

CHARACTERISTICS OF PUBLIC SECTOR ENTITIES

Prepared by:

Conceptual Framework Task Force

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Comments are requested by October 15, 2011

Consultation Paper 1

CONCEPTUAL FRAMEWORK TASK FORCE
CONSULTATION PAPER 1
CHARACTERISTICS OF PUBLIC SECTOR ENTITIES

This Consultation Paper provides an overview of the key characteristics of public sector entities identified by the Public Sector Accounting Standards Board's (PSAB's) Conceptual Framework Task Force. It seeks input from stakeholders regarding these characteristics and their accounting and reporting implications for general purpose financial statements.

Project Objectives

The objective of this project is to review and amend, if necessary, the conceptual framework in Sections PS 1000, *Financial Statement Concepts*, and PS 1100, *Financial Statement Objectives*. This review could also affect Section PS 1201, *Financial Statement Presentation*.

The issues to be considered include:

- how to measure financial performance;
- what financial statements can do and cannot do in measuring financial performance;
- what aspects of the key concepts underlying financial performance in the framework require review and why;
- alternative approaches to the key concepts being reviewed; and
- how the alternative approaches affect the measure of financial performance.

This project applies to all levels of government as well as government organizations that apply the CICA Public Sector Accounting (PSA) Handbook.

Reasons for project

A Joint Working Group comprised of selected PSAB members and Deputy Ministers of Finance was established to deal with concerns expressed by the senior government finance community. A final subgroup report was issued suggesting PSAB review its conceptual framework. The concern raised related to the definitions of revenue and expenses as they were leading to volatility in reported results and making it difficult to provide budget-to-actual comparisons.

In response, and in formulating its 2010-2013 Strategic Plan, PSAB planned its review in conjunction with the work being

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undertaken by the International Public Sector Accounting Standards Board. The senior government finance community expressed concern indicating that PSAB should be proactive in developing a “made-in-Canada” solution. PSAB agreed to revise its 2010-2013 Strategic Plan accordingly. Subsequently, PSAB approved a revised project proposal and a task force was recruited.

In April 2011, the Conceptual Framework Task Force began its review of the conceptual framework with the primary focus on the definitions of revenue and expenses. These definitions cannot be constructed without determining what financial performance should mean in the public sector. To do that, it is important that the key characteristics of public sector entities be considered.

Where are we in the process?

This Consultation Paper is the first document produced by the Task Force. It has not been approved by PSAB. The purpose of this Consultation Paper, and a second paper described below, is to seek input on the building blocks that will form the lens through which the existing concepts underlying financial performance in the PSA Handbook will be evaluated. The input received from the two consultations will be considered in drafting a statement of principles for PSAB approval for public comment.

What are the next steps?

A second consultation paper will be drafted and issued for consideration by stakeholders in the second quarter of 2012. It will likely discuss the following related to financial statements: users and what they need to have reported; the objectives of reporting in financial statements; the qualitative characteristics of information to be reported; elements; recognition and measurement.

The conceptual framework

What is a conceptual framework?

A conceptual framework is a coherent set of interrelated objectives and fundamentals that can lead to consistent standards and that prescribes the nature, function and limits of financial accounting and reporting. The objectives identify the goals and purposes of financial reporting. The fundamentals are the underlying concepts of financial reporting — concepts that guide the selection of transactions and other events to be accounted for, the measurement of those events and the means of summarizing and communicating them to interested parties. Concepts of that type are fundamental in the sense that other concepts flow from them and repeated reference to them will be necessary in establishing, interpreting and applying accounting standards.

The conceptual framework in the PSA Handbook sets out the concepts that underlie the preparation and presentation of financial statements for governments and government organizations that apply the PSA Handbook. A conceptual framework is the foundation on which generally accepted accounting principles (GAAP) are established. The framework does not override any specific public sector accounting standard. A conceptual framework is evolutionary, not static, and therefore, so is GAAP.

Why is a conceptual framework needed?

The adoption of a conceptual framework represents a deliberate choice of principles-based standard setting. A conceptual framework is intended to be a set of tools to help a standard setter in setting sound, internally consistent financial reporting standards and to help members of a standard setter's constituency not only understand and apply those standards but also contribute to their development. It will not automatically resolve complex financial reporting problems. However, a conceptual framework should:

- provide a set of common premises as a basis for discussion;
- provide precise terminology;
- help to ask the right questions;
- guide the exercise of professional judgment in making choices that are consistent with the framework and exclude from consideration potential solutions that are in conflict with it; and
- impose intellectual discipline on the reasoning process used to develop financial reporting standards.

Objectives of a public sector conceptual framework

The objectives of a public sector conceptual framework are:

- to assist PSAB in the development of future public sector accounting standards and in its review of existing standards;
- to assist PSAB's stakeholders in evaluating proposed standards as part of the due process of standard setting;
- to assist preparers of public sector financial statements in applying public sector accounting standards, and in dealing with topics that have yet to form the subject of a standard;
- to assist auditors in forming an opinion on whether public sector financial statements that are subject to audit comply with public sector accounting standards;
- to assist users of public sector financial statements in interpreting the information contained in financial statements prepared in compliance with public sector accounting standards; and
- to provide those who are interested in the work of PSAB with information about its approach to the formulation of public sector accounting standards applicable to the preparation and presentation of the financial statements of governments and government organizations that apply the PSA Handbook.

Applicability of the public sector conceptual framework

The public sector conceptual framework and GAAP are applicable to public sector entities that prepare general purpose financial statements in accordance with the PSA Handbook. General purpose financial statements are financial statements prepared in accordance with a financial reporting framework designed to meet the common financial information needs of a wide range of users.¹ Hereafter, these will be referred to as “financial statements”.

The components of a conceptual framework

The main components of a conceptual framework include:

- users and user needs;
- financial reporting objectives;
- qualitative characteristics of information to be reported
- elements of financial statements;
- general recognition criteria;
- general measurement criteria; and
- scope of the financial reporting entity.

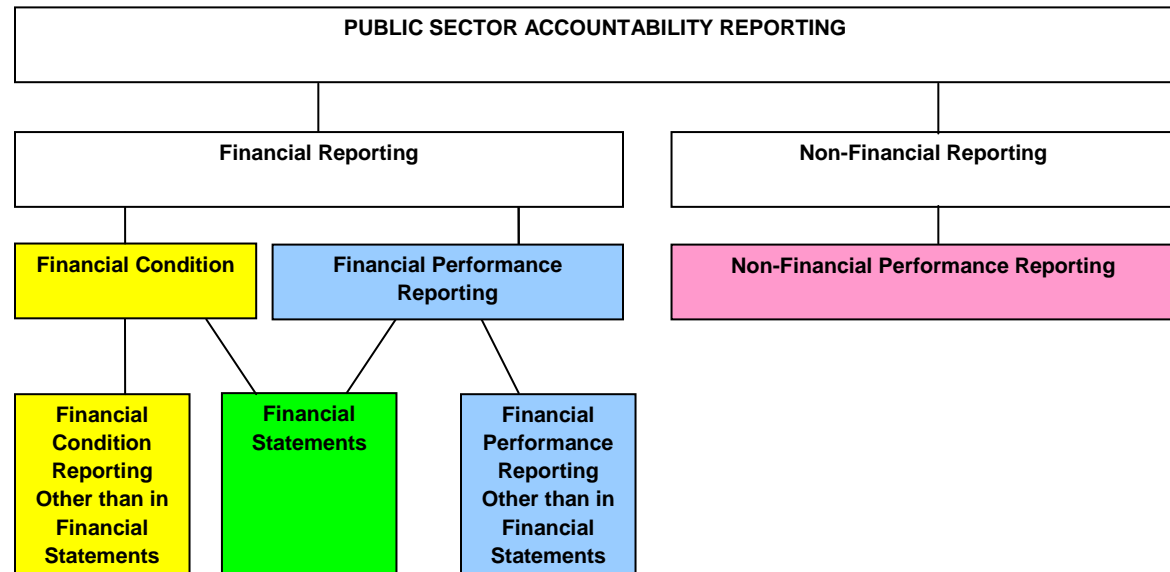
¹ In contrast, special purpose financial statements are financial statements prepared in accordance with a financial reporting framework that is designed to meet the financial information needs of specific users. For example, *Financial Statement Presentation*, paragraph PS 1201.028, provides an example of public sector entities preparing financial statements to comply with legislative reporting requirements, which would be special purpose financial statements.

The context of public sector financial reporting

What is the public sector?

The PSA Handbook defines the public sector as the federal, provincial, territorial and local governments and government organizations.² Each of these is a “public sector entity”.

What is the spectrum of public sector accountability reporting?



The complex nature of the public sector, its myriad of objectives and the overriding requirement for public accountability requires multi-faceted reporting on financial condition, financial performance and non-financial performance. Financial reporting in the public sector requires multidimensional accountability reporting comprising: financial statements; other information about a public sector entity’s financial condition; and supplementary financial performance information.

² An Exposure Draft currently out for comment proposes that the definition of the public sector in paragraph .03 of the Introduction to Public Sector Accounting Standards be amended to delete government partnerships and school boards from specific mention. School boards are considered government organizations so their separate mention is not required. Government partnerships are not controlled by a government and the basis of GAAP to be used is not dictated by the PSA Handbook but would instead be determined by the partners.

What public sector accountability reporting is the focus of this project?

The work of the Task Force focuses on financial statements. And, except for acknowledgment that financial statements form only a part of public sector accountability reporting, the conceptual framework also focuses only on financial statements. In particular, this project focuses on the concepts underlying the financial performance of a public sector entity as reflected in its financial statements. Financial statements are a fundamental component of public sector accountability reporting. They are a principal means of communicating financial information to those not involved in the entity's financial administration and they present aggregated information capable of integration with other financial information, schedules and reports provided by the entity.

Which public sector entities are affected by the conceptual framework?

Public sector entities that are governments or government organizations that apply the standards in the PSA Handbook would use the conceptual framework. In contrast, public sector entities that are government business enterprises, or other government organizations that apply International Financial Reporting Standards (IFRSs), would not be using this framework; a conceptual framework for these entities exists within IFRSs.

The key characteristics of public sector entities

Why identify the key characteristics of public sector entities?

The key characteristics set out the environment within which a public sector entity operates. Once identified, the key characteristics of public sector entities can be evaluated to determine which have accounting or financial reporting implications. A characteristic should only give rise to specific accounting or reporting requirements if those requirements meet users' needs for information about the public sector entity.

The nature and quality of the financial information reported in financial statements is determined by users' needs for information about the public sector entity and the attributes that make that information useful to users and support the achievement of the objectives of financial reporting.

What are the key characteristics of public sector entities?

The key characteristics of public sector entities are:

1. Public accountability
2. Multiple objectives
3. Rights, powers and responsibilities (Constitutional or devolved)
4. Lack of equity ownership
5. Operating and financial frameworks set by legislation
6. The importance of the budget
7. Governance structures
8. Nature of resources
9. Non-exchange transactions

Generally speaking, these are the key characteristics of public sector entities. However, an individual public sector entity may not have all of these characteristics.

Descriptions of the key characteristics of public sector entities

1. PUBLIC ACCOUNTABILITY

Governments are elected through a democratic process to have certain (Constitutional or devolved) rights, powers and responsibilities that require broad accountability to the public and their elected representatives. The governing bodies of many government organizations are appointed; however, these organizations are part of government. They use public resources and may have been given delegated powers and responsibilities that also demand broad accountability to the public and their

elected representatives. The complexity of the government financial reporting entity and the varied relationships between the government and its organizations adds to the need for broad public accountability.

Broader accountability to the public and their elected representatives is expected from all public sector entities as a function of the democratic process (hereafter referred to as “public accountability”). Public accountability is the overriding characteristic of public sector entities and providing information to demonstrate such accountability is the primary objective of public sector reporting.

Public accountability requires a public sector entity to justify the raising and management of public resources and how the resources are used. Public accountability is based on the premise that the public has the “right to know” (i.e., a right to receive openly declared facts that may lead to debates by the public and its elected representatives). Financial reporting plays a major role in fulfilling a public sector entity’s duty to be publicly accountable.

Public accountability normally involves:

- a responsibility conferred;
- an obligation to report back on the discharge of that responsibility;
- monitoring to ensure accountability; and
- possible sanctions for non-performance.

Public accountability is further facilitated to the degree that the task is clearly defined; the more vague and ambiguous the responsibilities, the more problematic it becomes to hold individuals or entities to account for performance. Normally when performance is measured, there is also some expectation that continuous future improvement or change will result from evaluating performance.

Public accountability requires transparency in the reporting of critical decisions, events, activities, policies and results. Transparency regarding the annual financial results and financial position of a public sector entity is enhanced by financial statements of high quality. Independently set accounting standards can contribute to transparency in public sector financial reporting by ensuring that the standards are set through a public and rigorous due process.

Financial statements provide the basis upon which other levels or kinds of accountability can be developed. At a minimum, the information provided in financial statements is essential for

assessing whether a public sector entity has exercised adequate financial stewardship over the resources provided to it and for assessing compliance with various performance expectations.

2. MULTIPLE OBJECTIVES

The objectives of most public sector entities are not to generate a profit. They are:

- service provision;
- resource reallocation; and/or
- policy development.

Public sector entities do not exist to generate a financial return on investment but rather to provide public services and goods as determined through the political process in an effective and efficient manner. The principal purpose is to provide services that enhance or maintain the wellbeing of the public. Maximizing the value generated by every dollar raised is an expectation of the public who have provided the resources. Public sector entities provide services that would generally not be provided by the private sector at the quantity, quality and price considered appropriate by public policy (for example, establishing and maintaining the legal system, national defence, providing public safety, education, health and transportation services).

Resource reallocation occurs in accordance with policy objectives such as economic stimulus and equalization but ultimately most reallocations (except maybe those related to social welfare) are a subset of the primary objective of service provision because the services are merely provided by another entity.

Public sector entities also have an objective of policy development (similar to strategic planning for a business) to manage issues arising or expected to arise in the jurisdiction. Some of these policies, such as fiscal and monetary policies and foreign affairs, will transcend the service provision and/or resource reallocation orientation of most government activities.

3. RIGHTS, POWERS AND RESPONSIBILITIES (CONSTITUTIONAL OR DEVOLVED)

The rights, powers and responsibilities of governments give them the ability to directly and indirectly affect the environment (and the economy) they operate in, as well as the nature and extent of the public accountability they provide.

Governments can:

- tax;
- penalize and fine;
- issue licenses to act/use/access, etc.;
- make and enforce laws and regulations;
- set monetary policy; and
- set fiscal policy.

These rights, powers and responsibilities may vary by level of government.

In return, governments have the responsibility to (and/or the expectation that they will):

- meet their Constitutional or devolved duties;
- set policies to manage the socio-economic issues of the jurisdiction (for example, the effective functioning of the economy, foreign affairs, social welfare, economic and political sovereignty, pollution, education, health, the proclaiming and safeguarding of borders and maintaining peace, order and good government within those borders, etc.) in an efficient, effective, sustainable and transparent manner through the stewardship and application of the public resources entrusted to them;
- deliver services and reallocate resources (for example, establishing and maintaining the legal system, national defence, providing public safety, education, health and transportation services) to meet identified policy objectives that have been subject to democratic scrutiny;
- bear risks of significant breadth and scope and thus act as residual risk holder in their jurisdiction in extraordinary circumstances (for example, natural disasters, economic intervention) and sometimes in cases where a risk to the public is otherwise unassumed or uninsured, regardless of whether the government has a contractual requirement to bear the risk.
- be accountable for the efficient, effective, sustainable and transparent management, stewardship and application of the public resources entrusted to them;
- exist and operate in perpetuity (i.e., long-term sustainability) to meet the needs of the jurisdiction; and
- be good managers of the economy and the business of government (including managing the trade surplus/deficit, the value of the dollar, government debt and other liabilities, as well as the sustainability and affordability of programs and policies).

Governments may choose to exercise these powers or meet these responsibilities directly or indirectly through various government organizations or in some cases through a reallocation of resources outside of government.

4. LACK OF EQUITY OWNERSHIP

Public sector entities do not act to enhance the economic position of the entity for the benefit of owners. Most public sector entities are created:

- through the Constitution (i.e., federal and provincial governments);
- by a Constitutional government (i.e., territorial and local governments); or
- by a government (i.e., government organizations);

without equity ownership or with nominal equity ownership to consummate their incorporation.

5. OPERATING AND FINANCIAL FRAMEWORKS SET BY LEGISLATION (I.E., LEGAL REQUIREMENTS)

Public sector entities must operate within and illustrate their compliance with legal requirements — not merely in the sense of engaging only in legal activities but also in the sense that the specifics of their operating and financial frameworks are set out in, or flow from, legislation. Compliance with those frameworks is mandated and public accountability reporting of compliance with the letter and spirit of those frameworks is integral to the requirements. All of the activities of governments and their organizations (including the nature and level of expenses/expenditures) and the financing of those activities are established in legislation. Transparent and public accountability against the promises and policies set out in legislation is fundamental to public sector reporting.

6. THE IMPORTANCE OF THE BUDGET

Most governments prepare and issue as public documents, or otherwise make publicly available, their financial budgets. The budget documents are widely distributed and referenced. The budget reflects the financial elements of the government's plans for the forthcoming period, is a key tool for financial management and control, and is the central component of the process that provides for government and legislative (or council) oversight of the financial dimensions of operations. Many government organizations that issue financial statements also make their budget documents publicly available.

Crucial public accountability is provided by comparing the budget with the actual results. The complexity of that comparison will vary depending on the differences between the concepts underlying financial performance as presented in the financial statements of a public sector entity and those underlying the budget of the entity (for example, the accounting basis used, such as accrual, modified accrual, cash, etc., or the organizations included in the financial statements may be different from those included in the Budget).

Budgets are policy documents in the public sector. The frameworks underlying budgets across the country have some similarities but there are also many differences among them. Such frameworks are under the control of individual governments and are established to reflect the policy choices and underlying structures of individual jurisdictions. Budgets of individual government organizations reflect a subset of the policies of the government and thus they can be considered policy documents too.

7. GOVERNANCE STRUCTURES

For the federal, provincial and territorial governments governance is provided by the Legislature (i.e., the Governor General, Lieutenant Governor and elected officials of the House of Commons and Senate or Legislative Assembly are responsible for approving legislation and taxation and spending). They grant authority to the Executive Council or Cabinet to administer resources and financial affairs and hold them accountable for their administration. The Executive Council or Cabinet (the Prime Minister or Premier and appointed members of the Cabinet) are responsible for delivering programs and services within the laws, expenditures and tax measures approved by the Legislature. For local governments, a similar governance role is played by the elected Council. Thus, for governments, the governance structure comprises elected officials.

For government organizations, the Board of Directors or other administrative body grants the authority for the financial and operating processes in accordance with the overall policies of the government. These governing bodies have a variety of structures and means of appointing members and, in some cases, they may be comparable to the boards of private sector enterprises except for the requirements to operate and report within the frameworks established in legislation.

8. NATURE OF RESOURCES

Resources of public sector entities are generally held for service provision rather than for their ability to generate future cash flows. Some of these resources include:

- resources inherited in right of the Crown;
- heritage and cultural resources;
- complex infrastructure systems; and
- intangible resources (for example, air and sea rights, the electromagnetic spectrum).

They are resources for which accountability is expected given the perpetual obligations and objectives of public sector entities. They may require perpetual and regular maintenance. These resources may be held or managed by government organizations.

9. NON-EXCHANGE TRANSACTIONS

Some of the rights, powers and responsibilities of public sector entities (see #3, “Rights, Powers and Responsibilities” above) give rise to non-exchange transactions³ (for example, taxes, fines and penalties, license and regulatory fees, social benefits). The transactions of many public sector entities are primarily non-exchange in nature and, thus, are more involuntary in nature than voluntary as would be the case for exchange transactions and donations. There is a high incidence of non-exchange transactions of financial significance in the public sector.

Your input is requested

The Conceptual Framework Task Force is requesting your input on the key characteristics of public sector entities. Some characteristics may be purely contextual in nature. Others may have accounting and reporting implications for the financial statements of public sector entities. The Task Force has no preconceived idea of what implications should arise from this consultation. As part of its mandate, the Task Force is expected to identify any accounting and reporting implications of these characteristics but would like to engage in broad consultation with stakeholders in advance of doing so.

Individuals, governments and organizations are invited to send written comments to the Task Force on the proposed key characteristics of public sector entities. Comments are requested from those who agree with the proposals as well as from those who do not. All comments received will be available on the website at www.psab-ccsp.ca shortly after the comment deadline, unless confidentiality is requested. The request for confidentiality must be stated explicitly in the response.

When comments have been prepared as a result of a consultative process within an organization, it is helpful to identify the groups consulted. Where relevant, it may also be appropriate to identify the source of individual comments in the response. Such identification will promote understanding of how the proposals are affecting various aspects of a government or organization and provide context to the Task Force in understanding the comments.

Comments are most helpful if they are related to a specific characteristic or subset of that characteristic. When expressing disagreement, please clearly explain the problem and indicate a suggestion, supported by specific reasoning, for alternative wording.

³ Section PS 3510, *Tax Revenue*, defines non-exchange transactions as: “transactions that are not exchange transactions (a defined term). In a non-exchange transaction, an entity either receives value from another entity without directly giving approximately equal value in exchange, or gives value to another entity without directly receiving approximately equal value in exchange”. The relationship between revenue and expenses for a public sector entity is not as direct as in an exchange transaction.

Please respond to the following questions:

1. Is the list of key characteristics of public sector entities complete? If not, what is missing and how should it be described?
2. Is each key characteristic appropriately described? Please explain any changes that should be made.
3. For each key characteristic (including any that you have added), does it have reporting or accounting implications for the financial statements of public sector entities (or for the financial statements of governments alone, or for the financial statements of government organizations alone)? Please explain what those implications would be. For example, are specific accounting questions raised (i.e., does an asset, liability, revenue or expense exist; when/how should an item be recognized in annual results; is the entity a going concern)? Or should particular items or indicators or comparisons be reported in the financial statements? Or is a new/different financial statement or a new/different financial statement format required? Please be as specific as you can.
4. For each of those characteristics that do not have identifiable accounting or reporting implications, should they still be included in the conceptual framework as contextual information about public sector entities?

Please note that some characteristics (for example, #3, “Rights, Powers and Responsibilities”) cover a lot of ground and you may want to discuss some aspects of a characteristic separately in your response if you feel that different accounting or reporting implications flow from distinct aspects of an individual characteristic. For example, maybe there are distinct accounting implications arising from the power to tax but the ability to set monetary policy is considered merely contextual when the impact on the financial statements is evaluated.

To be considered, comments must be received by October 15, 2011, addressed to:

Tim Beauchamp, Director
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277 Wellington Street West
Toronto, Ontario M5V 3H2

A PDF [response form](#) has been posted with this document to assist you in submitting your comments. You can save the form both during and after completion for future reference. You are not restricted by the size of the interactive comment fields in the response form and there is also a general comments section. Alternatively, you may send comments by e-mail (in Word format), to: ed.psector@cica.ca. In due course, a webinar discussing the proposed characteristics will also be posted on the PSAB web site at www.psab-ccsp.ca.

We welcome your input. Thank you for taking the time to respond.