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# CHARACTERISTIC FACTORS FOR PUBLIC SECTOR IN FINANCIAL DISCLOSURE

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**Abstract:**

*Specific for public sector, the financial statements there are under the impact of several factors. Characteristic elements of the public sector should be defined and quantified as the impact on financial reporting. IPSASB (The International Public Sector Accounting Standards Board) is concerned for these aspects and develops an ED (Exposure Draft) on this topic. Through quantitative and qualitative analysis, the study will examine the themes proposed for discussion by IPSASB and how they are perceived by respondents, representatives of public institutions. The results are useful for both Romanian legislator and practitioners which can assess future trends in the public sector financial reporting.*

**Key words:** *Financial Reporting, Public Sector, Characteristic Key, IPSASB*

## 1. Introduction

International accounting standards for public sector (IPSASB) is an independent body setting standards within the International Federation of Accountants (IFAC). It approved the publication of this project - "Key features of the public sector, with potential implications for financial reporting" in March 2011 (IFAC, 2012a). The text of this project can be modified according to comments received before August 31, 2011.

The IFAC has released international public-sector accounting standards for all public-sector entities, whether they are national central governments or local governments since 2000 (Oulasvirta, 2010). An accounting standard is a rule or a set of rules that regulate acknowledgement and valuation in accounting, and prepare and present accounting information in financial statements (Ristea, 2006)

This draft (ED), "Key Characteristics of the Public Sector with Potential Implications for Financial Reporting", was developed by the IPSASB, as part of its project on the conceptual framework for financial reporting purposes generally made by public sector entities (The conceptual framework). ED highlights certain features of the public sector, which may have implications for developing a conceptual framework

for public sector and, therefore, to establish public sector accounting standards. 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 (PSAB, 2011).

The "conceptual framework" takes place in stages. Its components have been grouped as follows, and are taken into account in the following order (IFAC, 2012a):

- Phase 1 - the scope of financial reporting, financial reporting objectives and users of general purpose financial reports (GPFRs), qualitative characteristics of information contained in GPFRs and the reporting entity;

- Phase 2 - the definition and recognition of "elements" of financial statements;

- Phase 3 - the measurement (or bases), which can be validly adopted for items that are recognized in the financial statements;

- Phase 4 - concepts that should be taken in deciding how to set financial and nonfinancial information in GPFRs.

In December 2010 the IPSASB issued (IPSASB, 2012a):

- An ED on Phase 1, Role, Authority and Scope; Objectives and Users; Qualitative Characteristics; and Reporting Entity;

- A Consultation Paper on Phase 2, Elements and Recognition in Financial Statements; and

- A Consultation Paper on Phase 3, Measurement of Assets and Liabilities in Financial Statements.

A previous managerial project of this document it was made in order to provide additional information useful for constituents. IPSASB believes that these discussions on ED will provide a solid base on the characteristics of public sector, which may have implications for developing a conceptual framework for public sector entities. However, IPSASB has not yet determined the best place for a final version of this document. It could be a part of the conceptual framework completed or could be located elsewhere in the "Handbook of International Accounting Standards for the Public Sector". In any final form is to be present, a fundamental part of the application and implementation remain professional judgment (Dragan, 2009).

The study is divided into five sections. Subsequent to achieve a general view on IPSASB involvement in regulating the financial statements of public sector, it follow analyze of key elements defined by ED (section 1). The research methodology captures elements of content analysis of responses offered by the 38 respondents (section 2). The results (section 3) give an insight into the possible form of ED's final version and on professionals' perception, directly involved in implementation and the conclusions are the final one.

## **2. Characteristic Key for Public Sector**

This paper identifies and provides a brief overview of some of the main features of the public sector, which is distinguished from the private sector. They have

potential implications on developing a conceptual framework that might reflect the circumstances of public sector and public sector accounting standards.

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 (PSAB, 2011).

The term "public sector" includes national governments, sub-national governments, local government units and regulatory agencies. In the context of this study, the term extends also to international organizations that are in the public sector, such as the United Nations.

There are many areas in which transactions, events and other economic phenomena taking place in the public sector are the same as the private sector. In such cases, the concepts should be applied to determine the appropriate financial reporting will probably be the same. However, the characteristics of public sector identified in this ED may lead to conceptual perspectives that differ from those private sectors. The key characteristics set out the environment within which a public sector entity operates (PSAB, 2011).

We find like the elements of differentiation in this document: the volume and financial significance of non-exchange transactions; the importance of the budget; nature of property, plant and equipment; responsibility for national and local patrimony; the longevity of public sector; the regulatory role of government; ownership or control the rights to natural resources and phenomena, and statistical basis of accounting.

*The volume and financial significance of non-exchange transactions*

One of the main goals of public sector entities is to deliver goods and services and not to generate profit. In non-exchange transactions, an entity receives value from another entity without directly provide approximately equal value in exchange, or gives value to another entity without directly receiving equal value in return.

Public sector entities engaging in commercial transactions more parts that are identical or similar to those in the private sector. These include contracts for the supply of goods and services from private providers, such as construction contracts, pay for employees under labor contract, and borrowing and lending in money markets. Non-exchange transactions involving the supply of goods and services, largely funded by voluntary transfers, mainly tax and transfers from other levels of government.

Economic theory suggests that governments have a role in providing public goods (called also social goods). A characteristic of this type of property is: consumption of goods by one individual does not reduce their availability for others, and individuals cannot be excluded from consuming these goods. One of the best examples is public parks.

*The importance of the budget*

Globally, the approved budget is the main way in which the legislature exercises oversight and citizens and their representatives are informed about financial decisions of government management.

Because of the budget's significance, information that helps users assess actual spending against budget estimates and the resulting budgetary surplus or deficit for the reporting period, compared with that budgeted, is important in determining how well a public sector entity has met its financial objectives. (IPSASB, 2012)

*Nature of property, plant and equipment*

In the private sector, the main reason for holding property, plant, equipment and other assets is to generate cash flows that contribute to the profits of the entity, either directly or in combination with other assets. Some assets will generate cash flows, but in most cases, generating cash inflows will not be the main objective in their possession.

Because of the nature of the services offered, a significant proportion of assets held by public sector entities are specialized, for example, roads and military assets.

*Responsibility for national and local patrimony*

Governments and other public sector entities may have increasing responsibilities national and local patrimony. These responsibilities include: protection and preservation of national art treasures, historic buildings that contribute to the nation's historic and cultural character. Governments generally are also responsible for parks and other conservation areas and indigenous flora and fauna.

*The longevity of public sector*

Governments can make a series of programs with long term horizons where the effects of previous decisions can become clear over many years, even decades, in the future.

The going concern principals are fundamental to financial statements. This means that the reporting entity will continue in the foreseeable future, unless there is intention to liquidate the entity if there is no realistic alternative. Because the financial consequences of many decisions will only become clear years or even decades into the future, prospective financial information covering lengthy time horizons may be necessary for accountability and decision-making purposes (IPSASB, 2012).

*The regulatory role of government*

Many governments have the power to regulate entities operating in certain sectors of the economy, either directly or through agencies specifically designed. Component of such agencies and their functioning are likely to be governed by legislative requirements.

The existence of such regulatory responsibilities will be taken into account in determining the reporting entity and scope of public sector financial reporting.

*Ownership or control the rights to natural resources and phenomena*

Governments often have the rights to natural resources such as mineral reserves, water, fishing grounds and forests, which allow them to grant licenses or obtain royalties and taxes. They also have rights over phenomena such as the electromagnetic spectrum. It may not be clear whether such rights give rise to assets, and, if so, whether such assets meet the criteria for recognition in financial statements (IPSASB, 2012).

*Statistical basis of accounting*

Reporting purposes in accordance with statistical bases of accounting is to provide aggregated information for macroeconomic analysis. Reporting statistical basis accounting is therefore extremely important of public sector.

For statistical reporting purposes, the public sector is divided into the Government (SGG) and public companies. Most of SGG (IFAC, 2012) include all institutional units whose output are intended for individual and collective consumption and are financed mainly by compulsory payments made by units other sectors and all institutional units principally engaged in the redistribution income and national wealth. SGG is usually sub-divided into four sub sectors: central government, state, local and social security funds. IPSASs and statistical bases of reporting financial information have different objectives, focus on different reporting entities and treat certain transactions and events differently.

### **3. Research methodology**

The objectives of this study are: the improvement of knowledge of International Accounting Standards for the Public Sector; the analysis of participants' responses; the identification of recommendations for improving financial respondents; the delimitation of suggestions according to their respondents.

A working document was studied exhibited the 38 respondents from different countries. Then, we have examined the documents submitted by respondents in which opinions were presented, improvements, and comments on the working document.

These responses were grouped according to membership respondents, the paragraphs in the document to which reference was made, and by country of origin of the respondents. There was made an empirical process on the collected data, obtaining an overview on the document "Key features of the potential implications for public sector financial reporting" posted on the IFAC website ( IFAC, 2012b).

The main questions on which the IPSASB will evaluate comments are:

- Do you agree that this document provides useful information on the basics public sector and identifies some potential implications of their financial reporting? If not, please indicate how this document should be amended.
- Do you agree that this document should be included in IPSASB literature? If agree, where would fit this document:
  - As part of the conceptual framework;
  - As a separate chapter of the "Handbook of International Public Sector Accounting";
  - In addition to any other status.

In analyzing these responses we have followed the following steps:

- Documentation on the 38 responses, posted on the IFAC website, with ED (IFAC, 2012b);
- Analysis and interpretation of responses, through a content analysis will build a database of answers given by respondents. By quantifying 1 (Yes) and 0 (No) will determine acceptance or denial of each view (N = 38) under discussion.

We must mention that, if a respondent did not respond to a question, in our analysis we considered that it is accepted, receiving a value. We based on the premise that if he did not agree, say so.

#### 4. Results

The interpretation of answers related to first question has the following structure:

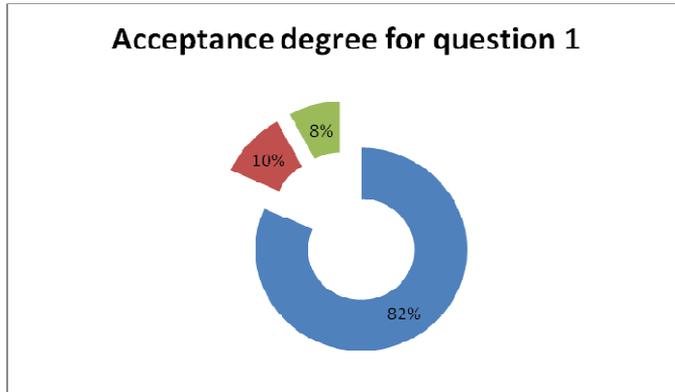


Figure 1. Acceptance degree for question 1.

According to the chart above, 82% of respondents, in number of 31, have agreed that this document provides useful information on key characteristics of public and identify potential implications of these features in financial reporting. Four members, representing 10%, not agreed with this statement, while three members (8%) had an ambiguous response.

The interpretation of answers related to second question has the following structure:

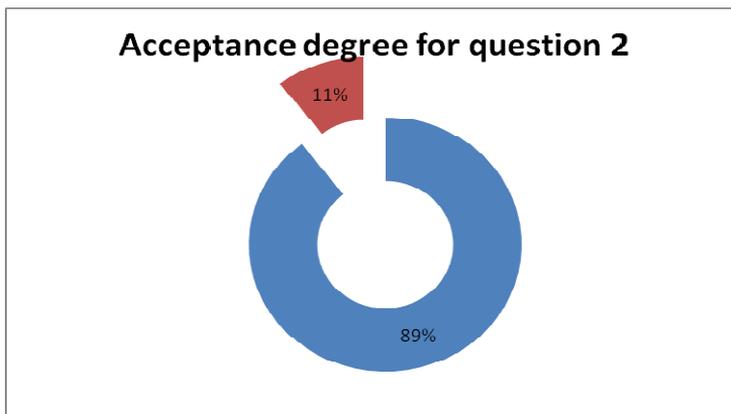


Figure 2. Acceptance degree for question 2

To question 2, relating to the introduction of this document in IPSASB literature, 34 respondents agreed, representing a rate of 89% of the total, while four

members (11%) had a negative answer. Of the 89% who responded yes to second question, 27 respondents (79%) chose as the location conceptual framework, 3 (9%) chose another location, and 4 (12%) did not specify a particular placement.

The situation of the countries answers is as follows:

Country (respondents)	QUESTION 1			QUESTION 2	
	YES	NO	It could be	YES	NO
South Africa	1			1	
SUA	5	1		5	1
Australia	5			4	1
Canada	6	2		7	1
UK	5			5	
France	3			2	1
Denmark	1			1	
Zambia	1			1	
Italy	1			1	
Brazil	1			1	
Kenya	1			1	
Germany			1	1	
New Zealand		1		1	
Holland			1	1	
Belgium	1			1	
Switzerland			1	1	

In addition to expressing an opinion, some countries have come up with detailed suggestions, of which we present selectively on the following:

*Canada - Quebec Ministry of Finance*

Quebec Ministry of Finance considers that the project would be more practical. He commented paragraphs 1.3., 2.3. and 6.6, suggesting that the term 'public sector' and users' needs of public sector financial reporting to be defined more precisely and also prospective financial information is not included in the scope of financial reports. Consider that it should be added to the document that transparency in presenting decisions, events, etc. is resulting from the obligation of public accountability.

*Government of Canada*

The Canadian Government considers that the scope of the project goes beyond financial reporting and this connection is not very clear. Also believes that the project should not be part of the conceptual framework, is a more useful source IPSASB website, or in-out standards and literature.

Provincial Government of Newfoundland and Labrador (Canada) suggests that the document should provide reasonable information to understand the differences between public and private sector and that there is too much subjectivity in

the longevity of the public sector, the regulatory role of government and the law on natural resources (p.6.3, 6.6, 7.2, 8.1).

*France - Conseil de normalization des Comptes Publics (CNOCP)*

Council believes that it should not be included as such in the conceptual framework itself, but should be used to support positions taken in developing the conceptual framework.

*Australia- Australian Council of Auditors-General (ACAG)*

Agrees on the importance of public sector characteristics and their implications, however, alter the shape of the project: the introduction should be detailed on the definition of "public sector" and its characteristics.

*Department of Finance and Deregulation (Australia)*

Contribute to positive answers to both questions. Furthermore, it identifies two levels that could impact financial reporting: National management critical role of government in economic, international understanding, cooperation intergovernmental management.

*Corte dei conti (Italy)*

Government believes that businesses should not be included in the public sector because their existence is due to revenue generation.

*Nyenrode University (Netherlands)*

Consider the following criteria for good governance, public sector: efficiency, effectiveness, economy, accountability, regularity, promptness, integrity, reliability and financial sustainability, quality of governance, good cooperation organizations, transparency.

*Institut der Wirtschaftspruefer in Deutschland (Germany),*

They identify an issue that separates the document public private sector (p.1.3) and should establish some criteria for the differentiation of these two sectors.

## **5. Conclusion**

In conclusion, working document (ED) highlights some features of public sector, which may have implications for developing a conceptual framework for public sector and, therefore, to establish public sector accounting standards. However, the IPSASB consider comments on all issues discussed in the ED. IPSASs and statistical bases of reporting financial information have different objectives, focus on different reporting entities and treat certain transactions and events differently. However, they also have many similarities in treatment, dealing with transactions and similar events and, in some cases, have a similar type of structure the report. Considering the allegations of respondents, that 80-90% of them agreed with the main features of the potential implications on public sector financial reporting. Thus, it appears that IPSASB objectives were met. The remaining respondents did not agree with the features, bringing some suggestions to improve this document. Based on these results, the project will be implemented.

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