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Submitted to: [www.ifac.org](http://www.ifac.org)

Dear Stephenie

#### **ED 47 Financial Statement Discussion and Analysis**

The New Zealand Accounting Standards Board (NZASB) is pleased to submit its comments on Exposure Draft 47 *Financial Statement Discussion and Analysis* (ED 47). We issued ED 47 for comment in New Zealand and, as a result, you may also receive comments directly from New Zealand constituents.

Having considered arguments for and against mandatory financial statement discussion and analysis (FSDA), we do not support the IPSASB's proposal to issue a standard on this topic (see also our response to Specific Matter for Comment 1). In our view the IPSASB should issue this guidance as a Recommended Practice Guideline (RPG).

The NZASB strongly supports guidance that would lead to high quality commentary that is consistent with and complements the financial statements and statements of service performance, but considers that a mandatory standard is not the best way to achieve this. A mandatory standard may even have the opposite effect if preparers respond by treating it as a compliance exercise or create an additional report.

We consider that the proposals in ED 47 would require further development if the IPSASB wished to issue a standard. In particular, we have identified a number of issues relating to scope, being:

- (a) Clarification of the information that should be included in the FSDA over and above that already disclosed in the financial statements. ED 47, paragraph 16, acknowledges the potential for similar information to be required by both FSDA and the financial statements. It states "However, some matters may be required to be included in the financial statements by relevant IPSASs that may also be required to be included in financial statement discussion and analysis in accordance with this Standard. In those cases, financial statement discussion and analysis should not merely repeat what is in the financial statements, but it should complement and supplement the financial statement

explanations by providing insights and perspectives thereon.” We do not consider that this guidance is sufficient to assist preparers in deciding for example, what information to provide about financial risks, over and above the risk disclosures already made in accordance with IPSAS 30 *Financial Instruments: Disclosures*. We consider that further detailed guidance is required in respect of this and other topics to help preparers identify the information that should be included in FSDA.

- (b) The links between FSDA and non-financial information such as objectives and strategies (we have separately discussed service performance information below); and
- (c) whether the focus of the FSDA is limited to past events, as reported in the historical financial statements, or is required to look to the future.

We consider that guidance, rather than a standard, would be more appropriate at this point. An RPG would provide an opportunity for useful guidance for those jurisdictions that do not already have such guidance or legislative requirements and, over time, an RPG could influence reporting by those that do have existing requirements. Furthermore, we note that a key reason the International Accounting Standards Board (IASB) issued *Management Commentary* as a practice statement rather than a standard is because of the need for flexibility in the face of existing national requirements.

We note that the IPSASB decided to limit the scope of the project to discussion and analysis of an entity’s general purpose financial statements. In our view, the scope of any discussion and analysis in the public sector should be on the general purpose financial report as a whole, not just on the financial statements.

Whilst we understand that the IPSASB has a separate project on service performance reporting and may not wish to prejudge the outcome of that project, we consider that any public sector guidance on analysis and discussion would be incomplete unless it signalled a strong expectation that the FSDA would be accompanied by a well-connected service performance discussion. We consider that IPSASB should issue guidance on service performance before issuing guidance on discussion and analysis. Explanations of variances in reported performance have limited value if they ignore a key aspect of public sector performance.

We have responded to the specific matters for comment posed in the Exposure Draft in the appendix to this letter. Our responses should be read in the context of our strong preference for the IPSASB to issue guidance rather than a standard.

If you have any queries or require clarification of any matters in this submission, please contact Joanne Scott ([joanne.scott@xrb.govt.nz](mailto:joanne.scott@xrb.govt.nz)) or me.

Yours sincerely



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## Appendix

### NZASB's comments and Responses to the Specific Matters for Comment on ED 47

#### Specific Matter for Comment 1:

Do you agree that the material presented in this Exposure Draft should be developed as an IPSAS, with the same level of authority as the accrual based IPSASs, which applies to all entities that prepare financial statements in accordance with IPSASs?

In responding to this question we have considered both arguments for and against having a standard which mandates the presentation of financial statement discussion and analysis (FSDA) in conjunction with general purpose financial statements.

We agree that all entities preparing financial statements should also present FSDA to accompany those statements. However, we are not persuaded that it is appropriate for the IPSASB to issue an IPSAS based on ED 47. The following factors have influenced our views:

- (a) The proposals would require further development if they were to be mandatory (see also our cover letter and our response to Specific Matter for Comment 3).
- (b) We are unsure how the proposals would work in practice and consider that there is potential for the proposals to undermine the credibility of the "IPSAS" brand. In particular, we are concerned that a "standard" is issued that uses the same terminology as a "financial reporting standard" while not applying to the financial statements. For example, we considered what would happen if an entity produced IPSAS-compliant financial statements but produced FSDA which was not in accordance with the proposed IPSAS on FSDA. The entity would be able to assert compliance with IPSASs in respect of its financial statements but would be unable to assert compliance in respect of the separate IPSAS on FSDA. In some jurisdictions, this could lead to an explicit audit qualification in respect of the FSDA. We consider that this would be confusing for users of the financial statements and could create a credibility problem for the management of the entity.
- (c) A number of public sector entities in New Zealand already provide discussion and analysis on their financial and service performance. In some cases this information is subject to legislative requirements and in other cases it is provided voluntarily. A mandatory standard on FSDA could overlap or conflict with existing requirements. It could lead to entities producing an additional report rather than trying to meet both sets of requirements in one report. We do not consider that this would be a desirable outcome. We would prefer the emphasis to be on producing high quality and accessible reporting, rather than on producing more reports. Non-mandatory guidance on FSDA is less likely to give rise to this concern.
- (d) Other jurisdictions are also likely to have existing legislative or administrative requirements for various types of public sector entities. A mandatory standard could also conflict with these requirements.

We note that the IASB faced a similar decision when it was considering the status to accord its guidance on *Management Commentary* and subsequently decided to issue a non-mandatory Practice Statement. We have reviewed some of the comments made by respondents to the IASB Exposure Draft preceding the issue of the Practice Statement and note that avoiding inconsistency with existing national requirements was a common theme.

On the other hand, the IPSASB, as an international standard setter could issue a standard on FSDA and regulators or legislators in each jurisdiction could choose whether or not to require application of that standard. Under this approach it would need to be clear that compliance with the FSDA standard is not required in order for an entity to be able to assert that its financial

statements are in compliance with IPSASs, with the potential for confusion about the scope of IPSASs.

Having regard to the above comments, our preference would be for the IPSASB to issue a Recommended Practice Guideline (RPG) on this topic. Providing guidance by way of an RPG could lead to improvements in existing reporting and provide a benchmark for jurisdictions that do not currently have any requirements or guidance.

Further, we note that guidance on *Reporting on the Long-Term Sustainability of a Public Sector Entity's Finances* will not be issued as a Standard. As both documents address information that supplements the financial statements, we recommend that they be accorded the same status.

We recommend that any forthcoming guidance acknowledge that similar information may already be required in a particular jurisdiction, and give entities guidance on whether information must be duplicated or whether cross referencing to that other information is adequate.

**Specific Matter for Comment 2:**

Do you agree that IPSAS 1 should be amended to clearly indicate that financial statement discussion and analysis is not a component of the financial statements?

Yes, we consider that if the IPSASB were to issue an IPSAS on FSDA it would be appropriate to clarify that FSDA is not a component of the financial statements.

**Specific Matter for Comment 3:**

Is the scope of financial statement discussion and analysis clearly defined so as to distinguish it from other issues being addressed by the IPSASB (e.g., financial statements, service performance reporting, reporting on the long-term sustainability of public finances)?

As outlined in our cover letter we consider that the scope of FSDA, as outlined in ED 47, needs further clarification. We note there instances where we consider further development is required.

In instances where an entity is already likely to have made disclosures in the financial statements that are relevant to FSDA, we consider that there needs to be more guidance on deciding what additional information should be reported in the FSDA.

We consider that service performance reporting is an essential component of a general purpose financial report and that a service performance report should be accompanied by associated explanations (similar to the discussion and analysis of the financial statements). The two forms of commentary need to be well connected: for example, poorer financial performance can limit the levels of service performance, or higher levels of service performance may cause higher levels of expenditure which negatively affect financial performance.

The financial statements report on historical events and transactions. We consider that as the purpose of the FSDA is to provide users with a better understanding of those historical events and transactions, and any requirements to discuss future events and transactions or provide oriented information should be limited and appropriately justified.

**Specific Matter for Comment 4:**

Is the required content for financial statement discussion and analysis appropriate?

Subject to our preference that the guidance be voluntary, and our comments about the need to clarify the links between FSDA and other types of information presented by an entity, we consider that the proposed content is generally appropriate.

We note that the proposed content is broadly similar to that required by the U.S. Securities and Exchange Commission's (SEC) Form 10-Q. Form 10-Q, together with Item 303 of Regulation S-K *Management's Discussion and Analysis ("MD&A") of Financial Condition and Results of Operations* is one of the most commonly requested mandatory financial filings requested by investors. We are not suggesting that the disclosures should be identical to those required in the private sector but, given the focus on user needs in the IPSASB's developing conceptual framework, the IPSASB might want to consider why these disclosures are useful.

The ED does not address the issue of entities presenting information on a basis different to that in the financial statements (commonly referred to as non-GAAP information). We note that a number of regulators have issued or are considering issuing guidance on non-GAAP information. One of the matters they are addressing is whether additional disclosures should be made so that the non-GAAP information is not misleading. Although the IPSASB is not a regulator, a discussion of non-GAAP information could be appropriate in the context of discussing the requirement in paragraph 10 that "financial statement discussion and analysis shall be consistent with the financial statements".

**Specific Matter for Comment 5:**

Do you agree with the transitional provisions and effective date?

In the event that the IPSASB decides to proceed and issue a standard, we consider that the proposed transitional provisions would be appropriate. Any transitional provisions would need to be reviewed on completion of the project on first-time adoption (as the location of some transitional provisions may change).

**Specific Matter for Comment 6:**

Is the Implementation Guidance useful to understanding the requirements of the proposed IPSAS?

We do not consider that implementation guidance is essential, but acknowledge that it could be useful, particularly for those countries which do not have existing guidance on this topic.

**Specific Matter for Comment 7:**

Is the Illustrative Example a useful way of illustrating the requirements of the proposed IPSAS?

We are concerned that some of the material covered in the Illustrative Examples is very broad and could be used as an opportunity to make political statements, rather than explaining the background to the financial statements. For example, the discussion about the "Economic Action Strategy" goes beyond material that is usually contained in a general purpose financial

report. If the Illustrative Example is retained, we recommend that it (i) be limited to issues of direct relevance to general purpose financial reporting; (ii) include an explanation of how the information in the FSDA links to the financial statements themselves and other general purpose information presented by the entity, including service performance information and information on long term sustainability and (iii) a note that there may be other aspects of the entity's strategy that are not included in the general purpose financial report.

Another suggestion for the Illustrative Examples is the use of a section on "frequently asked questions" as a way of making information more accessible to readers. We are aware of an entity that has used this approach and has had positive feedback (see Sky Television Limited Annual Report 2011, pages 9 and 10, <http://www.skytv.co.nz/company-profile.aspx>).