Swiss Comments to

ED Key Characteristics of the Public Sector with Potential Implications for Financial Reporting

Table of Content Page

1. Introduction

The Swiss Public Sector Financial Reporting Advisory Committee (SRS-CSPCP) has discussed ED *Key Characteristics of the Public Sector with Potential Implications for Financial Reporting* and comments as follows. The SRS-CSPSP was established in 2008 by the Swiss Federal Ministry of Finance together with the Ministers of Finance at the cantonal level. One of its aims is to provide the IPSAS Board with a consolidated statement for all the three Swiss levels of government (municipalities, cantons and Confederation).

2. Comments to Exposure Draft

2.1. Specific Matter for Comment 1

SRS-CSPCP strongly agrees that there is a need to identify where the public sector presents characteristics that are different from those of the private sector and that necessitate a different financial reporting than that used in the private sector.

For persons, who do not have wide knowledge of the public sector, this introduction is certainly helpful.

The focal matters listed in the draft are all characteristic for the public sector. How far the list/description should go is a question of the level of detail. However, the following topics seem to have been given too little attention. All of them can have a significant impact on financial reporting in the public sector.

As this consultation is likely to be key for the further development of the IPSAS, the SRS-CSPCP has attempted to make detailed comments.

In general it is to be commented that the paper could be better organised. In the present version the individual elements follow one another without evidence of an underlying logic. The beginning should – as is already the case – be the **Introduction** with the statement that the chief objective in the public sector is not the generation of profits (by maximising income or minimising costs) (Headings 1 and 2). The next section would deal with the **purpose of the state**. One possibility would be to select a wide and familiar classification of state purposes. A traditional classification is for example that of Musgrave & Musgrave (1989)[1]. The authors distinguish three types of purposes: correction of the allocation of resources, re-distribution of income and wealth, and stabilisation of the economy (macro-economic). These purposes appear in the Key Characteristics, but without any logic, and are widely scattered. Elements for the redistribution of income and wealth can be found already under Heading 1.4. Other elements concerning the allocation of resources are found under Headings 2.8 and 2.9 and 5. After the functions the state's various **intervention possibilities** should be discussed, which are controlled for the most part through the budget[2]: (a) by the expenditures and revenues (including taxes, which are treated under Headings 2.4 to 2.7); (b) by ownership (Heading 8); (c) by regulation (Heading 7). Then should follow the **control of public action** with (a) the going concern principle; (b) the importance of the budget-process (Heading 3) and (c) the importance of statistics (Heading 9).

It should be made clear in every item how it impacts financial reporting.

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1 MUSGRAVE R.A., MUSGRAVE P.B. (1989), *Public Finance in Theory and Practice*, McGraw-Hill, New York, 5th ed.

2 It is important to emphasise that expenditures and revenues (including capital expenditures and revenues) serve as instruments for implementing public policies. The same applies for elements in the balance sheet (administrative assets and debt).

This is reflected in the following comments on the individual headings. On the left the additions suggested by the SRS-CSPCP are listed. On the right is quoted the corresponding Heading in the ED. In addition a reference is given to the above comments on the general structure of the paper.

<table>
<tr><th>Additions</th><th>Heading / Comment</th></tr>
<tr><td>The diversity in the public sector
The expression Public Sector covers a great diversity that is not brought out in the ED:
• Different sizes of the governments from a few dozen inhabitants up to several ten or hundreds of thousands;
• Different economic and social development;
• Different financial and asset position (financial significance);
• Different types of units (governments, other entities);
• Different financing sources (taxes, fees, sales, transfers, financial income);
• Different co-determination possibilities of the citizens (e.g. direct democracy).</td><td>Heading 1 (Introduction)</td></tr>
<tr><td>Tasks of the public sector
In many cases the public sector is entrusted with tasks imposed by the legislative. For such tasks frequently no private providers can be found or they are not willing or in a position to provide the services demanded for the public in an adequate manner and at sensible prices. Typically these services may include (not exhaustive, see also COFOG):
• Welfare (old age care, health, poverty)
• Transport (rail and road infrastructure)
• Education, research (educational level, research location)
• Internal and external security
• Foreign relations</td><td>Separate headings or Heading 1; relevant for segment reporting</td></tr>
<tr><td>Non-commercial transactions
Non-commercial transactions are a peculiarity of the public sector. This should be reflected in the reporting in a suitable form. The criteria for distinguishing between commercial and non-commercial transactions should be laid down in an IPSAS. What interests the reader is the measurement of the efficiency and effectiveness of the services provided, that is the cost and the quality of the goods and services provided by the polity.
Because there is frequently no market, earnings and market values are seldom the correct valuation methods. Therefore as a rule historic cost valuation is applied.</td><td>Heading 2.1</td></tr>
</table>

Additions	Heading / Comment
Performance measurement In the public sector the comparison between governments is very important, because usually on the basis of the costs (or the expense) it represents the only possibility of measuring performance approximately. As there is no competitive market, the result does not reflect the performance. The result shows only whether in the short term the revenues (mainly taxes) are sufficient to cover expenditure. It contains no information about the quality of the performance (benefit in the sense of utility) provided by the government. In the private sector the financial reporting is therefore sufficient to assess the entity’s financial performance, which is given by the ratio of costs and benefits, and to compare it with others. But not in the public sector. Because the reporting cannot show the benefits, it should as a minimum include the information that permits the measurement and comparison of the costs (or expense).	Heading 2.4
Goods The difference between (pure) public goods, goods for the provision of public services and market goods should be explained more prominently, because it is a key characteristic between the public and the private sector. The differentiation should therefore emphasise the non-market situation rather than the market situation. The reference to exchange and non-exchange transactions is also not helpful in every case.	Heading 2.8 Heading 2.9 Heading 4 Possibly own headings (to be added)
The role of the budget The title of Heading 3 should be changed: “role” instead of “importance”. Publicity In contrast to the private sector, in the public sector the budget is public. It also serves the lawful implementation of financial management, namely through the credit law (basis for raising taxes, expenditure authority, commitment credits, payment appropriations) and the exercise of democratic rights (for example financial referendum). Financial control In the public sector the income statement plays a special role, because a government must cover its expenditures (mainly wages and subventions) by its revenues (mainly taxes), this also under the pressure of tax competition or measures to support the economy. The income statement also serves budget comparison purposes and in this connection the reader of financial reports accords it special attention. On the other hand the balance sheet does not have the same importance as in the private sector, where the total assets and the amount of equity permit calculation of profit ratios (return on equity). In the public sector the equity plays a secondary role, because the risk of insolvency is low and there are no shareholders.	Heading 3

Additions	**Heading / Comment**
The importance of the budget (continued) Nevertheless, the significance of the balance sheet must not be underestimated. After all, the budget impacts the level of debt. Budget constraints Governments are by law confronted ever more with fiscal or budget constraints. It must be possible with the financial reporting to demonstrate observance of these constraints at the time of budgeting, when closing the accounts and also in the context of the medium- and long-term financial planning.	Heading 3
Going concern principle and division of the assets From the financial reporting aspect the going concern principle requires the distinction between Administrative Assets and Non-Administrative Assets. Administrative Assets are defined as all assets that are earmarked for the fulfilment of public-sector duties. Administrative Assets are thus characterized by a permanent dedication to a purpose established by the public sector. Administrative Assets are all those assets that relate to the provision of public services and that have a useful life extending over several fiscal years. In contrast, assets can be considered realizable (Non Administrative Assets) if they can be liquidated without violating specific legal (public-law) obligations.	Heading 6
Going concern principle and balance sheet amounts Because many government transactions are not for profit, the carrying amounts of assets are not defined by their capacity to generate cash or their market value. It does not make sense to value an asset on an earnings basis, when its purpose is not to earn a yield but to provide goods and services at as low a cost as possible. The same applies to the market valuation of an asset, which in no event is to be sold. Therefore a true and fair presentation depends on their purpose. For example the grant of a concessionary loan by a government that has transferred some of its obligations to another entity has only the objective of financing the outsourced services. The government has no reason and does not intend to sell the loan to a third party. For this reason a valuation approach should be selected, which discloses the total costs of the government (recording of a non-monetary service in the amount of the non-invoiced interest) in accordance with IPSAS 23 instead of an earnings based valuation (for the carrying amount of the concessionary loan). The reader of the balance sheet is not interested in the amount, at which a loan, which is never going to be sold, can be sold. He is more interested in the costs for the government and of the services financed by the loan.	Heading 6

Additions	Heading / Comment
Intergenerational aspects The financial reporting should also permit a statement as to whether or not expenditures are fairly allocated to the generations. This requires that they (a) provide information about the temporal allocation of the financing of administrative assets; (b) permit the analysis and calculation of a possible structural (business cycle adjusted) surplus or deficit. They should thus show whether the equivalence principle[3] is being observed. This also applies for goods and services in the public sector that are geared more to the private sector, and are financed by charges. In this way it also becomes clear that the financial performance statement is more important than the financial position statement.	Heading 5.2
Control of cooperation with other governments A peculiarity of the public sector is also the many relationships between governments, whether horizontally or vertically. This, in particular in connection with transfers (for example fiscal equalisation) or the allocation of tasks between regional jurisdictions (for example in questions of asylum). The financial reporting should therefore enable control of these relationships.	New heading in conjunction with the intervention possibilities
Equity of controlled entities The financial means provided by governments to an entity that performs an outsourced state function without seeking to make a profit are not as a rule equivalent to risk capital. Frequently they are only funds to finance a service through another entity. For this reason, in these cases, the information in the financial reporting should reflect only the financing costs.	New heading in conjunction with the intervention possibilities
Scope of consolidation – control principle In determining the scope of consolidation at present no differences are made between the public and the private sectors. A government can control significant public corporations (GBEs), which operate in areas, which differ substantially from the tasks of government. Examples are bank groups with commercial operations, telecom suppliers, logistics groups. In many cases the inclusion of these corporations in the consolidated accounts makes a statement that is useless for control of the budget. The Swiss Governments (e.g. the Swiss Confederation) frequently refrain voluntarily from control over such investments to avoid intervening in the private sector.	New heading in conjunction with the intervention possibilities

[3] Olson Mancur (1969), The Principle of "Fiscal Equivalence": The Division of Responsibilities among Different Levels of Government, American Economic Review, 59(2), pp. 479-87

Additions	Heading / Comment
Scope of consolidation – control principle (continued) The present consolidation standards (IPSAS 6-8) derive from the convergence programme. Scarcely any exceptions were made to IAS 27, IAS 28 and IAS 32. After the new consolidation standards have been put into force by the IASB (they are now being revised), the IPSASB should consider removing these standards from the convergence programme and developing its own consolidation standards or using them as a basis, but making more extensive variations from the new IFRS. In contrast to the private sector, in the public sector consolidated accounts do not have the same importance.	New heading in conjunction with the intervention possibilities

2.2. Specific Matter for Comment 2

The *Key Characteristics* should be part of the *Conceptual Framework*. Otherwise they lose importance. With their integration into the *Conceptual Framework* the variations from IAS/IFRS because of peculiarities in the public sector would rest on a stronger foundation, which would be looked at positively.

The individual parts of the *Conceptual Framework* should be supplemented with an introduction that seemingly remains to be written. The introduction should explain the aim and purpose of the *Framework* and its general structure. After this introduction the *Key Characteristics* would emphasise, as a first chapter, the peculiarities of the public sector and the differences compared with the private sector. Only then should follow the actual four phases of the *Conceptual Framework*.

Lausanne, September 27, 2011