produce two types of ex-post financial information: (a) government finance statistics (GFS) on the general government sector (GGS) for the purpose of macroeconomic analysis and decision making, and (b) general purpose financial statements (GPFS) for accountability and decision making at an entity level, including GPFSs for the whole of government reporting entity.

19.18. The overarching standards for macro-economic statistics are set out in the *System of National Accounts* (SNA). The SNA is a framework for a systematic and detailed description of the national economy and its components, including the GGS. These standards are then implemented at national or regional level, for example in the European Union through the European System of Accounts. Internationally recognized macroeconomic statistical methodologies are harmonized with the SNA to the extent possible, while remaining consistent with their own specific objectives. GFS-oriented reporting guidelines include the IMF's Government Finance Statistics Manual (GFSM), which is the key source of guidance for non-European Union government finance statistics and the EU's legislated rules for national accounts—the European System of Accounts.

20.19. IPSAS financial statements and GFS reports have much in common. Both reporting frameworks are concerned with (a) financial, accrual-based information, (b) a government's assets, liabilities, revenue, and expenses and (c) comprehensive information on cash flows. There is considerable overlap between the two reporting frameworks that underpin this information.

21.20. However, IPSASs and GFS reporting guidelines have different objectives. The objectives of financial reporting by public sector entities are to provide information about the reporting entity that is useful to users of GPFRs for accountability purposes and decision-making purposes. GFS reports are used to (a) analyze fiscal policy options, make policy and evaluate the impact of fiscal policies, (b) determine the impact on the economy, and (c) compare fiscal outcomes nationally and internationally. The focus is on evaluating the impact of the GGS and broader public sector on the economy, and the influence of government on other sectors of the economy. The GFS reporting framework was developed specifically for public sector input to other macroeconomic statistics within the complete macroeconomic statistics framework.

22.21. The different objectives and focus on different reporting entities lead to the different treatment of some transactions and events. The removal of differences between the two accounting frameworks that are not fundamental to their different objectives and a reliance on a single integrated financial information system to generate both IPSAS-compliant financial statements and GFS reports can provide benefits to users in terms of report quality, timeliness and understandability.

~~23.~~22. In developing its *Conceptual Framework* and other literature the IPSASB has considered the objectives and requirements of statistical accounting guidance and the concepts that underpin them. The IPSASB has issued a Policy Paper, *Process for Considering GFS Reporting Guidelines during Development of IPSASs*, which sets out the IPSASB's process for considering GFS reporting guidelines during the development of IPSASs.

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an impact on how they, are recognized, measured, and presented to best support assessments of the entity by service recipients and resource providers.

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The Importance of the Approved Budget

7. Most governments and other public sector entities prepare annual financial budgets typically covering the revenue to be raised and spending plans. In many jurisdictions there is a constitutional requirement to prepare and make publicly available a budget approved by the legislature (or equivalent). Legislation often defines the contents of that documentation. A government's approved budget is an important method by which the legislature (or equivalent) exercises oversight and constituents and their elected representatives hold the entity's management financially accountable. The approved budget is often the basis for setting taxation levels, and is part of the process for obtaining legislative approval for spending.
8. Because of the approved budget's significance, information that enables users to compare actual spending, revenues and the resulting surplus or deficit with the budget facilitates an assessment of the extent to which a public sector entity has met its financial objectives. Such information promotes accountability and informs decision making in subsequent budgets. Reporting against budget is commonly the mechanism for demonstrating compliance with legal requirements relating to the public finances. The needs of users for budget information is discussed in Chapter 2.

The Nature and Purpose of Assets in the Public Sector

9. In the public sector, the primary reason for operating property, plant, and equipment and other assets is for their service potential rather than to generate cash flows¹. Because of the types of services provided, a significant proportion of assets used by public sector entities are specialized, for example roads and military assets. There may be a limited market for such assets and, even then, they may need considerable adaptation in order to be used by other operators. These factors have implications for the measurement of such assets. Chapter 7 discusses measurement bases for assets.
10. Governments and other public sector entities may hold items that contribute to the historical and cultural character of a nation or region (for example, art treasures, historical buildings, and other artifacts). They may also be responsible for national parks and other areas of natural significance with native flora and fauna. Such items and areas are not generally held for sale, even if markets exist. Rather, governments and public sector entities have a responsibility to preserve and maintain them for current and future generations.

¹ Many public sector assets will generate cash flows, but this is often not the main reason for operating them.

11. Governments often have powers over natural and other resources such as mineral reserves, water, fishing grounds, forests and the electromagnetic spectrum. These powers allow governments to grant licenses for the use of such resources or to obtain royalties and taxes from their use. The definition of an asset and recognition criteria for assets are discussed in Chapters 5 and 6.

The Longevity of the Public Sector and the Nature of Public Sector Programs

12. Assessments of the going concern principle that underpins the preparation of the financial statements need to reflect public sector circumstances. Governments have sovereign powers to tax. Many public sector programs are long term and the ability to meet commitments depends upon future taxation and contributions. Many commitments arising from public sector programs and powers to levy future taxation do not meet the definitions of a liability and an asset in Chapter 5. Such commitments and powers are therefore not recognized in the financial statements.
13. Consequently the statement of financial performance and statement of financial position cannot provide all the information that users need on long-term programs, particularly those delivering social benefits. Reports on the long-term sustainability of key programs are therefore relevant to assessments of accountability by service recipients and resource providers. The financial consequences of many decisions will have an impact many years or even decades into the future, so GPFRs containing prospective financial information on the long-term sustainability of an entity's finances, covering lengthy time horizons, are necessary for accountability and decision-making purposes as stated in Chapter 2.
14. The nature and longevity of nation states and institutions is also central to assessments of going concern. While political control may change regularly, nation states have very long existences. While they may encounter severe financial difficulties and may default on sovereign debt obligations nation states continue to exist. If sub-national entities get into financial difficulties, national governments might act as lenders of last resort or provide large scale guarantees. The main service delivery commitments of sub-national entities may continue to be funded by a higher level of government. Sub-national entities may also be amalgamated. In other cases public sector entities that are unable to meet their liabilities as they fall due may continue to exist by restructuring their operations.

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16. Governments may also regulate themselves and other public sector entities. Judgment may be necessary to determine whether such regulations create rights of, and obligations on, public sector entities that require recognition as assets and liabilities, or whether the public sector entity's ability to amend such regulations has an impact on how such rights and obligations should be accounted for. Chapter 5 considers rights and obligations.

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18. The overarching standards for macro-economic statistics are set out in the *System of National Accounts* (SNA). The SNA is a framework for a systematic and detailed description of the national economy and its components, including the GGS. These standards are then implemented at national or regional level, for example in the European Union through the European System of Accounts. GFS-oriented reporting guidelines include the IMF's Government Finance Statistics Manual (GFSM).
19. IPSAS financial statements and GFS reports have much in common. Both reporting frameworks are concerned with (a) financial, accrual-based information, (b) a government's assets, liabilities, revenue, and expenses and (c) comprehensive information on cash flows. There is considerable overlap between the two reporting frameworks that underpin this information.
20. However, IPSASs and GFS reporting guidelines have different objectives. The objectives of financial reporting by public sector entities are to provide information about the reporting entity that is useful to users of GPFRs for accountability purposes and decision-making purposes. GFS reports are used to (a) analyze fiscal policy options, make policy and evaluate the impact of fiscal policies, (b) determine the impact on the economy, and (c) compare fiscal outcomes nationally and internationally. The focus is on evaluating the impact of the GGS and broader public sector on the economy, within the complete macroeconomic statistics framework.
21. The different objectives and focus on different reporting entities lead to the different treatment of some transactions and events. The removal of differences between the two accounting frameworks that are not fundamental to their different objectives and a reliance on a single integrated financial information system to generate both IPSAS-compliant financial statements and GFS reports can provide benefits to users in terms of report quality, timeliness and understandability.
22. In developing its *Conceptual Framework* and other literature the IPSASB has considered the objectives and requirements of statistical accounting guidance and the concepts that underpin them. The IPSASB has issued a Policy Paper, *Process for Considering GFS Reporting Guidelines during Development of IPSASs*, which sets out the IPSASB's process for considering GFS reporting guidelines during the development of IPSASs.

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**International Public
Sector Accounting
Standards Board™**

Agenda Item 2A.1B

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