

Comments on
IPSASB
CONCEPTUAL FRAMEWORK
EXPOSURE DRAFT 2

"Measurement of Revenue and Expenses in Financial Statements"

Graeme Hall-Watson BCA. CPA.

Introductory Comments

I have had 22 years as a corporate accountant in the private sector and for the last 18 years I have specialised in financial reporting and budgeting in the public sector, most significantly in local government. Since Australia introduced accrual accounting into this sector in 1994, the issue of financial reporting on sustainability through the maintenance of the entity's physical operating capability, has been the focus I have pursued. Many Queensland local governments have adopted this reporting framework.

The measurement of and the reporting on the physical operating capability has not been recognised in the submissions I have read to date. The ability of a public sector entity to deliver services to the community on a perpetual basis relies on its ability to maintain its physical operating capability at a financially sustainable level.

While the IPSASB correctly seeks to identify and measure the value of assets and liabilities, the components of equity do not get a mention. The attached discussion paper that I have written seeks to bring the components of equity into focus as an important element of reporting on the financial performance and sustainability of the entity.

When considering the maintenance of the physical operating capability, it is important to report on whether the opening value has been maintained at the end of the reporting period. The measurement of this is found in the net operating result. I would suggest that in adopting this framework, a profit has not been made unless the physical operating capability at the end of the period has been maintained. My discussion paper goes into this in more detail.

Within the public sector and in particular local government, there are elements of current period revenue and expenses that have no or little relevance in the measurement of the financial performance in the reporting period, but do impact on the ability to maintain the financial performance in future periods. These are items of capital income and capital expenditure as described in my paper.

While all enterprises seek to be financially successful, the measurement of this outcome should be seen as fundamentally different for the stakeholders. For those in the public sector the indicators of financial sustainability at all levels of government are different from the private sector. The community, whether it be at national, state or at local government level, require financial reports that clearly identify whether the elected representatives are administering their responsibilities to

perpetually deliver services to the community they represent. Simply recognising all revenue and expenses in the statement of financial performance, without identifying the operating component or elements, fails this test.

My discussion paper on "Business Sustainability, the Accounting Concepts of Capital and Funded Depreciation" is attached as my contribution to the debate.

Graeme Hall-Watson April 28th 2013

BCA. (NZ) CPA. (Australia)

Director

Framme Accounting Services

Brisbane, Australia.

Email: framme@bigpond.net.au

SPECIFIC MATTERS FOR COMMENT

Specific Matter for Comment 3

Do you agree with the definition of revenue?

Yes - but

I agree with the definition of revenue for the public sector. The recognition of revenue in the financial reports must have a matching principle in the public sector, to ensure the operating result and net result can provide the reader with reliable financial indicators of financial performance.

However as mentioned above, it should also identify and define operating revenue and capital revenue. The criteria for the recognition of all revenue is the same, but the need to split it is equally important as it provides the right information to be able to correctly assess the financial performance. Without knowing the total of operating income and operating expenses, the net operating result can not be determined. It is this operating result that is the main indicator of whether the opening physical operating capacity has been maintained. This is detailed further in my attached discussion paper.

Operating revenue may be defined as that which is received for the purpose of funding operating expenses recognised in the period.

Capital revenue may be defined as that which is received for the specific purpose of funding the acquisition or construction of capital assets. The restriction is imposed as a condition by the funds provider. These would include capital grants and capital contributions that are restricted to be expended on capital assets. Capital income that will be disclosed in the statement of financial performance will include a profit that arises from the disposal of capital assets or a gain that arises

from a change in value of capital assets that must be recognised through the statement of financial performance. The value of physical assets contributed to the entity is recognised as capital revenue.

Specific Matter for Comment 4

Do you agree with the definition of expenses?

Yes - but

I agree with the definition of expenses for the public sector. The recognition of expenses in the reporting must have a matching principle in the public sector to ensure the operating result and net result can provide the reader with reliable financial indicators of financial performance.

However as mentioned above, it should also identify and define operating expenses and capital expenses. The criteria for the recognition of all expenses is the same, but the need to split it is equally important for the reader to assess the correct financial performance. Without knowing the total of operating income and operating expenses, the net operating result can not be determined. It is this operating result that is the main indicator of whether the opening capital capacity has been maintained.

Operating expenses may be defined as recurrent outflows incurred for the purpose of delivering recurrent services to the community and includes the cost of consumption of the service potential of the capital assets used in the delivery of those services (depreciation).

Capital outflows may be defined as expenditures that directly affect the net capital asset value of the entity. This would therefore include funds used to pay down capital loans or debt. Capital expenses that will be disclosed in the statement of financial performance will include the loss from the disposal of capital assets and changes in value of capital assets that give rise to a loss.

Specific Matter for Comment

4. Revenue and Expenses

Definitions

4.7 Financial Performance

I disagree with the statement that "The difference between revenue and expenses is the entity's surplus or deficit for the period, which is the primary indicator of financial performance"

In the public sector and in particular the local government sector, it is the difference between the operating income and operating expenses that is the indicator of financial performance not the net result that arises from deducting total expenses from total revenue. Unless the opening capital capacity has been maintained as measured by an operating surplus or deficit, a profit has not been made in the period.

For example, the inclusion of the revenue arising from the recognition of a physical asset in the measurement of financial performance, can turn an operating deficit into a net surplus. The underlying operating deficit which indicates a reduction in the entity's physical operating capacity is totally masked by the inclusion of this capital revenue when assessing the financial performance. The recognition of physical assets in a reporting period adds to opening capital value in the next reporting period, but does not add to the financial performance in the current period.

In the statement of financial performance there should be recognition firstly of the operating income and expenses arriving at a net operating surplus or deficit. After the operating result the capital income and expenses should be recognised arriving at a net result for the period. The net result has little significance in the measurement of financial performance in local government.

The measurement of management's financial performance should be gauged on whether the entity's opening physical operating capability has been maintained. This is a strong indicator of financial sustainability. The net result does not provide the reader with this information.

Your faithfully,

Graeme Hall-Watson

Director

Framme Accounting Services

Email: framme@bigpond.net.au