

## NARRATIVE REPORTING



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## Agenda Item

# 9

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**Date:** May 31, 2011  
**Memo to:** Members of the IPSASB  
**From:** Joy Keenan  
**Subject:** Narrative Reporting – Discuss Issues

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### Objectives

- To **agree** on the structure and content of the Issues Paper to address the IPSASB's comments and directions; and
- To **agree** on next steps.

### Agenda Material

#### 9.1 Issues Paper

### Background

1. At its March 2011 meeting, the IPSASB considered a first draft of an issues paper (IP). The IP followed the scope set out in the March 2008 Project Brief, which limited the scope of the project to narrative reports that were essentially the same as “management discussion and analysis” or “management commentary” reports in the private sector. That is, the report would focus on information contained in the financial statements.
2. Since the project brief was approved, the IPSASB has been working on a Conceptual Framework that broadens the scope of financial reporting to general purpose financial reports (GPFRs). In particular, the IPSASB is currently developing proposals on “presentation and disclosure” which could have a direct bearing on this project.
3. In addition, in some jurisdictions, the term “narrative report” is used to describe and define the content of reports that may be broader than those noted above, and also include such matters as service performance, long-term fiscal sustainability. The IPSASB therefore considered whether a broader scope was appropriate, particularly given that the IPSASB currently has specific projects under way on these broader topics. It was noted that this project needs to consider developments in these three IPSASB projects. However, the TBG considers that this project may proceed independently on certain issues, given that the type of reporting is related directly to the general purpose financial statements (GPFSs).

4. The IPSASB provided staff and the TBG with a number of comments for further development of the issues paper (see the draft March 2011 Minutes excerpt included as Appendix A to this agenda paper). Staff has attempted to incorporate those comments in the revised Issues Paper (agenda paper 9.1).
5. In addition, to the extent possible, detailed references to Conceptual Framework ED 1 have been included as Appendices to the Issues Paper rather than as quotes within the paper itself.
6. The TBG held a conference call meeting on May 4, 2011 to discuss a revised draft which reflected changes to address the IPSASB's direction. The TBG considered in depth two main issues on which the IPSASB's views are sought:
  - (a) The name of such reports; and
  - (b) The authoritative status of the report.
7. The TBG subsequently provided staff with comments on further revisions to incorporate the TBG's comments.
8. Although the TBG has reviewed and discussed the Issues Paper, it has not reached a consensus on all issues. The TBG's views are presented as appropriate.
9. The IPSASB is asked to consider whether the revised paper addresses the IPSASB's comments appropriately, and what further changes are necessary to the paper.
10. In addition, staff is seeking the IPSASB's comments on the following issues which would require drafting of additional information in developing a draft consultation paper.

### Issue for the IPSASB's Specific Consideration

## OBJECTIVES OF FINANCIAL STATEMENT DISCUSSION AND ANALYSIS

### Forward-looking information

11. The concept of forward-looking information is introduced in paragraphs 39–56 of the Issues Paper.
12. Some standards (e.g., IASB, FASAB) require a forward-looking focus. In others, such as GASB and PSAB, the intent is to provide information about the current financial statements that are expected to have a significant effect on financial position or results of operations to allow users to make assessments about future operations and future service potential of the entity.
13. The December 2010 IFRS Practice Statement, *Management Commentary: A Framework for Presentation*, contains the following guidance on forward-looking information:

**forward-looking information** Information about the future. It includes information about the future (for example, information about prospects and plans) that may later be presented as historical information (ie results). It is subjective and its preparation requires the exercise of professional judgement.

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- 17 Management commentary should communicate management's perspective of the entity's direction. Such information does not predict the future, but instead sets out management's objectives for the entity and its strategies for achieving those objectives. The extent to which management commentary looks forward will be influenced by the regulatory and legal environment within which the entity operates.
- 18 Management should include forward-looking information when it is aware of trends, uncertainties or other factors that could affect the entity's liquidity, capital resources, revenues and the results of its operations. Such information should focus on the extent to which the entity's financial position, liquidity and performance may change in the future and why, and include management's assessment of the entity's prospects in the light of current period results. Management should provide forward-looking information through narrative explanations or through quantified data, which may—but are not required to—include projections or forecasts. Management should disclose the assumptions used in providing forward-looking information.
- 19 Management should explain how and why the performance of the entity is short of, meets or exceeds forward-looking disclosures made in the prior period management commentary. For example, if management stated targets for future performance in previous reporting periods, it should report the entity's actual performance in the current reporting period and analyse and explain significant variances from its previously stated targets as well as the implications of those variances for management's expectations for the entity's future performance.

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BC27 The content of management commentary is not necessarily bound to the reporting period described by the financial statements to which it relates. Some information within management commentary looks to the future. The Board concluded that the inclusion of forward-looking information within management commentary helps users of the financial reports assess whether past performance is indicative of future performance and whether the progress of the entity is in line with management's stated objectives.

BC38 Many respondents to the exposure draft were concerned about the focus on forward-looking information. However, the Board decided that forward-looking information is important. Explanations of management's perspective of the entity's direction, targets and prospects, in addition to explanations of past events, can help users of the financial reports to develop expectations about the entity from its past performance and current state. Furthermore, the Board observed that the Practice Statement allows flexibility for management in determining to what extent management commentary includes forward-looking information. In particular, the Board observed that the Practice Statement clearly indicates that the extent of forward-looking information will be influenced by the regulatory and legal environment within which the entity operates. Moreover, although disclosure of forward-looking information is encouraged in many jurisdictions, this does not necessarily mean providing forecasts or projections. The Board notes that in some jurisdictions there are safe harbour provisions to restrict liability claims or regulatory provisions, or both, for forward looking information. However, those safe harbour provisions require cautionary statements to be included with the forward-looking information.

BC39 The Board considered the view that forward-looking information might present an over-optimistic picture of the entity. However, the Board observes that forward-looking information must possess the qualitative characteristics, including faithful representation, and thus must be neutral. Furthermore, management must disclose its assumptions used in providing the forward-looking information, thus enabling users to evaluate the reasonableness of the assumptions.

BC40 An example of what the Board envisages as forward-looking information that does not include forecasts or projections is again the commentary that could be provided for a defined benefit pension plan that has a deficit (described in paragraph BC34). In that example, management could provide forward-looking information by explaining management's objectives and strategies for remedying the plan deficit. These strategies might include a planned future increase in contributions, changes in investment strategy or changes to the plan. Management could also provide an explanation of how general market trends or other risks might affect the deficit and the strategies of management for remedying the deficit. This disclosure could include some quantitative information, but it is not necessarily a forecast or a projection.

BC41 In developing the exposure draft, the Board considered the view that detailed application guidance or illustrative examples are necessary to put into operation the guidance around forward-looking information included in the Practice Statement. However, the Board decided not to include such detailed guidance because there is a risk that undue emphasis could be placed on the application guidance or illustrative examples. Furthermore, the Board observed that such guidance or examples could be misinterpreted and thus reduce the flexibility in applying the framework. Many respondents to the exposure draft supported the Board's decision not to include detailed application guidance or illustrative examples.

14. Staff considers that a similar approach could be taken in this project. Forward-looking information is consistent with the preparation of the budget. However, the inclusion of such information could be non-mandatory guidance, regardless of what authoritative status this project results in (i.e., projections or forecasts would not be required). In addition, there are proposed requirements in the Issues Paper regarding faithful representation (balance, disclosure of assumptions) that would help ensure unbiased reporting of forward-looking information.

**Staff Recommendation:**

15. Staff proposes that this project should develop non-mandatory guidance on forward-looking information.

**Question for the IPSASB:**

- Do you agree that the project should develop non-mandatory guidance on forward-looking information?

**ILLUSTRATIVE EXAMPLES**

16. The Issues Paper does not include detailed disclosure requirements regarding specific discussion and analyses required for the various financial statement items.
17. Paragraph 1 of agenda paper 9.1 states, "The form and content of such reports varies across jurisdictions and among public sector entities to meet the legal and economic circumstances of each jurisdiction and the specific circumstances of each entity."

18. Some of the legislative requirements, the PSASB SORP<sup>1</sup>, and the proposed Israel Guidance contain examples the types of information to be provided in financial statement discussion and analysis about financial statement items (e.g., assets, liabilities, revenues, expenses, contingencies). IPSAS 24, *Presentation of Budget Information in Financial Statements*, contains illustrative examples to show how budget information could be presented. Appendix B to this agenda paper contains an excerpt from the PSAB SORP on the type of guidance that could be developed.
19. However, as noted in paragraph BC41 of the IASB Practice Statement preceding paragraph 14 above, there is a risk that by including detailed guidance on content of the disclosures, undue emphasis could be placed on the application guidance or illustrative examples.
20. Staff considers that this additional non-authoritative guidance is helpful particularly in jurisdictions that have not previously prepared financial statement discussion and analysis. It also helps promote comparability both within the entity (year-over-year reports) and among entities.

**Staff Recommendation:**

21. Staff proposes that non-mandatory guidance should be provided on the content of discussion and analyses about specific financial statement items, similar in the level of detail to that in the PSASB SORP-1 (see Appendix B).

**Question for the IPSASB:**

- Do you agree that non-mandatory guidance about specific financial statement items should be developed?

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<sup>1</sup> The CICA's Public Sector Accounting Board's Statement of Recommended Practice, SORP-1, *Financial Statement Discussion and Analysis*.

## Appendix A: Excerpt from Draft March 2011 IPSASB Meeting Minutes

### 6. NARRATIVE REPORTING

#### Discuss issues (Agenda Item 7)

It was noted that the project brief for this project had been approved three years previously and the scope of the project identified at that time was related to the financial statements only. Members noted that the scope of this project needs to be clear as does the scope of GPFRs – i.e., is this type of report a GPFR, or is it considered part of the GPFS if it relates to the financial statements only? A Member questioned whether this project should be a convergence project based on the IASB's IFRS Practice Statement, *Management Commentary*.

Another Member noted that in some jurisdictions, the term “narrative report” or “management discussion and analysis” includes matters beyond the financial statements, such as performance reporting and long-term fiscal sustainability reporting, which may overlap with other IPSASB projects. The scope as defined in the project brief may be too narrow to address them.

A Member pointed out that the intent of this project was to address reports that explain the information in the financial statements, through a management lens. There are linkages between this project and the presentation phase (Phase 4) of the Conceptual Framework and service performance reporting; however, there are advantages to focusing on the GPFS, notably that it fulfills a need for better analysis of financial statement information. A concern was expressed as to whether the project should wait to proceed until Phase 4 of the Conceptual Framework was completed. Another Member indicated the project needs to work in tandem with Phase 4, bearing in mind the noted interdependencies.

In discussing whether the title of the project/term used to describe this type of report, Members did not agree that it was necessary to decide at this time. The appropriate term will be reconsidered at the June 2011 IPSASB meeting.

Other Members supported the scope identified in the project brief.

Members had the following comments on the Issues Paper presented:

- Under “Objectives”, the implied prospective focus may not be appropriate in light of the budget. On the other hand, the IASB Practice Statement does include such an element. It was suggested that “risk” be considered rather than “challenges”.
- The comparison of actual results to budget is important for accountability purposes.
- Service recipients should be outlined further, with examples provided.
- Under “Qualitative characteristics”, it was suggested that additional text about intended actions should be considered. However, it was also noted that the information provided in narrative reports should be fact based.
- Under “Main attributes”, a Member noted that “management insights” needed to be unbiased, i.e., they should not be politically motivated.
- It was also noted that it was important that information provided be verifiable and that assumptions related to forward-looking information should be supportable.
- Under “Essential content elements”, it was noted that the paper should clarify that the purpose of narrative reporting should not simply repeat what is in the financial statements, but explain them.
- The discussion of “risks” should be more balanced; it should refer also to “opportunities”.

- With respect to strategy, there should not be a time frame specified (i.e., delete reference to “long term”).
- In addition, it was questioned whether “strategy” was too private sector focused. The term “policy” was suggested.
- With respect to strategy, it was questioned whether the items identified are those that could be or should be included.
- There should be a caution to not bring in general commentary on the economy that doesn’t relate specifically to the financial statements. It was also noted that information that would be in the budget cannot be commented on in advance.

A question was raised as to whether the narrative report would be subject to audit. A Member noted that, at present, audit standards in some jurisdictions would require the auditor to review the information provided to ensure there is nothing incorrectly stated or misleading in the narrative report in relation to the financial statements. A Member responded that users may not be aware of this subtlety, and may consider narrative reports to be part of the audited financial statements.

In another Member’s jurisdiction, it was noted that narrative reports are additional to, but not part of the financial statements and are also subject to audit alongside the financial statements. There was pressure from users to expand narrative reports, which increased the importance of audits. Auditors were required to do analyses of trends and impacts.

It was also questioned whether this project could result in a standard, given that it is GPFS related (similar to IPSAS 22 for statistical information). It was noted that if it was desired that the information would not be subject to audit it would need to be outside the IPSASs. This issue needs to be explored further. A Member pointed out, however, that “narrative reporting on financial statements” did not mean that it was part of the audited financial statements.

The Executive Director, Professional Standards informed the IPSASB that the audit standard referred to was currently under review; there may be a requirement that MD&A would be subject to audit in the future. A Member noted that the IPSASB needs to follow this development to assess whether there are any tripwires for the work currently under way on GPFRs and GPFSs. There is a perception that auditors need to do more for MD&A.

It was questioned whether there is standardized language used in such reports. A Member noted that the reports are generally heterogeneous. It is important, therefore, to be very precise about the scope of the project in relation to the GPFS and GPFRs, and the terminology. It was also questioned whether the IPSASB would be looking at “integrated reporting”. It was noted that during the development of this project, we should follow the IASB’s integrated reporting initiative, as well as the IPSASB’s service performance reporting and Phase 4 projects.

It was questioned whether this should be mandatory guidance, and what our constituency expects. A Member responded that in his jurisdiction, user research indicated that narrative reports are the most important feature of financial reporting. However, the information provided must be limited to currently-known facts; there should be no “political spin”.

A Member noted that the project should consider who is responsible for providing the information. In some jurisdictions, it may be the Executive branch of government that is responsible.

The IPSASB will continue its deliberations of the issues in this project at the June 2011 meeting.

**Appendix B: Excerpt<sup>2</sup> from PSAB Statement of Recommended Practice SORP-1, Financial Statement Discussion and Analysis**

Financial assets

- 57 An analysis of financial assets provides users with relevant information regarding the amount of resources available to the government that can be converted to cash if necessary. Thus, it provides users with information regarding the amount of funds readily available to meet the government's liabilities and commitments, and to finance future operations.
- 58 In order to demonstrate and further the understanding of the nature and magnitude of resources available to the government, the analysis of financial assets may include, for example:
- (a) an overview of financial assets by major classification;
  - (b) an analysis of change in financial assets to illustrate volatility in the sources of funds, which would assist users with their assessment of future implications;
  - (c) an analysis of provisions for loan losses to demonstrate and assess collectability of funds;
  - (d) an analysis of the rates of return on investment and portfolio composition;
  - (e) an analysis of the government's investment in government business enterprises as a percentage of the total financial assets;
  - (f) an analysis of taxes receivable to total tax revenues; and
  - (g) an analysis of restricted and designated assets set aside for specific purposes.

Liabilities (including debt)

- 59 An analysis of liabilities provides users with relevant information to enhance their understanding and assessment of the demands on financial resources. Information related to liabilities may also assist users in assessing the government's debt management decisions and identifying the government's exposure to such things as interest rate risk and currency rate risk.
- 60 Governments often finance their activities through the use of debt or by incurring other long-term liabilities. Therefore, users must understand the implications of long-term liabilities, and the government's exposures to them, to properly assess its current and future financial position and changes in financial position. The cost associated with holding debt or incurring other long-term liabilities must be clearly expressed.

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<sup>2</sup> Additional guidance is provided on other financial statement items and disclosures.

- 61 In order to illustrate the government's use of debt and other long-term liabilities, the analysis may include, for example, the following:
- (a) A breakdown of the government's debt by domestic issues versus foreign issues.
  - (b) A high-level description of the government's debt management policies and strategies, and the general terms and conditions associated with the debt.
  - (c) An analysis of the government's total debt to assess trends in the government's level of debt. Specific ratios or indicators may also be useful to highlight the magnitude of government debt and the changes in it over time. For example, an analysis of the total debt outstanding at year end to the total liabilities of the government may be provided. The impact of the debt servicing cost, expressed as public debt charges to revenues, may also be included.
  - (d) An assessment of any unfunded retirement and other employment or post employment benefit liabilities. This may include a discussion related to the timing of when the unfunded liability needs to be provided for.
  - (e) An analysis of deferred revenues and the terms and conditions associated with the amounts and the commitments associated with them. The government is not entitled to these revenues until it performs specific actions as outlined in the terms and conditions of the related contract or agreement.
  - (f) An analysis of any sinking funds available for the discharge of long-term liabilities.

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## NARRATIVE REPORTING – ISSUES PAPER

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## Introduction

### Background

1. This project was initiated to provide a framework for the form and content of public sector narrative reports. At present, there is no internationally generally accepted form or content for public sector narrative reports<sup>1</sup>. The form and content of such reports varies across jurisdictions and among public sector entities to meet the legal and economic circumstances of each jurisdiction and the specific circumstances of each entity. For example, in some jurisdictions, the requirement to provide such reports is in legislation or regulation, while in others such reports are prepared on a voluntary basis. In some jurisdictions, there is a standard for narrative reporting issued by a standard-setting body specifically for public sector entities, while in other jurisdictions, public sector entities follow private sector standards, or the form and content of such reports may be left to management's discretion.

### March 2008 Approved Project Brief

2. The Project Brief identified the scope of the project as follows:

The scope of the project is to determine how a narrative explanation by management in the public sector should be used to enhance the usefulness of financial information within general purpose financial statements (GPFSs) and how it should be included within general purpose financial reports (GPRs).

The guidance developed would apply to all public sector entities other than Government Business Enterprises.

3. Conceptual Framework ED 1, *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: Role, Authority and Scope; Objectives and Users; Qualitative Characteristics; and Reporting Entity*, applies to GPRs<sup>2</sup>. The scope of “narrative reporting” as anticipated in the Project Brief was limited to the GPFS. At its March 2011 meeting, the IPSASB tentatively reconfirmed this scope for the project.
4. The Project Brief identified the following main issues to be considered:
  - What are the objectives of narrative reporting?
  - What are the main attributes of high quality narrative explanations?
  - Are there essential content elements to include in narrative reporting?
  - What type of guidance is appropriate?
5. This paper explores the issues identified in the Project Brief, as well as others that arise from the IPSASB's Conceptual Framework project. The project will also consider relevant issues that arise in the IPSASB projects dealing with long-term fiscal sustainability and service performance reporting. However, it is recognized that, because this project is

<sup>1</sup> The March 2008 project brief refers to “narrative reports”. This project will consider whether that is an appropriate term for the type of reports being addressed.

<sup>2</sup> Paragraph 1.6 of Conceptual Framework ED 1 notes that “GPRs of public sector entities include, but are more comprehensive than, financial statements including their notes.”

intended to relate solely to the financial statements, the issues in those broader projects relating to GPFRs may not necessarily apply to this project.

6. Although the approved Project Brief indicated this is not a convergence project, the IFRS Practice Statement, *Management Commentary: A Framework for Presentation*, issued in December 2010, will also be considered to the extent that it contains guidance that is relevant to the public sector, as it is the only currently available international standard dealing with this issue.

## Scope

### Name of Report

### Background

7. The Project Brief uses the term, “narrative reporting”. The covering memo accompanying the Project Brief indicated that, “At this stage, staff proposes to use the term “narrative reporting” for operational purposes, with a view to determining the most appropriate title once the project has progressed.”
8. Staff research on legislation and regulation governing such reports in the public sector and the development of other guidance and proposed pronouncements since the time the Project Brief was prepared have tended to use the term “narrative reporting” in a broader sense. For example, certain jurisdictions include service performance reporting and comparisons with budget within the scope or understanding of narrative reporting (e.g., FASAB, South African Treasury and Municipal Finance Act, New Zealand Public Finance Act 1989 and Local Government Act 2002 Schedule 10 Part 3). These are the subject of existing IPSASs or projects under way. There may also be requirements to report on compliance (e.g., New Zealand Local Government Act 2002 Schedule 10 Part 3).
9. In addition, the December 2010 Exposure Draft, *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: Role, Authority and Scope; Objectives and Users; Qualitative Characteristics; and Reporting Entity* (Conceptual Framework ED 1), notes under the caption of “Narrative Reports”:

2.25 In some cases, quantitative measures of the outputs and outcomes of the entity’s service delivery activities during the period and anticipated activities in future periods will provide relevant information about the achievement of these service delivery objectives—for example, information about the cost, volume, and frequency of service delivery, and the relationship of services provided to the resource base of the entity. In other cases, the achievement of service delivery objectives may need to be communicated by an explanation of the quality of particular services provided or the outcome of certain programs.

This reference to the communication of an explanation of service delivery quality could imply that such an explanation would be part of the narrative report. However, the

approved project brief excludes service performance reporting from the scope of this project.

10. The December 2010 IFRS Practice Statement defines management commentary as follows:

IN3. Management commentary is a narrative report that provides a context within which to interpret the financial position, financial performance and cash flows of an entity. It also provides management with an opportunity to explain its objectives and its strategies for achieving those objectives. Users routinely use the type of information provided in management commentary to help them evaluate an entity's prospects and its general risks, as well as the success of management's strategies for achieving its stated objectives. ...

This definition also implies there are other types of narrative reports than those specifically related to the financial statements, and clearly distinguishes management commentary on the financial statements from other types of narrative reports.

11. The IPSASB tentatively agreed at its March 2011 meeting<sup>3</sup>, that the scope of narrative reporting addressed in this project should not include or subsume service performance reporting, or other types of reports that may form part of GPFRs, but that it should deal strictly with the analysis and discussion of the information contained in the GPFSSs. It was also noted that an appropriately descriptive term needed to be developed for the type of report addressed in this project.

#### Alternative Terms Considered

12. The TBG is of the view that the term should be addressed now, in the early stage of the project development, to ensure there is a clear understanding of the scope of the project as development progresses. The TBG has considered the terms, "narrative reports" and "management commentary". The TBG has also considered the US standards issued by the GASB and FASB, which use the term "management discussion and analysis".
13. The TBG notes the confusion which would likely result from using the term "narrative reporting" because of its broad connotation. While the TBG considers that the private sector terms "management discussion and analysis" and "management commentary" are well understood, the level of management responsible for preparation of such reports may vary in the public sector. In addition, these terms do not specifically refer to the link with the GPFSSs.
14. The Israel Government Accounting Standards Board has issued draft guidance, *Narrative Information Attached to the Financial Statements of a Public Sector Entity*, which "... defines the preparation and presentation requirements of narrative information attached to financial statements of a public sector entity (here and after – "a management report"), which shall be attached to the annual financial statements of a public sector entity (here and

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<sup>3</sup> An excerpt from the draft March 2011 IPSASB meeting Minutes are included as an Appendix to Agenda Paper 9.0.

after – "the entity") and be prepared by the entity's management." It clearly links the term "narrative information" to the GPFS.

15. In Canada, the CICA's Public Sector Accounting Board (PSAB) has issued Statement on Recommended Practice (SORP) 4, *Financial Statement Discussion and Analysis* to address the same type of report this project will apply to.

#### Staff Recommendation

16. The term "financial statement discussion and analysis" (FSDA) should be used. This term is considered the most descriptive term to:
  - (a) Limit the scope to GPFSs rather than broader types of reports which may be referred to as narrative reports in some jurisdictions; and
  - (b) Clearly describe the type of information (discussion and analysis) that would be included in the report.
17. This term will be used for the remainder of this paper.

#### Question for the IPSASB:

- Do you agree that the term "financial statement discussion and analysis" is the most appropriate term to describe the type of report addressed in this project?

#### Proposed Working Definition

##### Common Elements

18. In developing a working definition of financial statement discussion and analysis, the common elements of such reports, identified in existing pronouncements (including standards, legislation and regulation), were considered.
19. From the research conducted, the common elements of financial statement discussion and analysis included:
  - (a) Complements and supplements the GPFS;
  - (b) Provides management insights;
  - (c) Based on currently-known facts;
  - (d) Objective, unbiased and balanced;
  - (e) Consistent with GPFS, but not repetitive.
20. Canada's Public Sector Accounting Standards Board (PSAB) contains an additional element to those noted above: the report is considered a government responsibility:

##### **GOVERNMENT RESPONSIBILITY**

- 14 **Financial statement discussion and analysis should include a statement acknowledging the government's responsibility for its preparation.**
- 15 Responsibility for the preparation of the FSD&A rests with the government, and this should be clearly communicated to the users. To promote transparency and accountability, the FSD&A would include an acknowledgment of the government's responsibility for its preparation, to ensure that users are aware of who is responsible and that the government has approved the document.

21. PSAB's Handbook Section, PS 1000, *Financial Statement Concepts*, defines "government" as:

"Government" refers to the elected and appointed policy-makers and administrators who together perform the executive function and are the preparers of financial statements."

22. The IFRS Practice Statement also requires management to be responsible for preparing management commentary. Paragraph BC29 of the IFRS Practice Statement refers to the definition of "key management personnel" in IAS 24, *Related Party Disclosures*.
23. The term "management" has been used in certain existing IPSASs, notably IPSAS 20, *Related Party Disclosures*, which describes in detail what is meant by "key management personnel"<sup>4</sup>. Given that key management personnel is the group responsible for planning and controlling the activities of the entity, managing the entity's resources, and for the entity's overall achievement of its objectives, key management personnel would generally be those responsible for preparing financial statement discussion and analysis.

### Proposed Working Definition

24. Based on existing elements of definitions of narrative reporting, staff proposes the following working definition<sup>5</sup> of financial statement discussion and analysis:

**Financial statement discussion and analysis** is a report prepared by key management personnel of the entity that complements<sup>6</sup> and supplements<sup>7</sup> the entity's financial statements prepared in accordance with IPSASs, by providing discussion and analysis of information presented in the financial statements. It is based on currently-known facts, consistent with the financial information reported in the financial statements.

#### Questions for the IPSASB:

- Do you agree with the proposed working definition?
- Are there any other elements that need to be included in the definition to more clearly describe the nature of the report?

### Objectives and Users of Financial Statement Discussion and Analysis

25. At its March 2011 meeting, the IPSASB tentatively agreed that the objectives, users and qualitative characteristics of GPFRs identified in Conceptual Framework ED 1<sup>8</sup> are also applicable to this project.

<sup>4</sup> An excerpt of IPSAS 20 which sets out the description of "key management personnel" is included as Appendix C. The definition in IPSAS 20 is largely consistent with that in IAS 24.

<sup>5</sup> This term will be reconsidered as the project progresses and may be subject to change.

<sup>6</sup> The Oxford Dictionary defines "complements" as: 'to add something in a way that enhances or improves'. Dictionary.com notes further that 'it is often applied to putting together two things, each of which supplies what is lacking in the other, to make a complete whole.'

<sup>7</sup> The Oxford Dictionary defines "supplements" as: 'to add an extra element or amount to'. Dictionary.com notes further that it means to merely add to something.

<sup>8</sup> Relevant excerpts from Conceptual Framework ED 1 are included in Appendices A and B.

## Objectives

26. Transactions entered into by public sector entities are increasingly complex and the GPFSS that report on such transactions are consequently increasingly complex and detailed. Financial statement discussion and analysis assists users in understanding and interpreting GPFSS by providing more user-friendly descriptions of the entity's financial operations than the financial statements alone, and in ways that users can readily understand. It may also demonstrate linkages and dependencies among financial statement items that users may not otherwise be able to discern.
27. Financial statement discussion and analysis may encourage better analysis of an entity's current operations. For example, identification of the main events, trends, and factors influencing the current reporting period, provides useful information for decision making regarding the use of scarce resources. It may also help identify potential impacts on future reporting periods. Some pronouncements on financial statement discussion and analysis require a forward-looking point of view. Thus, such information is not a prediction of the future, but is intended to set out management's objectives for the entity and its strategy for achieving those objectives. Some pronouncements include requirements that the information presented in financial statement discussion and analysis is unbiased or balanced and that it is fact-based.
28. Frameworks for pronouncements (standards or guidance) developed by standard setters generally adopt an approach of linking the objectives pertaining to financial statement discussion and analysis to their financial reporting frameworks.
29. For example, the Israel Government Accounting Standards Board's proposed guidance indicates the objective of such information is to "...provide to the users information about the entity's objectives and activities, including information about factors that affect the entity."
30. In jurisdictions for which financial statement discussion and analysis is required by legislation or regulation, the objectives may not be specifically stated or may be stated in more general terms. Most legislation or regulation pertaining to financial statement discussion and analysis sets out requirements only.
31. For example, the South African Municipal Finance Act indicates the following purpose of the annual report (of which the narrative report is a part):
  - (a) To provide a record of the activities of the municipality or municipal entity during the financial year to which the report relates;
  - (b) To provide a report on performance against the budget of the municipality or municipal entity for that year; and
  - (c) To promote accountability to the local community for the decisions made throughout the year by the municipality or municipal entity.

Item (c) relates directly to the IPSASB GPFR objective of accountability.

32. The New Zealand annual report must provide the information that is necessary to enable an informed assessment to be made of the department's performance during the financial year (including an assessment against the intentions, measures and standards set out at the start of the financial year in the information on the department's future operating intentions in accordance with sections 40 and 41). This objective is consistent with the IPSASB GPFR objective of decision making.
33. The main specific objectives of financial statement discussion and analysis, identified from existing and proposed pronouncements and legislative and regulatory requirements, include:
- (a) Enhance user understanding, and assessing usefulness, of GPFs (e.g., operations, successes, and challenges in present and future);
  - (b) Explain financial statement information (e.g., what has happened, why, and implications); and
  - (c) Provide context for the related financial statements.

**Questions for the IPSASB:**

- Do you agree with the identified objectives of financial statement discussion and analysis identified in paragraph
- 33?
- Are there objectives that should be added, deleted, or amended?

**Users and their Needs**

34. There are two primary users<sup>9</sup> of narrative reports of public sector entities:
- (a) Service recipients (taxpayers and other members of the community that benefit from the services provided by the government or other public sector entity, whether as a result of exchange or non-exchange transactions); and
  - (b) Resource providers ("involuntary resource providers" such as taxpayers, and "voluntary resource providers" such as lenders, donors, suppliers, fee-for-service consumers and employees).

Narrative reporting assists these users by providing information beyond that contained in the financial statements. It complements and supplements the financial statements by expanding on and explaining information contained in the financial statements.

35. Service recipients and their representatives require information as input to assessments of such matters as whether the range, volume and cost of services provided during the reporting period, and the amounts and sources of their cost recoveries, are appropriate and whether current levels of taxes or other charges are sufficient to maintain the volume and quality of services currently provided. They also require information about the entity's anticipated future objectives, and the amounts and sources of cost recoveries necessary to support those activities. Financial statement discussion and analysis assists in providing users with more in-depth information about costs and revenue sources, such as taxes and other charges, to assist them in making such assessments.

<sup>9</sup> See Appendix A for details of users of GPFs, which are also applicable to financial statement discussion and analysis.

36. Resource providers require information as input to assessments of such matters as whether the entity is achieving the objectives established as the justification for the resources raised during the reporting period; funded current operations from funds raised in the current period from taxpayers or from borrowings or other sources; and is likely to need additional (or less) resources in the future, and the likely sources of those resources. Lenders and creditors require information as input to assessments of the liquidity of the entity and to confirm that the amount and timing of repayment will be as agreed. Financial statement discussion and analysis provides more detailed information about funding and resources.
37. The nature of the information provided in financial statement discussion and analysis to meet the needs of service recipients and their representatives and resource providers is further explored in the discussion of the qualitative characteristics and essential elements.
38. Conceptual Framework ED 1 specifically discusses the usefulness of narrative reports in providing the information required by service recipients and their representatives and resource providers and their representatives:

2.24 Narrative reports can provide additional information about the major factors underlying the financial and service delivery performance of the entity during the reporting period. They can also outline the assumptions that underpin expectations about, and factors that are likely to influence, the entity's future performance. This will assist users to better understand and place in context the financial and non-financial information included in GPFRs, and enhance the role of GPFRs in providing information useful for accountability and decision-making purposes.

**Questions for the IPSASB:**

- Do you agree that the user needs identified above are appropriate for financial statement discussion and analysis?

## **Qualitative Characteristics of, and Constraints on Information Contained in Financial Statement Discussion and Analysis**

39. As already established, the qualitative characteristics for information contained in financial statement discussion and analysis are the same as those for GPFRs, set out in Conceptual Framework ED 1, namely:
- Relevance;
  - Faithful representation;
  - Understandability;
  - Timeliness;
  - Comparability; and
  - Verifiability.

The constraints of such information are:

- Materiality;
- Cost-benefit; and

- Balance between the qualitative characteristics.
40. The qualitative characteristics apply to all financial and non-financial information reported in GPFRs, including historic and prospective information, and explanatory material or other narrative reporting. However, the extent to which the qualitative characteristics can be achieved may differ depending on the degree of uncertainty and subjective assessment or opinion involved in compiling the financial and non-financial information.
  41. These qualitative characteristics and constraints are discussed below as they relate specifically to financial statement discussion and analysis.

### Relevance

42. Financial statement discussion and analysis should provide management perspective and insights which increases the relevance of the information. Financial and nonfinancial information is relevant if it is capable of making a difference in achieving the objectives of financial reporting. For narrative reports to be relevant they must pertain to the specific circumstances of the entity and add management's insights. Management of an entity has the detailed knowledge of the transactions, events, and conditions reflected in the entity's financial report and of the policies that govern the entity's operations. For example, a discussion of the risks the entity faces would provide relevant information to users about exposure or vulnerability to concentrations (e.g., significant loans to particular regions or industries) or dependence on a particular source of revenue. In addition, a comparison of actual results to those budgeted provides information relevant for accountability purposes.
43. Management also possesses informed expectations regarding the future based on that knowledge. For example, some pronouncements on narrative reporting require a summary or overview of the entity's objectives, significant events and conditions that affected the financial statements (e.g., significant changes, unplanned events), which provides the starting point for assessing the entity's financial performance and trends for the future. Financial statement discussion and analysis may also discuss the entity's intended actions (i.e., future-oriented information). In such cases, it is important that such information also meet the qualitative characteristics of faithful representation and verifiability as discussed below.
44. Generic or "boilerplate" disclosures that do not relate to the specific operations, practices and circumstances of the entity are unlikely to be relevant. Likewise, information that simply repeats financial statement information or note disclosures in the financial statements without analysis or explanations that provide insight into the entity's past performance or prospects is unlikely to be relevant to users and may, in fact, make it more difficult for users to understand the most significant matters the entity faces. For example, commentary on the economy that relates specifically to the financial statements would be relevant information for users.

### Faithful representation

45. Faithful representation is attained when the depiction of the phenomenon is complete, neutral, and free from material error. To faithfully represent information in the underlying

financial statements, information presented in narrative reports should be consistent with, and based on, the underlying financial statements.

46. Narrative reports that faithfully represent the information in the GPFS would be:
  - (a) based on currently-known facts, decisions, or conditions;
  - (b) based on verifiable and supportable assumptions;
  - (c) consistent with the financial statements; and
  - (d) balanced in discussing both positive and negative facts and views of management.
47. Information that excludes certain facts (e.g., negative) is incomplete and thus could be biased (not neutral). In cases when a narrative report presents ratios, tables, or charts, they should not distort the information in the financial statements by, for example, using a scale that exaggerates a positive or negative trend.

#### **Understandability**

48. Understandability is the quality of information that enables users to comprehend its meaning. Narrative reports complement and supplement the financial statements. They are intended to help users of the financial statements by explaining and interpreting the complex events and transactions in the financial statements in a readable, clear, and simple manner. Reports are not understandable when they use descriptions that are too technical, or provide excessive detail or are too vague in describing those events and transactions.

#### **Timeliness**

49. Timeliness means having information available for users before it loses its capacity to be useful for accountability and decision-making purposes. Narrative reports discuss and analyze the current financial statements. In doing so, they may be useful in predicting future results by explaining significant changes and highlighting trends. They may, for example, include an analysis of trends in financial performance that provides information that is useful beyond the date of the narrative report.

#### **Comparability**

50. Comparability is the quality of information that enables users to identify similarities in, and differences between, two sets of phenomena. It is not a quality of an individual item of information, but rather a quality of the relationship between two or more items of information. In some jurisdictions, comparisons with prior years' results are required. Comparability would be enhanced when the same principles and practices are used for each period for such items as determining ratios and preparation of tables and charts included in a narrative report. In addition, disclosure of those principles and practices, including underlying assumptions and formulae, may be useful in interpreting the analyses.

#### **Verifiability**

51. Verifiability is the quality of information that helps assure users that information in GPRFs faithfully represents the phenomena that it purports to represent. In some cases it may not be possible to verify the accuracy of all qualitative and quantitative explanations of such information until a future period, if at all. For example, if the entity's policy, strategy and risk management are included in a narrative report, such information would be less verifiable than, for example, a ratio calculated from information provided in the financial

statements. Verifiability is enhanced when the underlying assumptions and formulae used in the analyses are disclosed. In addition, the methodologies adopted in compiling it, and the factors and circumstances that support any opinions expressed or disclosures made, should be transparent.

### Materiality

52. Information is material if its omission or misstatement could influence the discharge of accountability by the entity, or the decisions that users make on the basis of the entity's GPFRs prepared for that reporting period. Narrative reports need to be concise to be useful, therefore management must select the most important, or material, matters to discuss. This means that some items that are material to the financial statements, notes, and other sections of the GPFFR may not be discussed in the narrative report. For example, a line-by-line analysis of the financial statements is not generally appropriate. Instead, MD&A should summarize the most important items, explain the relevant causes and effects, and place them in context. Inclusion of immaterial disclosures could make the more important information difficult to find.
53. When dealing with qualitative or future-looking information (e.g., expectations about financial results in the future), it is not generally possible to specify a uniform quantitative threshold above which a particular type of information becomes material.

### Cost-benefit

54. The benefits of financial reporting should justify the costs it imposes. The benefit to users of a narrative report that presents a clear and understandable analysis of the complex information contained in the financial statements must be weighed against such costs as collecting and processing the information used in the analysis, and presenting underlying assumptions and methodologies that support such analysis.

### Balance among the qualitative characteristics

55. In some cases, a balancing or trade-off between qualitative characteristics may be necessary to achieve the objectives of financial reporting. For example, there is often a trade-off between the timeliness of information and its reliability. Narrative reports should aim to achieve a balance among the qualitative characteristics to meet the objectives of providing the information. In some cases, depending on the circumstances of the entity, the relative importance of a particular qualitative characteristic may be greater than in others.
56. The information presented in financial statement discussion and analysis needs to be consistent with the qualitative characteristics.

#### Questions for the IPSASB:

- Are there additional factors that should be considered in discussing the qualitative characteristics of narrative reports to those identified above?

## Essential Content of Financial Statement Discussion and Analysis

### Overview

57. The discussion and analysis presented in financial statement discussion and analysis needs to be consistent with the qualitative characteristics.
58. Although the specific information contained in an entity's financial statement discussion and analysis will vary depending on the facts and circumstances specific to the entity, certain essential elements are important to all financial statement discussion and analysis. The standard setters generally did not specify detailed lists of specific disclosures, but rather, the type of content expected to be reported at a high level with examples of what such disclosures might look like. This approach recognizes that the matters that are significant to an entity are also specific to that entity. It allows entities to discuss and analyze those matters most relevant to their individual circumstances within the framework provided for the content of the report.

### Standards and Guidance issued by Standard Setters

59. Certain common elements of information required in financial statement discussion and analysis were identified among jurisdictions, whether set out in standards or in legislation or regulation of public sector entities.
60. Pronouncements issued by standard setters identified some similar elements of financial statement discussion and analysis:
  - (a) Overview or summary;
  - (b) Nature of the entity's operations;
  - (c) Risks and uncertainties;
  - (d) Policy, strategy and risk management;
  - (e) Changes from prior year; and
  - (f) Analysis of significant trends related to financial statement items.
61. In addition to containing similar elements to those noted above, the Israel draft guidance contains the following essential elements for the Management Report (the term used for narrative information attached to financial statements of a public sector entity), which are more specific to that country:
  - A Management Report shall include an overview of the data from the entity's financial statements, in accordance with its operations, as follows:
    - (a) The financial position of the entity;
    - (b) The operating results;
    - (c) Special events;
    - (d) Contingent liabilities;
    - (e) Critical accounting estimates.

Detailed guidance is also provided for each of these items. These requirements are similar to those found in legislative or regulatory requirements for financial statement discussion and analysis in other jurisdictions (see paragraphs 62–66 below).

### Legislative and Regulatory Requirements

62. Legislative or regulatory requirements tend to reflect the specific needs of the jurisdiction, and may not, therefore, provide relevant information to users in other jurisdictions.

63. Article 58(1) of the Central Government of the Netherlands Government Accounting Act 2001 requires that:
- (a) The financial information includes information on obligations, expenditures, income, revenues, expenses, capital expenditures, capital income and balance sheet items, as stated in the accounting records and the accompanying notes.
  - (b) The financial information presented in the annual report can be clearly distinguished from the non-financial information.
64. In Germany, the management report (Lagebericht) is additional to, but not part of the financial statements (Abschluss) but is nevertheless subject to audit.
65. The Netherlands' *Besluit begroting en verantwoording provincies en gemeenten* for local governments requires the budget<sup>10</sup> to at least contain the following paragraphs, unless the aspect concerned is irrelevant for the respective province or municipality:
- (a) local taxes;
  - (b) financial strength;
  - (c) maintenance of capital assets;
  - (d) financing;
  - (e) management;
  - (f) related parties; and
  - (g) land use policy.

Certain of these aspects would be within the scope of financial statement discussion and analysis, while others are specific requirements of the jurisdiction's regulatory framework.

66. Japanese agencies of central government, which are called "Incorporated Administrative Agencies", and national universities must prepare for their annual reports including "business report", which is considered similar to "narrative reporting". The annual report is required to include:

Financial Information

- (1) Overview of Financial Statements;
- (2) Overview of Investments (e.g., facilities);
- (3) Overview of Budgeted Amounts and Actual Amounts; and
- (4) The Relationship between Reduction of Expenses and the Target of Efficiency.

There are also some practices in Japan where national and local governments prepare narrative explanations regarding particularly changes in financial statements items. There are no prescribed standards or guidelines.

### Proposed Essential Elements

67. Staff proposes the following essential elements<sup>11</sup> for financial statement discussion and analysis, derived from the elements identified through the research and presented above:

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<sup>10</sup> The annual report should contain the paragraphs that are included in the budget in accordance with Article 9. These contain the justification of that which is included in the respective paragraphs in the budget.

- (a) Statement of responsibility of the preparer of the report;
- (b) Overview or summary;
- (c) Nature of the entity's operations;
- (d) Risks and uncertainties;
- (e) Policy, strategy, and risk management;
- (f) Changes from prior year; and
- (g) Analysis of significant trends.

These elements are discussed further below.

- 68. A statement of responsibility promotes transparency and accountability of the preparer of the report by acknowledging who is responsible for the report. See also the discussion under "Scope" regarding the preparer of the report.
- 69. The overview or summary provides an executive overview of the financial statements and outlines the significant events and activities, without simply reiterating the information presented in the financial statements. Some members of the TBG think this is an issue that should be left to the preparer of the report; however, it is mandatory in the PSAB SORP, which describes its purpose as follows:
  - 34 As a starting point in understanding the government's financial position and changes in financial position, it is necessary to understand how the financial statements provided interrelate and complement each other. Although each statement conveys a particular message about the state of the government's finances, none is likely to provide all the financial information useful for a particular decision.
  - 35 The purpose of the highlights section is not to simply reiterate the information that is presented in the financial statements, but to add value by providing an executive overview of those statements and the significant in-year activities that have affected them.
- 70. The nature of the entity's operations helps users to understand the entity and the environment in which it operates. For example, information about the entity's operations may include:
  - (a) Trends, events and developments in the legal, regulatory, and macro-economic environment specific to the entity, which have or may have a material impact on the entity and its financial performance.
  - (b) A list of the organizations and segments comprising the entity being reported on (e.g., controlled entities, associates, jointly-controlled entities, and any significant changes).
  - (c) The entity's main programs, services, service delivery methods.
- 71. Information about the entity's risks and uncertainties helps users to evaluate the impact of risks currently (e.g., contingent liabilities reported in the financial statements) as well as expected outcomes. Information provided may include its main exposures to risk and changes in those risks, along with its policies and strategies for mitigating the risks. It may

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<sup>11</sup> Note that some of these items may already be contained in the GPFS; however, the purpose of the financial statement discussion and analysis would be to provide further insights on them to enhance the usefulness of the financial statements.

also include the entity's evaluation of the effectiveness of its risk management strategies. Because risks and uncertainties may have a pervasive effect on the financial statements, discussion and analysis may be reported separately in the financial statement discussion and analysis, or in relevant sections throughout the report. As part of a balanced approach to reporting, the discussion would also consider any opportunities the entity has. It is noted however, that these would need to be fact-based and take into account currently known conditions, as well as to state any underlying assumptions.

72. A discussion of the entity's policies, strategies, and risk management helps users obtain a complete picture of the entity's exposure, which allows them to evaluate the entity's financial position and financial performance. Such disclosure may include the entity's decision to "self-insure", or to mitigate risk by transferring or sharing it, or through insurance.
73. Additional information may be provided about uncertainties such as environmental issues, and significant events occurring subsequent to the reporting date, which may affect the entity's future operations (e.g., debt issuance, guarantees issued in relation to a financial crisis or service concession arrangement). Information may also be provided about the entity's opportunities; however in reporting such information, care must be taken to ensure it is fact-based, unbiased, and verifiable. This means, for example, that the assumptions made are based on conditions that exist at the reporting date and events that occurred in the preceding period.
74. Information about changes from the prior year, such as variance analysis and actual-to-budget comparisons, is important in helping users to understand trends that may affect future resource requirements. IPSAS 24, *Presentation of Budget Information in Financial Statements*.
75. IPSAS 24.19 states:

Management discussion and analysis, operations review, or other public reports that provide commentary on the performance and achievements of the entity during the reporting period, including explanations of any material differences from budget amounts, are often issued in conjunction with the financial statements. In accordance with paragraph 14(c) of this Standard, explanation of material differences between actual and budget amounts will be included in notes to the financial statements, unless (a) included in other public reports or documents issued in conjunction with the financial statements, and (b) the notes to the financial statements identify the reports or documents in which the explanation can be found.
76. IPSAS 24 permits changes between the original and final budget (para. 29(b)) to be in another report (e.g., financial statement discussion and analysis). In such cases, a cross reference to the other document is required. In addition, the financial statement discussion and analysis would be expected to go beyond the IPSAS 24 requirements to simply explain the differences, and provide greater management insights about the implications.

77. Financial statement discussion and analysis may include quantitative analysis of significant variances between the prior year and current year, including assets, liabilities, revenues, and expenses. This allows users to assess the results of past events, and to understand the extent to which past performance may be indicative of future performance. It also assists in understanding and assessing trends in the entity's financial position and changes in financial position. For example:
- (a) An analysis of financial assets provides information regarding the amount of resources available to be converted to cash if necessary. In addition, specific ratios and analysis of cash flows may be useful to highlight liquidity.
  - (b) Analyses of revenues by major source may indicate trends and dependencies on specific revenue sources (e.g., government business enterprises (GBEs), transfers, or royalties).
  - (c) Analyses of expenses may demonstrate the entity's allocation and use of resources, provide insight into the cost of programs and services, and assist in evaluating the cost of borrowing to finance spending.
  - (d) Discussion of significant commitments, contingencies, and subsequent events assists users in assessing future revenue requirements of the entity.

When such information is presented in a graphical format, the scale of such illustrations should be on a basis that faithfully represents the relationships of the items being analyzed. In addition, narrative explanations of such illustrations may also be required to accurately present the information.

78. In some cases, a significant change may have occurred during the reporting period, but the financial statements and quantitative analyses may not illustrate a significant variance because of offsetting factors. Explanations contained in financial statement discussion and analysis may identify and explain significant variances between the current year and prior year such as variances due to changes in how a service is delivered, changes in programs and services provided, and changes due to the level of revenues raised or costs incurred. Some of these may be within the control of the entity (e.g., taxation rates, new or discontinued programs or services, restructuring operations, or changing the method of service delivery), while others may be due to external factors (e.g., a decreased tax base, wage contracts, and unexpected events such as a natural disaster). Such explanations may assist users in assessing possible future changes in current services and commitments of the entity.
79. Analysis of significant trends assists users in gaining a better understanding of the entity's financial position and financial performance in the reporting period, which can be used as a basis for assessing its future financial position and financial performance. In some cases, analyses may include forward-looking information. In such cases, supporting assumptions and formulae used in the analyses, as well as the methodologies adopted in compiling it would be disclosed. It is necessary that assumptions used be based on currently-known facts and circumstances.

**Questions for the IPSASB:**

- Do you agree with the main common elements of financial statement discussion and analysis identified in paragraph 67?
- Are there additional essential content elements?
- Is it necessary to provide additional guidance on the content of discussion and analysis pertaining to the various financial statement items noted in paragraph 67 (See the analysis in Agenda Paper 9.0 on the question of additional guidance on disclosures in the financial statement discussion and analysis for the specific financial statement items)?

## Type of Guidance

### Background

80. Financial statement discussion and analysis provides a means of improving public sector entities' accountability and decision making. The guidance developed would provide a framework for the preparation of high-quality financial statement discussion and analysis to ensure such reports help achieve the objectives of GPFRs by improving accountability and decision making in the public sector.
81. However, it is acknowledged that the current state of such reporting is still in its early stages of its evolution and development, and that the form and content of financial statement discussion and analysis are expected to develop in the future. For example based on the research done, it was found that in some jurisdictions, financial statement discussion and analysis:
- (a) is required with detailed requirements set out in legislation or regulation;
  - (b) is required with detailed requirements set out in standards (e.g., GASB and FASAB in the US, and the UK FReM); or
  - (c) is voluntary, and there may or may not be standards in place.
82. Given the state of current practice, it is not a foregone conclusion that this project will mandate which entities should be required to publish financial statement discussion and analysis, how frequently an entity should do so, or the level of assurance to which financial statement discussion and analysis should be subjected. This eventuality was recognized in Paragraph BC 1.7 of Conceptual Framework ED 1, which states: "Acknowledging a more comprehensive scope for financial reporting does not mean that it is inevitable that authoritative requirements will be developed to direct reporting on all matters that may be encompassed by that scope."
83. The Project Brief indicated that the decision on the type of pronouncement to be issued by the IPSASB ranges from:
- (a) Issuing a mandatory IPSAS (authoritative);
  - (b) Issuing a standard that applies when certain conditions exist (e.g., IPSAS 24);
  - (c) Issuing specific non-mandatory guidance; and

(d) Recognizing best practices.

84. The TBG has not reached a consensus on this issue.

## Alternatives

### 1. Authoritative Guidance

85. Under this approach, the pronouncement would be a mandatory standard for public sector entities, other than GBEs.

86. This is the approach followed for the US standards; GASB<sup>12</sup> Statement 34: *Basic Financial Statements—and Management’s Discussion and Analysis for State and Local Governments*, and FASAB<sup>13</sup> Statement of Federal Financial Accounting Standards (SFFAS) 15, *Management’s Discussion and Analysis*, which requires:

A report that presents a Federal reporting entity’s financial statements in conformance with Federal accounting principles should include management’s discussion and analysis (MD&A) of the financial statements and related information.

87. Under this approach the standard is mandatory for all entities. This approach recognizes the importance of the information contained in financial statement discussion and analysis.

88. Staff does not consider this approach appropriate, because, at present, entities voluntarily choose to follow IPSASs; they cannot therefore be mandated to follow the proposed standard on financial statement discussion and analysis.

### 2. Authoritative Guidance for Entities Required to or Electing to Prepare Reports

89. Under this approach, the guidance would be mandatory for public sector entities, other than GBEs that are required or elect to make their financial statement discussion and analysis publicly available to enhance the transparency of their financial reporting. This is the same approach as is taken in IPSAS 24, *Presentation of Budget Information in Financial Statements*. IPSAS 22, *Disclosure of Financial Information about the General Government Sector*, is mandatory when an entity elects to present financial statement discussion and analysis. This is also the approach followed for the IFRS Practice Statement and the PSAB SORP.

90. The standard would not require entities to prepare financial statement discussion and analysis. Thus, for entities in jurisdictions with legislation or regulation requiring preparation of such reports for public sector entities, the standard would need to be followed if the entity follows IPSASs. This means that although the entity chooses to prepare financial statement discussion and analysis, if it does follow IPSASs, it would need to follow this standard in preparing the financial statement discussion and analysis.

<sup>12</sup> US Governmental Accounting Standards Board.

<sup>13</sup> US Federal Accounting Standards Advisory Board.

91. Even if the basic principles for the financial statement discussion and analysis are mandatory under the stipulated circumstances, it is still possible for the IPSAS under this approach to contain non-authoritative implementation guidance or illustrative examples, so there would still be flexibility in the information presented for each entity.
92. Some members of the TBG are strongly in favour of this approach.

### 3. Non-mandatory Guidance

93. In this case, the guidance would be non-mandatory. It would likely fall into the same category of IPSASB pronouncement as is being considered in the service performance reporting project.
94. One TBG member noted that this option may depend on how detailed the proposed guidance is. For example, if the guidance is more detailed, it may be preferable if it is non-mandatory, to allow sufficient flexibility to meet legislative or regulatory requirements, if they exist.

### 4. Best Practice

95. Under this approach the guidance would be entirely non-authoritative, and would outline best practices to encourage public sector entities to provide certain information.
96. A flexible approach, such as that adopted in the jurisdictions that have either issued standards on, or have a legal or regulatory requirement for, financial statement discussion and analysis, would permit entities to discuss and analyze the trends, events, and factors that are most relevant to their particular circumstances.

### Staff Recommendation

97. Staff considers the first alternative—authoritative guidance—to be the most appropriate alternative because it provides a basic framework for financial statement discussion and analysis. It will promote consistency in reporting among all entities that are required to or choose to prepare financial statement discussion and analysis.

#### **Question for the IPSASB:**

- Do you agree that the TBG should proceed on the basis that this project will result in an authoritative standard?
- If so, are there any implications for the form and content of the information that should be considered for inclusion in financial statement discussion and analysis?

## Appendix A: Extract from Conceptual Framework ED 1 on Objectives of Financial Reporting and Users of GPFRs

### **2 Objectives of Financial Reporting and Users of General Purpose Financial Reports**

- 2.1 The objectives of financial reporting by public sector entities are to provide information about the entity that is useful to users of GPFRs for accountability purposes and for decision-making purposes (hereafter referred to as “useful for accountability and decision-making purposes”).
- 2.2 Financial reporting is not an end in itself. Its purpose is to provide information useful to users of GPFRs. The objectives of financial reporting are therefore determined by reference to the users of GPFRs, and their information needs.

#### **Users of General Purpose Financial Reports**

- 2.3 Governments and other public sector entities raise resources from taxpayers, donors, lenders and other resource providers for use in the provision of services to citizens and other service recipients. These entities are accountable for their management and use of resources to those that provide them with resources, and to those that depend on them to use those resources to deliver necessary services. Those that provide the resources and receive, or expect to receive, the services will also require information as input for decision-making purposes.
- 2.4 Consequently, GPFRs of public sector entities are developed primarily to respond to the information needs of service recipients and resource providers who do not possess the authority to require a public sector entity to disclose the information they need for accountability and decision-making purposes. The legislature (or similar body) and members of parliament (or a similar representative body) are also primary users of GPFRs when acting in their capacity as representatives of the interests of service recipients and resource providers. Therefore, for the purposes of this Conceptual Framework, the primary users of GPFRs are service recipients and their representatives and resource providers and their representatives.
- 2.5 Citizens receive services from, and provide resources to, the government and other public sector entities. Therefore, citizens are primary users of GPFRs. Some service recipients and some resource providers that rely on GPFRs for the information they need for accountability and decision-making purposes may not be citizens—for example, residents who pay taxes and/or receive benefits but are not citizens; some multilateral or bilateral donor agencies and many lenders and corporations that provide resources to, and transact with, a government; and those that fund, and/or benefit from, the services provided by international governmental organizations.
- 2.6 GPFRs prepared to respond to the information needs of service recipients and their representatives and resource providers and their representatives for accountability and decision-making purposes may also provide information useful to other parties and for other purposes. For example, government statisticians, analysts, the media, financial advisors, public interest and lobby groups and others may find the information provided

by GPFRs useful for their own purposes. Organizations that have the authority to require the preparation of financial reports tailored to meet their own specific information need may also use the information provided by GPFRs for their own purposes—for example, regulatory and oversight bodies, audit institutions, subcommittees of the legislature or other governing body, central agencies and budget controllers, entity management and, in some cases, lending institutions and providers of development and other assistance. While these other parties may find the information provided by GPFRs useful, they are not the primary users of GPFRs. Therefore, GPFRs are not developed to specifically respond to their particular information needs.

### **Information Needs of Service Recipients and Resource Providers**

2.7 Service recipients include taxpayers and other members of the community that benefit from the services provided by the government or other public sector entity, whether as a result of exchange or non-exchange transactions.

2.8 For accountability and decision-making purposes, service recipients and their representatives will require information as input to assessments of such matters as whether:

- The entity is using resources economically, efficiently, effectively and as intended, and whether such use is in their interests;
- The range, volume and cost of services provided during the reporting period, and the amounts and sources of their cost recoveries, are appropriate; and
- Current levels of taxes or other charges are sufficient to maintain the volume and quality of services currently provided.

They will also require information about the entity's anticipated future service delivery activities and objectives, and the amounts and sources of cost recoveries necessary to support those activities.

2.9 Resource providers include “involuntary resource providers” such as taxpayers, and “voluntary resource providers” such as lenders, donors, suppliers, fee-for-service consumers and employees.

2.10 For accountability and decision-making purposes, resource providers and their representatives will require information as input to assessments of such matters as whether the entity:

- Is achieving the objectives established as the justification for the resources raised during the reporting period;
- Funded current operations from funds raised in the current period from taxpayers or from borrowings or other sources; and
- Is likely to need additional (or less) resources in the future, and the likely sources of those resources.

2.11 Lenders and creditors will require information as input to assessments of the liquidity of the entity and to confirm that the amount and timing of repayment will be as agreed. Donors will require information to support assessments of whether the entity is using resources economically, efficiently, effectively and as intended. They will also need

information about the entity's anticipated future service delivery activities and resource needs. In most cases, governments that provide resources to international governmental organizations are dependent on GPFRs of those organizations for information for accountability and decision-making purposes.

*Accountability and Decision Making*

2.12 Service recipients and resource providers will require information for accountability purposes and as input for making decisions. For example:

- Lenders, creditors, donors and others that provide resources on a voluntary basis, including in an exchange transaction, make decisions about whether to provide resources to support the current and future activities of the government or other public sector entity. In some circumstances, members of the legislature or similar representative body who depend on GPFRs for the information they need, can make or influence decisions about the service delivery objectives of government departments, agencies or programs and the resources allocated to support their achievement; and
- 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. In addition, in many cases, they do not have the discretion to choose whether or not to accept the goods and services provided by a public sector entity or to choose an alternative service provider. Consequently, they have little direct or immediate capacity to make decisions about whether to provide resources to the government, the resources to be allocated for the provision of services by a public sector entity or whether to purchase or consume the services provided. However, they can make decisions about their voting preferences, and representations they make to elected officials or other representative bodies—these decisions may have resource allocation consequences for certain public sector entities.

2.13 Information provided in GPFRs for accountability purposes will contribute to, and inform, decision making. For example, information about the costs, efficiency and effectiveness of past service delivery activities, the amount and sources of cost recovery, and the resources available to support future activities will be necessary for the discharge of accountability. This information will also be useful for decision making by some users of GPFRs, including decisions that donors and other financial supporters make about providing resources to the entity.

**Information Provided by General Purpose Financial Reports**

2.14 To respond to the information needs of users, GPFRs will need to provide information about the financial position of the government or other public sector entity as at the reporting date and its financial performance, cash flows, and changes in net assets during the reporting period. GPFRs will also need to provide financial and non-financial information about such matters as the government's or other public sector entity's:

- Service delivery activities, achievements or outcomes during the reporting period, including whether resources have been used economically, efficiently, and effectively, and in accordance with approved budgets and other authority that justified the raising and use of those resources; and

- Plans and objectives for service delivery in the future, including the anticipated amount and sources of the resources needed to support those plans and objectives.

*Financial Position, Financial Performance and Cash Flows*

- 2.15 Information about the financial position of a government or other public sector entity will enable users to identify the resources of the entity that can be used to provide particular services in future periods and claims to those resources at the reporting date. This will provide information useful as input to assessments of such matters as:
- The extent to which management has discharged its responsibilities for safekeeping and managing the resources of the entity;
  - The extent to which resources are available to support future service delivery objectives; and
  - The amounts and timing of future cash flows necessary to service and repay existing claims to the entity's resources.
- 2.16 Information about the financial performance of a government or other public sector entity will inform assessments of matters such as whether the entity has acquired resources economically, and used them efficiently and effectively to achieve its service delivery objectives. Information about the costs of service delivery and the amounts and sources of cost recovery during the reporting period will enable users to determine whether operating costs were recovered from, for example, taxes, user charges, contributions and transfers or were financed by increasing the level of indebtedness of the entity.
- 2.17 The financial performance of public sector entities will not be fully or adequately reflected in any measure of their financial result (whether described as "surplus or deficit," "profit or loss," or by other terms). Rather, assessments of their financial performance will involve analysis of such matters as:
- The purposes for which resources were used during the reporting period;
  - The costs, efficiency and effectiveness of service delivery during the reporting period; and
  - Changes during the reporting period in the amount and composition of the resources that are available for the provision of services in the future and claims to those resources.
- 2.18 Information about the cash flows of a government or other public sector entity contributes to assessments of financial performance and the entity's liquidity and solvency. It indicates how the entity raised and used cash during the period, including its borrowing and repayment of borrowing and its acquisition and sale of, for example, property, plant, and equipment. It also identifies the cash received from, for example, taxes and investments and the cash transfers made to, and received from, other governments, government agencies or international organizations. Information about cash flows can also support assessments of the entity's compliance with spending mandates expressed in cash flow terms, and inform assessments of the likely amounts and sources of cash inflows needed in future periods to support service delivery objectives.

*Compliance with the Budget*

- 2.19 Governments and other public sector entities are accountable to constituents for their use of the resources raised from them, or raised or provided on their behalf. The approved budget of a government or other public sector entity reflects the financial characteristics of the entity's plans for the forthcoming period. It is used to justify the raising of monies from taxpayers and other resource providers, and establishes the authority for expenditure of public monies.
- 2.20 Information that assists users in assessing the entity's compliance with legally adopted or approved budgets, and its adherence to relevant legislation or other authority governing the raising and use of public monies, is included in GPFRs. Such information is necessary for the discharge of a government's (or other entity's) accountability to its constituents, and will inform decision making.

*Service Delivery Achievements*

- 2.21 Reporting non-financial as well as financial information about service delivery activities, achievements or outcomes during the reporting period will provide input to assessments of the economy, efficiency, and effectiveness of the entity's operations. Reporting this information is necessary for a government or other public sector entity to discharge its obligation to be accountable—that is, to account for, and justify the use of, the financial resources raised from, or on behalf of, constituents. Decisions that donors make about the allocation of resources to particular entities and programs are also made, at least in part in response to information about service delivery achievements during the reporting period, and future service delivery objectives.

*Prospective Financial and Non-financial Information*

- 2.22 Decisions made by a government or other public sector entity in a particular period about programs for delivering and funding services in the future can have significant consequences for:
- Constituents who will be dependent on those services in the future; and
  - 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.
- 2.23 Information about the entity's anticipated future service delivery activities and objectives, their likely impact on the future resource needs of the entity, and the likely sources of funding for such resources, will be necessary as input to any assessment of the ability of the government or other public sector entity to meet its service delivery and financial commitments in the future. The disclosure of such information in GPFRs will enhance the accountability of the entity and provide additional information useful for decision-making purposes.

*Narrative Reports*

- 2.24 Narrative reports can provide additional information about the major factors underlying the financial and service delivery performance of the entity during the reporting period. They can also outline the assumptions that underpin expectations about, and factors that are likely to influence, the entity's future performance. This will assist users to better

understand and place in context the financial and non-financial information included in GPFRs, and enhance the role of GPFRs in providing information useful for accountability and decision-making purposes.

- 2.25 In some cases, quantitative measures of the outputs and outcomes of the entity's service delivery activities during the period and anticipated activities in future periods will provide relevant information about the achievement of these service delivery objectives—for example, information about the cost, volume, and frequency of service delivery, and the relationship of services provided to the resource base of the entity. In other cases, the achievement of service delivery objectives may need to be communicated by an explanation of the quality of particular services provided or the outcome of certain programs.

### **Other Sources of Information**

- 2.26 GPFRs play a significant role in communicating information necessary to support the discharge of a government's or other public sector entity's obligation to be accountable, as well as providing information useful as input for decision-making purposes. However, some information useful for accountability and decision-making purposes may also be provided by reports other than GPFRs. Consequently, service recipients and resource providers may also need to consider information from other sources, including reports on current and anticipated economic conditions, government budgets and forecasts, and information about government policy initiatives not reported in GPFRs

## Appendix B: Extract from Conceptual Framework ED 1 on the Qualitative Characteristics of, and Constraints on, Information included in General Purpose Financial Reports

### **3 Qualitative Characteristics of, and Constraints on, Information included in General Purpose Financial Reports**

- 3.1 GPFRs present financial and non-financial information about economic or other phenomena. The qualitative characteristics of information included in GPFRs are the attributes that make that information useful to users and support the achievement of the objectives of financial reporting. The objectives of financial reporting are to provide information useful for accountability and decision-making purposes.
- 3.2 The qualitative characteristics of information included in GPFRs of public sector entities are relevance, faithful representation, understandability, timeliness, comparability, and verifiability.
- 3.3 Materiality, cost-benefit, and achieving an appropriate balance between the qualitative characteristics are pervasive constraints on information included in GPFRs.
- 3.4 Each of the qualitative characteristics is integral to, and works with, the other characteristics to provide in GPFRs information useful for achieving the objectives of financial reporting. However, in practice, all qualitative characteristics may not be fully achieved, and a balance or trade-off between certain of them may be necessary.
- 3.5 The qualitative characteristics apply to all financial and non-financial information reported in GPFRs, including historic and prospective information, and explanatory material or other narrative reporting. However, the extent to which the qualitative characteristics can be achieved may differ depending on the degree of uncertainty and subjective assessment or opinion involved in compiling the financial and non-financial information. The need for additional guidance on interpreting and applying the qualitative characteristics to information that extends the scope of financial reporting beyond financial statements including their notes will be considered in the development of any IPSASs and other pronouncements of the IPSASB that deal with such matters.

#### **Relevance**

- 3.6 Financial and non-financial information is relevant if it is capable of making a difference in achieving the objectives of financial reporting. Financial and non-financial information is capable of making a difference when it has confirmatory value, predictive value, or both. It may be capable of making a difference, and thus be relevant, even if some users choose not to take advantage of it or are already aware of it.
- 3.7 Financial and non-financial information has confirmatory value if it confirms or changes past (or present) expectations. For example, information will be relevant for accountability and decision-making purposes if it confirms expectations about such matters as the extent to which managers have discharged their responsibilities for the efficient and effective use of resources, the achievement of specified service delivery objectives, and compliance with relevant budgetary, legislative and other requirements.

- 3.8 GPFRs may present information about an entity's anticipated future service delivery activities, objectives and costs, and the amount and sources of the resources that are intended to be allocated to providing services in the future. Such future oriented information will have predictive value and be relevant for accountability and decision-making purposes. Information about economic and other phenomena that exist or have already occurred can also have predictive value in helping form expectations about the future. For example, information that confirms or disproves past expectations can reinforce or change expectations about financial results and service delivery outcomes that may occur in the future.
- 3.9 The confirmatory and predictive roles of information are interrelated—for example, information about the current level and structure of an entity's resources and claims to them helps users to confirm the outcome of resource management strategies during the period, and to predict an entity's ability to respond to changing circumstances and anticipated future service delivery needs. The same information helps to confirm or correct users' past expectations and predictions about the entity's ability to respond to such changes. It also helps to confirm or correct prospective financial information included in previous GPFRs.

### **Faithful Representation**

- 3.10 To be useful in financial reporting, information must be a faithful representation of the economic and other phenomena that it purports to represent. Faithful representation is attained when the depiction of the phenomenon is complete, neutral, and free from material error. Information that faithfully represents an economic or other phenomenon depicts the substance of the underlying transaction, other event, activity or circumstance—which is not necessarily always the same as its legal form.
- 3.11 In practice, it may not be possible to know or confirm whether information presented in GPFRs is fully complete, neutral, and free from material error. However, information should be as complete, neutral, and free from material error as is possible.
- 3.12 A depiction of an economic or other phenomenon is complete if it includes all information that is necessary for faithful representation of the phenomenon that it purports to depict. An omission of some information can cause the representation to be false or misleading, and thus not useful to users of GPFRs. For example, a complete depiction of the item "plant and equipment" in GPFRs will include a numeric representation of the aggregate amount of plant and equipment together with other quantitative, descriptive and explanatory material necessary to faithfully represent that class of assets. In some cases, this may include the disclosure of information about such matters as the major classes of plant and equipment, factors that have affected their use in the past or might impact on their use in the future, and the basis and process for determining their numeric representation. Similarly, prospective financial and non-financial information, and information about the achievement of service delivery objectives and outcomes, included in GPFRs will need to be presented with the key assumptions that underlie that information, and any explanations that are necessary to ensure that its depiction is complete and useful to users.
- 3.13 Neutrality in financial reporting is the absence of bias. It means that the selection and presentation of financial and non-financial information is not made with the intention of

- attaining a particular predetermined result—for example, to influence in a particular way users' assessment of the discharge of accountability by the entity or a decision or judgment that is to be made, or to induce particular behaviour.
- 3.14 Neutral information faithfully represents the economic and other phenomena that it purports to represent. However, to require information included in GPFRs to be neutral does not mean that it is not without purpose or that it will not influence behaviour. Relevance is a qualitative characteristic and, by definition, relevant information is capable of influencing users' assessments and decisions.
- 3.15 The economic and other phenomena represented in GPFRs generally occur under conditions of uncertainty. Information included in GPFRs will therefore often include estimates that incorporate management's judgment. To faithfully represent an economic or other phenomenon, an estimate must be based on appropriate inputs, and each input must reflect the best available information. Caution will need to be exercised when dealing with uncertainty. It may sometimes be necessary to explicitly disclose the degree of uncertainty in financial and non-financial information to faithfully represent economic and other phenomena.
- 3.16 Free from material error does not mean complete accuracy in all respects. Free from material error means there are no errors or omissions that are individually or collectively material in the description of the phenomenon, and the process used to produce the reported information has been applied as described. In some cases, it may be possible to determine the accuracy of some information included in GPFRs—for example, the amount of a cash transfer to another level of government, volume of services delivered or the price paid for the acquisition of plant and equipment. However, in other cases it may not—for example, the accuracy of an estimate of the value or cost of an item or the effectiveness of a service delivery program may not be able to be determined. In these cases, the estimate will be free from material error if the amount is clearly described as an estimate, the nature and limitations of the estimation process are explained, and no material errors have been identified in selecting and applying an appropriate process for developing the estimate.

### **Understandability**

- 3.17 Understandability is the quality of information that enables users to comprehend its meaning. GPFRs of public sector entities should present information in a manner that responds to the needs and knowledge base of users, and to the nature of the information presented. For example, explanations of financial and non-financial information and narrative reporting of achievements and expectations should be written in plain language, and presented in a manner that is readily understandable by users. Understandability is enhanced when information is classified, characterized, and presented clearly and concisely. Comparability also can enhance understandability.
- 3.18 Users of GPFRs are assumed to have a reasonable knowledge of the entity's activities and the environment in which it operates, to be able and prepared to read GPFRs, and to review and analyze the information presented with reasonable diligence. Some economic and other phenomena are particularly complex and difficult to represent in GPFRs, and some users may need to seek the aid of an advisor to assist in their understanding of them. All efforts should be undertaken to represent economic and other phenomena

included in GPFRs in a manner that is understandable to a wide range of users. However, information should not be excluded from GPFRs solely because it may be too complex or difficult for some users to understand without assistance.

### **Timeliness**

- 3.19 Timeliness means having information available for users before it loses its capacity to be useful for accountability and decision-making purposes. Having relevant information available sooner can enhance its usefulness as input to assessments of accountability and its capacity to inform and influence decisions that need to be made. A lack of timeliness can render information less useful.
- 3.20 Some items of information may continue to be useful long after the reporting period or reporting date. For example, for accountability and decision-making purposes, users of GPFRs may need to assess trends in the financial and service delivery performance of the entity and its compliance with budgets over a number of reporting periods. In addition, the outcome and effects of some service delivery programs may not be determinable until future periods—this may occur in respect of programs intended to, for example, enhance the economic well-being of constituents, reduce the incidence of a particular disease, or increase literacy levels of certain age groups.

### **Comparability**

- 3.21 Comparability is the quality of information that enables users to identify similarities in, and differences between, two sets of phenomena. Comparability is not a quality of an individual item of information, but rather a quality of the relationship between two or more items of information.
- 3.22 Comparability differs from consistency. Consistency refers to the use of the same accounting policies and procedures, either from period to period within an entity or in a single period across more than one entity. Comparability is the goal, and consistency helps in achieving that goal.
- 3.23 Comparability also differs from uniformity. For information to be comparable, like things must look alike, and different things must look different. An over-emphasis on uniformity may reduce comparability by making unlike things look alike. Comparability of information in GPFRs is not enhanced by making unlike things look alike, any more than it is by making like things look different.
- 3.24 Information about the entity's financial position, financial performance, compliance, service delivery achievements, and its future plans is necessary for accountability purposes and useful as input for decision-making purposes. The usefulness of such information is enhanced if it can be compared with, for example:
- The budget of the entity for the reporting period, or prospective financial and non-financial information previously presented for that reporting period or reporting date;
  - Similar information about the same entity for some other period or some other point in time; and

- Similar information about other entities (for example, public sector entities providing similar services in different jurisdictions).
- 3.25 Consistent application of accounting policies to prospective financial and non-financial information and actual outcomes will enhance the usefulness of any comparison of projected and actual results. Comparability with other entities may be less significant for narrative reporting of management's perception or opinion of the factors underlying the entity's current performance.

### **Verifiability**

- 3.26 Verifiability is the quality of information that helps assure users that information in GPFRs faithfully represents the phenomena that it purports to represent. Supportability is sometimes used to describe this quality when applied in respect of explanatory information and prospective financial and non-financial quantitative information disclosed in GPFRs—that is, the quality of information that helps assure users that explanatory or prospective financial and non-financial quantitative information faithfully represents the phenomena that it purports to represent. Whether referred to as verifiability or supportability, the characteristic implies that different knowledgeable and independent observers could reach general consensus, although not necessarily complete agreement, that either:
- The information represents the phenomena that it purports to represent without material error or bias; or
  - An appropriate recognition, measurement, or representation method has been applied without material error or bias.
- 3.27 To be verifiable, information need not be a single point estimate. A range of possible amounts and the related probabilities also can be verified.
- 3.28 Verification may be direct or indirect. With direct verification, an amount or other representation is itself verified, such as by (a) counting cash, (b) checking records of service response times or records of patients treated, (c) observing marketable securities and their quoted prices, or (d) confirming that the factors identified as influencing past service delivery performance were present and operated with the effect identified. With indirect verification, the amount or other representation is verified by checking the inputs and recalculating the outputs using the same accounting convention or methodology. An example is verifying the carrying amount of inventory by checking the inputs (quantities and costs) and recalculating the ending inventory using the same cost flow assumption (for example, average cost or first-in-first-out).
- 3.29 The quality of verifiability (or supportability if such term is used to describe this characteristic) is not an absolute—some information may be more or less capable of verification than other information. However, the more verifiable is the information included in GPFRs, the more it will assure users that the information faithfully represents the phenomena that it purports to represent.
- 3.30 GPFRs of public sector entities may include financial and other quantitative information and explanations about (a) key influences on the entity's performance during the period, (b) the anticipated future effects or outcomes of service delivery programs undertaken

during the reporting period, and (c) prospective financial and non-financial information. It may not be possible to verify the accuracy of all quantitative representations and explanations of such information until a future period, if at all.

- 3.31 To help assure users that prospective financial and non-financial quantitative information and explanations included in GPFRs faithfully represents the phenomena that they purport to represent, the assumptions that underlie the information disclosed, the methodologies adopted in compiling it, and the factors and circumstances that support any opinions expressed or disclosures made should be transparent. This will enable users to form judgements about the appropriateness of those assumptions and the method of compilation, measurement, representation and interpretation of the information.

### **Constraints on Information Included in General Purpose Financial Reports**

#### *Materiality*

- 3.32 Information is material if its omission or misstatement could influence the discharge of accountability by the entity, or the decisions that users make on the basis of the entity's GPFRs prepared for that reporting period. Materiality depends on both the nature and amount of the item judged in the particular circumstances of each entity. GPFRs may encompass qualitative and quantitative information about service delivery achievements during the reporting period, and expectations about service delivery and financial outcomes in the future. Consequently, it is not possible to specify a uniform quantitative threshold at which a particular type of information becomes material.
- 3.33 Assessments of materiality will be made in the context of the legislative, institutional and operating environment within which the entity operates and, in respect of prospective financial and non-financial information, the preparer's knowledge and expectations about the future. Disclosure of information about compliance or non-compliance with legislation, regulation or other authority may be material because of its nature—irrespective of the magnitude of any amounts involved. In determining whether an item is material in these circumstances, consideration will be given to such matters as the nature, legality, sensitivity and consequences of past or anticipated transactions and events, the parties involved in any such transactions and the circumstances giving rise to them.

#### *Cost-Benefit*

- 3.34 Financial reporting imposes costs. The benefits of financial reporting should justify those costs. Assessing whether the benefits of providing information justify the related costs is often a matter of judgment, because it is often not possible to identify and/or quantify all the costs or benefits of information included in GPFRs.
- 3.35 The costs of providing information include the costs of collecting and processing the information, the costs of verifying it and/or presenting the assumptions and methodologies that support it, and the costs of disseminating it. Users incur the costs of analysis and interpretation. Omission of useful information also imposes costs, including the costs that users incur to obtain needed information from other sources and the costs that result from making decisions using incomplete data provided by GPFRs.

- 3.36 Preparers expend the majority of the effort to provide information in GPFRs. However, service recipients and resource providers ultimately bear the cost of those efforts—because resources are redirected from service delivery activities to preparation of information for inclusion in GPFRs.
- 3.37 Users reap the majority of benefits from the information provided by GPFRs. However, information prepared for GPFRs may also be used internally by management and result in better management decision making. The disclosure of information in GPFRs consistent with the principles identified in this Conceptual Framework and IPSASs derived from them will enhance and reinforce perceptions of the transparency of reporting by governments and other public sector entities and contribute to the more accurate pricing of public sector debt. Therefore, public sector entities may also benefit in a number of ways from the information provided by GPFRs.
- 3.38 Application of the cost-benefit constraint involves assessing whether the benefits of reporting information are likely to justify the costs incurred to provide and use the information. When making this assessment, it is necessary to consider whether one or more qualitative characteristics might be sacrificed to some degree to reduce cost.
- 3.39 In developing IPSASs, the IPSASB considers information from preparers, users, academics, and others about the expected nature and quantity of the benefits and costs of the proposed requirements. Disclosure and other requirements which result in the presentation of information useful to users of GPFRs for accountability and decision-making purposes and satisfy the qualitative characteristics are prescribed by IPSASs unless the costs of compliance with those requirements are assessed by the IPSASB to be greater than their benefits.

*Balance Between the Qualitative Characteristics*

- 3.40 The qualitative characteristics work together in different ways to contribute to the usefulness of information. For example, neither a depiction that faithfully represents an irrelevant phenomenon, nor a depiction that unfaithfully represents a relevant phenomenon, results in useful information. Similarly, to be relevant, information must be timely and understandable.
- 3.41 In some cases, a balancing or trade-off between qualitative characteristics may be necessary to achieve the objectives of financial reporting. The relative importance of the qualitative characteristics in each situation is a matter of professional judgment. The aim is to achieve an appropriate balance among the characteristics in order to meet the objectives of financial reporting.

## Appendix C: Excerpt from IPSAS 20 – “Key Management Personnel”

### Key Management Personnel

6. Key management personnel include all directors or members of the governing body of the reporting entity, where that body has the authority and responsibility for planning, directing, and controlling the activities of the entity. At the whole-of-government level, the governing body may consist of elected or appointed representatives (for example, a president or governor, ministers, councilors and aldermen or their nominees).
7. Where an entity is subject to the oversight of an elected or appointed representative of the governing body of the government to which the entity belongs, that person is included in key management personnel, if the oversight function includes the authority and responsibility for planning, directing, and controlling the activities of the entity. In many jurisdictions, key advisors of that person may not possess sufficient authority, legal or otherwise, to satisfy the definition of key management personnel. In other jurisdictions, key advisors of that person may be deemed to be key management personnel because they have a special working relationship with an individual who has control over an entity. They therefore have access to privileged information, and may also be able to exercise control or significant influence over an entity. Judgment is required in assessing whether an individual is a key advisor, and whether that advisor satisfies the definition of key management personnel, or is a related party.
8. The governing body, together with the chief executive and senior management group, has the authority and responsibility to plan and control the activities of the entity, to manage the resources of the entity and for the overall achievement of entity objectives. Therefore, key management personnel will include the chief executive and senior management group of the reporting entity. In some jurisdictions, civil servants will not have sufficient authority and responsibility to qualify as key management personnel (as defined by this Standard) of the whole-of-government reporting entity. In these cases, key management personnel will consist only of those elected members of the governing body who have the greatest responsibility for the government; often these persons are referred to as Cabinet Ministers.
9. The senior management group of an economic entity may comprise individuals from both the controlling entity and other entities that collectively make up the economic entity.