

FINANCIAL STATEMENT DISCUSSION AND ANALYSIS



**INTERNATIONAL FEDERATION
OF ACCOUNTANTS**

545 Fifth Avenue, 14th Floor Tel: (212) 286-9344
New York, New York 10017 Fax: (212) 286-9570
Internet: <http://www.ifac.org>

Agenda Item

5

Date: November 22, 2011
Memo to: Members of the IPSASB
From: Joy Keenan
Subject: Approve Exposure Draft

Objective

To **approve** an Exposure Draft (ED)

Agenda Material

- 5.0 Covering Memo (includes extracts from September 2011 Minutes)
- 5.1 Draft ED – Financial Statement Discussion and Analysis
- 5.2 Analysis of Type of Pronouncement to be Issued

Background

1. The Task-Based Group (TBG) assisting staff in this project consists of:
 - Hong Lou (Yangchun Lu)
 - Bharti Prasad (Preeti Jha)
 - Ron Salole
 - Frans van Schaik

The TBG met once via conference call and reviewed two drafts of the draft ED.

2. At its June 2011 meeting, the IPSASB considered an issues paper which followed the scope set out in the March 2008 Project Brief. The scope of the project in the Project Brief was limited 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 should focus on information contained in the financial statements.
3. The IPSASB had a lengthy discussion at its September 2011 meeting about whether the mandatory guidance should be an IPSAS or another type of pronouncement (see draft Minutes). The IPSASB tentatively decided that mandatory guidance should be produced and

instructed staff to develop a draft ED of a mandatory standard for consideration at its December 2011 meeting (see Agenda Paper 5.1).

4. The IPSASB is asked to consider whether the draft ED addresses the IPSASB's comments appropriately, and what further changes are necessary to approve the draft ED for issuance.
5. Note that your comments need not be limited to information presented in the draft ED. Please also consider whether any critical issues have not been identified and addressed, as well as the overall structure and presentation of the document.

Questions for the IPSASB:

- 1. Overall, do you consider the draft ED to be complete?**
- 2. Is the flow and logic of the draft ED appropriate?**

Specific Issues for Discussion

Scope and Authority

6. The draft ED in Agenda Paper 5.1 reflects the IPSASB's tentative decision to produce a mandatory IPSAS, following the IPSASB's due process.
7. At the September 2011 meeting, staff was also directed to develop a paper outlining pros and cons of various approaches, including the consideration as to whether financial statement discussion and analysis should be mandatory as the IPSASB had previously tentatively agreed to (see paper 5.2).
8. A discussion of alternatives reflecting staff's preferred position has been added the Basis for Conclusions and the matter has been identified in the Specific Matters for Comment, as directed by the IPSASB in September 2011.

Questions for the IPSASB:

- 3. See Agenda Paper 5.2?**

Links to the IPSASB Conceptual Framework

9. As directed by the IPSASB at the September 2011 meeting, the specific references to the objectives, users, and qualitative characteristics have been moved from the body of the draft ED to Implementation Guidance and shortened considerably.

Question for the IPSASB:

- 4. Is the extent of guidance linking financial statement discussion and analysis with the objectives, users, and QCs of GPFRs appropriate?**

Content of Financial Statement Discussion and Analysis

10. The draft ED contains general principles and specific required disclosures. These were derived from material in the June 2011 Issues Paper and existing pronouncements (both IPSASs and those related to financial statement discussion and analysis).

11. Additional guidance has been provided that indicates that if the matter is addressed in financial statements, it is not required to be duplicated in the financial statement discussion and analysis.
12. Staff considers these requirements strike an appropriate balance between the need for flexibility to allow entities to tailor the disclosures to their specific circumstances and promoting a degree of consistency among entities.

Questions for the IPSASB:

- 5. Do you agree with the specific required financial statement discussion and analysis content and related guidance in the draft ED?**
- 6. Does the draft ED clearly explain the IPSASB's rationale for the required content?**

Transition

13. The transitional provisions are consistent with IPSAS 1, but additional wording is provided to indicate that financial statement discussion and analysis is intended to cover the two accounting periods required to be presented under IPSAS 1.

Question for the IPSASB:

- 7. Is the intent of the transitional provisions in the draft ED clear?**

Basis for conclusions

14. The draft ED contains a Basis for Conclusions that reflects the IPSASB's tentative conclusions on key issues. It includes the matters identified for inclusion agreed to at the September 2011 IPSASB meeting (type of pronouncement, why not a convergence project, basis for required content).

Questions for the IPSASB:

- 8. Are the explanations provided in the draft Basis for Conclusions appropriate?**
- 9. Should the Basis for Conclusions address additional matters?**

Implementation guidance

15. At the June 2011 meeting, the IPSASB tentatively decided the draft ED should contain implementation guidance on types of information that may be included in financial statement discussion and analysis to illustrate the principles in the draft ED. At the September 2011 meeting the IPSASB further agreed to include in the ED an illustrative example.
16. The example has been further developed since the September meeting.

Questions for the IPSASB:

- 10. Do you agree with the material included in the Implementation Guidance?**
- 11. Do you agree with the Illustrative Example included in the draft ED?**

Appendix A: Extract from Draft September 2011 IPSASB Minutes

8. FINANCIAL STATEMENT DISCUSSION AND ANALYSIS

Discuss draft Exposure Draft (Agenda Item 7)

Staff outlined the prior decisions of the IPSASB that were the basis for developing the draft ED:

- The guidance developed should be mandatory; and
- The report relates solely to the financial statements (not the broader forms of “narrative reporting”). Thus, the title of the report was to be “financial statement discussion and analysis” to clearly indicate the nature of the report.

Authority and Type of Pronouncement

There was some discussion as to whether the financial statement discussion and analysis was considered part of the financial statements. If so, it was noted that consequential changes would be required to IPSAS 1, *Presentation of Financial Statements*.

A concern was also expressed that if the pronouncement developed were an IPSAS, this would create problems with the audit of the financial statements. If an entity asserts compliance with IPSASs for its financial statements, it would include the proposed standard on financial statement discussion and analysis. Requiring financial statement discussion and analysis to be part of the financial statements could create difficulties in asserting compliance with IPSASs which, in turn, could result in qualified audit opinions. A Member pointed out that producing an IPSAS did not necessarily mean that financial statement discussion and analysis is part of the financial statements and subject to audit; only that if IPSAS-based financial statements are prepared, financial statement discussion and analysis should accompany them. Another Member countered that the impact is to draw the financial statements and financial statement discussion and analysis together and in substance, to extend the boundary of the financial statements.

Members agreed that financial statement discussion and analysis was crucial to accountability and thus should be mandatory. The issue therefore centers on what type of pronouncement should be issued. Staff was directed to prepare an analysis of the pros and cons of the three possible types of a final pronouncement. The Specific Matters for Comment in the ED and the Basis for Conclusions should outline the issues.

There was discussion of whether it was intended that financial statement discussion and analysis would be required for interim financial statements. Members agreed that it should be required only for the annual financial statements of an entity and that this should be clearly articulated.

This would also be included as a specific matter for comment in the ED.

Definition

Members agreed that the proposed definition of financial statement discussion and analysis is circular and needs to be clarified.

It was agreed that the reference to “information” should be replaced with “transactions and events”.

Future-oriented Information

A Member noted the proposed ED contained some language that seemed to indicate a requirement for forward-looking information to be included in financial statement discussion and analysis. Another Member pointed out that financial statements although presenting historical information also have predictive ability. Members agreed that the guidance should be clarified to specifically not require future-oriented information.

Implementation Guidance and Illustrative Example

Members agreed that, because of the subjective nature of certain of the proposed qualitative characteristics identified, compliance may be difficult. Members also noted that those characteristics, which were consistent with the qualitative characteristics in CF-ED1, should be moved from the main body of the proposed standard, and included in implementation guidance, after shortening the related discussion of each characteristic substantially.

With respect to the need for implementation guidance, Members noted that including such guidance could have a negative impact on the need for financial statement discussion and analysis to be specific to an entity, and instead, promote a “checklist” preparation of such reports, which would decrease their usefulness. On balance, however, Members supported further development of the illustrative example because it would illustrate, during consultation, the principles in the ED, which would allow for better-informed comments on the ED. A Member noted that such examples were generally well-received by jurisdictions without significant resources to develop their own approach when initially adopting a proposed standard.

Required Content

Members generally supported the proposed required content of financial statement discussion and analysis. Members agreed on the following matters:

- This section of the proposed ED should be moved up as it is the requirements for financial statement discussion and analysis.
- Guidance needs to be provided for required financial statement discussion and analysis content in cases where the required content is also part of the requirements for the financial statements and addressed in other IPSASs (i.e., the information should not be simply repeated in financial statement discussion and analysis—it is important that financial statement discussion and analysis provide further explanations not in the financial statements). This would apply, for example, to the guidance on the organization chart, actual-to-budget comparisons.
- The risks discussed should not be limited to financial risks, but should be entity-wide. The entity’s opportunities should also be included.
- There needed to be more discussion in the body of the proposed Standard under the paragraph 59(f) in “entity’s financial statements” section (in addition to the material in the proposed Implementation Guidance presented in the agenda papers). This section also should include a discussion of other relevant financial statement matters, such as related party transactions.
- The Basis for Conclusions needs to provide a rationale for the IPSASB’s choice of the required content elements to be included in financial statement discussion and analysis.

Transitional Provisions

- Members agreed that the transitional provisions should only refer to the case where no comparative information is provided in the financial statements. Implementation should be on a prospective basis that covers the two-year period covered by the financial statements prepared under IPSASs.

Next Steps

- The IPSASB will discuss a revised draft ED at its December 2011 meeting, with a view to approval.

Exposure Draft 48

Month 2012

Comments are requested by MM DD, 2012

*Proposed International Public Sector Reporting
Standard*

**Financial Statement Discussion and
Analysis**



International Federation
of Accountants

REQUEST FOR COMMENTS

The International Public Sector Accounting Standards Board, an independent standard-setting body within the International Federation of Accountants (IFAC), approved for publication in December 2011 this Exposure Draft, ED 48, *Financial Statement Discussion and Analysis*. The proposals in this Exposure Draft may be modified in light of comments received before being issued in final form. **Comments are requested by May 31, 2012.**

Respondents are asked to submit their comments **electronically** through the IFAC website (www.ifac.org), using the “Submit a Comment” link on the [Exposure Drafts and Consultation Papers page](#). Please submit comments in both a PDF and Word file. Also, please note that first-time users must register to use this feature. All comments will be considered a matter of public record and will ultimately be posted on the IFAC website. Although IFAC prefers that comments be submitted electronically, e-mail may be sent to stepheniefox@ifac.org. Comments can also be faxed to the attention of the IPASB Technical Director at +1 (416) 977-8585, or mailed to:

The Technical Director
International Public Sector Accounting Standards Board
International Federation of Accountants
277 Wellington Street, 4th Floor
Toronto, Ontario M5V 3H2 CANADA

Copies of this exposure draft may be downloaded free-of-charge from the IFAC website at <http://www.ifac.org>

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Objective of the Exposure Draft

The objective of this Exposure Draft (ED) is to propose an authoritative Standard for the preparation of financial statement discussion and analysis by public sector entities.

Guide for Respondents

The IPSASB would welcome comments on all of the matters discussed in this Exposure Draft. Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording.

The Specific Matter for Comment requested in the Exposure Draft is provided below.

Specific Matter for Comment 1

Do you agree that the material presented in this Exposure Draft should be developed as a mandatory IPSAS?

**INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARD
XX (ED 48)—FINANCIAL STATEMENT DISCUSSION AND
ANALYSIS
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IPSAS XX (ED 48), *Financial Statement Discussion and Analysis* is set out in paragraphs 1–45. All the paragraphs have equal authority. IPSAS XX (ED 48) should be read in the context of its objective, the Basis for Conclusions, and the *Preface to International Public Sector Accounting Standards*. IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

1. The objective of this Standard is to prescribe reporting requirements for an entity's financial statement discussion and analysis that relates to financial statements prepared and presented under the accrual basis of accounting in accordance with International Public Sector Accounting Standards (IPSASs). The Standard does not specify detailed lists of specific disclosures, but rather, the type of content expected to be reported at a with examples of what such disclosures might look like to allow entities to tailor the disclosures to their specific circumstances.

Scope

2. **This Standard shall be applied to all financial statement discussion and analysis related to general purpose financial statements prepared and presented under the accrual basis of accounting in accordance with IPSASs.**
3. This Standard applies only to financial statement discussion and analysis. It does not apply to other information presented in either the general purpose financial statements or in general purpose financial reports.
4. **This Standard applies to all public sector entities other than Government Business Enterprises.**
5. The *Preface to International Public Sector Accounting Standards* issued by the IPSASB explains that Government Business Enterprises (GBEs) apply IFRSs issued by the IASB. GBEs are defined in IPSAS 1, *Presentation of Financial Statements*.

Definition

6. **The following term is used in this Standard with the meaning specified:**

Financial statement discussion and analysis is a report prepared by those responsible for the preparation of an entity's financial statements that discusses and analyzes significant items, transactions, and events presented in the financial statements and the trends and factors that influenced them.

Terms defined in IPSASs are used in this Standard with the same meaning as in those Standards, and are reproduced in the *Glossary of Defined Terms* published separately.

Objective of Financial Statement Discussion and Analysis

7. **Where an entity prepares its general purpose financial statements in accordance with IPSASs, it shall also prepare financial statement discussion and analysis in accordance with this Standard.**
8. Transactions entered into by public sector entities may be complex and the financial statements that report on such transactions may be consequently complex and detailed. The objective of financial statement discussion and analysis is to assist the users of the financial statements in understanding and interpreting the financial statements, by

expanding on and explaining information contained in the financial statements in ways that they can more readily understand.

9. Financial statement discussion and analysis accompanies the entity's financial statements but is not part of the audited financial statements of an entity. Some jurisdictions may nevertheless require financial statement discussion and analysis to be included as part of the entity's financial statements and to be audited.
10. **Financial statement discussion and analysis shall include information that possesses the qualitative characteristics of general purpose financial reports identified in Conceptual Framework ED 1¹.**
11. **Financial statement discussion and analysis shall include clear and concise information about significant financial statement items, transactions, and events presented in the financial statements that, in management's view, are most relevant to assisting users to understand the financial statements.**
12. Financial statement discussion and analysis provides management perspective and insights about the financial statements. It needs to be clear and concise to be useful, therefore management must select the most important, or material, matters to include, should use descriptions that are not too technical, and should not provide excessive detail. Inclusion of information about immaterial items could make the more important information difficult to find.

Identification and Responsibility

13. **Financial statement discussion and analysis shall be identified clearly, and distinguished from other information in the same published document.**
14. Financial statement discussion and analysis is based on, and intended to complement and supplement, the financial statements prepared using IPSASs. For the purposes of this Standard, it is assumed that:
 - (a) The party responsible for the preparation of the financial statement discussion and analysis is the same party having responsibility for the preparation and presentation of the entity's financial statements as described in IPSAS 1, *Presentation of Financial Statements*; and
 - (b) An entity will present the financial statements and the financial statement discussion and analysis in the same general purpose financial report (GPFR).
 - (c) Financial statement discussion and analysis will be prepared to accompany the annual financial statements.

¹ The qualitative characteristics of GPFRs are described in Conceptual Framework ED 1 (CF—ED1), *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: Role, Authority and Scope; Objectives and Users; Qualitative Characteristics; and Reporting Entity*. CF—ED1 is available at: <http://ifac.org/Guidance/EXD-Details.php?EDID=0147>

15. Information in a published document that is prepared using IPSASs should be distinguished from other information that may be useful to users but is not the subject of those requirements. Therefore, when the financial statements and financial statement discussion and analysis are included in a published document that also includes other information, it is important to clearly distinguish them from that other information, which is not the subject of this Standard.
16. **An entity shall disclose in the financial statement discussion and analysis that it has complied with this Standard in preparing its financial statement discussion and analysis.**
17. In some jurisdictions, preparation of financial statement discussion and analysis is required by legislative, regulatory, or other externally-imposed regulations. In such cases, the financial statement discussion and analysis may also refer to the relevant authority to demonstrate the entity's compliance with the relevant authority.

Content of Financial Statement Discussion and Analysis

18. **To the extent it does not replicate information in the financial statements financial statement discussion and analysis shall include, at a minimum:**
 - (a) **An overview of the financial statements;**
 - (b) **An overview of the entity;**
 - (c) **Information about the entity's strategy;**
 - (d) **An analysis of the current period financial statements;**
 - (e) **Information about the entity's financial risks and uncertainties, including its financial risk management strategy; and**
 - (f) **Analyses of variances and trends.**
19. Financial statement discussion and analysis provides a means of improving public sector entities' accountability and decision making. Some of the matters included in financial statement discussion and analysis may also be required to be included in the financial statements in accordance with IPSASs. It is not intended that financial statement discussion and analysis simply repeat what is in the financial statements, but that it complement and supplement the financial statement explanations by adding management's insights and perspectives thereon.
20. In addition, other IPSASs permit certain information to be disclosed elsewhere in information published with the financial statements. Such other information may be disclosed in financial statement discussion and analysis.

21. 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, as discussed below.

Overview of the financial statements

22. The overview or summary provides an executive overview of the financial statements and outlines the significant events and activities that have affected those financial statements, without simply reiterating the information presented in the financial statements. It may also include a brief discussion of the purpose of, and information provided by, each of the financial statements and their interrelationships. In addition, this section of the financial statement discussion and analysis would describe the scope of the financial discussion and analysis when certain information is not presented on the same basis as the related financial statements (e.g., due to unavailability of information for the entire entity, or for the full reporting period of the financial statements).

Overview of the entity

23. An overview the entity helps users to understand the entity and the environment in which it operates. For example, additional information provided about the entity's operations in financial statement discussion and analysis may include:
- (a) The entity's mission and vision.
 - (b) An organization chart.
 - (c) 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 (e.g., the impact of a regional or international financial crisis on employment, the tax base, or interest rates in the jurisdiction).
 - (d) The entity's service delivery methods (e.g., outsourcing, service concession arrangements) and significant changes in them.

Information about the entity's objectives and strategy

24. Financial statement discussion and analysis should report the entity's objectives and strategies in a way that enables users of the financial statements to understand the entity's priorities and to identify the resources that must be managed to deliver results. For example, information about how management intends to address economic and demographic trends and the threats and opportunities associated with those trends provides users of the financial statements with insight that may shape their expectations about the entity's future performance.

25. Management should discuss significant changes in an entity's objectives and strategies from the previous period or periods. Discussion of the relationship between objectives, strategy, management actions and executive remuneration is also helpful.

The entity's current period financial statements

26. **Financial statement discussion and analysis shall be consistent with the financial statements, unbiased, and based on currently-known facts and verifiable and supportable assumptions.**
27. Financial statement discussion and analysis complements and supplements the related financial statements. It is important that information presented in the financial statement discussion and analysis does not go beyond or contradict the information presented in the financial statements.
28. If information from the financial statements has been adjusted for inclusion in financial statement discussion and analysis, that fact should be disclosed. If financial performance measures that are not required or defined by IPSASs are included within financial statement discussion and analysis, those measures should be defined and explained, including an explanation of the relevance of the measure to users. When financial performance measures are derived or drawn from the financial statements, those measures should be reconciled to measures presented in the financial statements that have been prepared in accordance with IPSASs. In addition, narrative explanations of such illustrations may also be required to accurately and completely present the information.
29. Financial statement discussion and analysis may also demonstrate linkages and dependencies among financial statement items that users may not otherwise be able to identify. Information about the entity's financial statements should include information about the entity's:
- (a) Financial position;
 - (b) Financial performance;
 - (c) Cash flows;
 - (d) Related party transactions; and
 - (e) Commitments, contingencies, and events after the reporting date.
30. A line-by-line analysis of the financial statements is not generally appropriate. Instead, financial statement discussion and analysis should summarize the most important items, explain the relevant causes and effects, and place them in context.
31. When reporting at a whole-of-government level, it is necessary to report specific information by significant segment (e.g., geographic regions or industry such as agriculture, manufacturing, fishing, banking) or function (e.g., health, welfare, education, transportation, recreation, justice) to allow for a better understanding of the significant activities for which the entity is accountable. When the entity is not a

government, the nature of the entity's operations may be more homogeneous and readily apparent from the financial statements without reporting by segment.

Financial risks and uncertainties

32. Information about the entity's financial 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, its opportunities, along with its policies and strategies for mitigating the risks and capitalizing on opportunities. It may also include the entity's evaluation of the effectiveness of its financial risk management strategies. It is noted, however, that these need to be fact-based and take into account currently-known conditions. In addition, underlying assumptions need to be disclosed.
33. Because financial 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. Information about the entity's financial risks and uncertainties may include a discussion of such matters as a summary of the entity's investment policy and other means of managing its financial risks, insurance coverage (e.g., self-insurance), and other financial controls intended to safeguard financial assets. It may also include the relevant legislation, regulation or body that sets the financial risk management policies for the entity (e.g., when financial risks are managed at a government-wide level).
34. A discussion of the entity's financial risk management strategy helps users obtain a complete picture of the entity's exposure to financial risks (i.e., those that directly affect financial statement items and disclosures), 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.
35. 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 current period.
36. For example, a discussion of the risks the entity faces provides 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.

An analysis of the current period financial statements

37. This Standard does not require the entity to disclose forward-looking information, such as forecasts or projections. However, financial statement discussion and analysis may include analyses of trends and variances that enhances the predictive ability of the financial statements.
38. In some cases, financial statement discussion and analysis may include management's perspectives on the potential impacts of those trends. Management possesses informed expectations regarding the entity's future operations based on its detailed knowledge of the entity's current operations. In such cases, supporting assumptions and formulae used, as well as the methodologies adopted in compiling it should be disclosed. The assumptions used should be based on currently-known facts and circumstances and should be mutually consistent.
39. 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 addition, identification of the main events, trends, and factors influencing the current reporting period may help users identify potential impacts on future reporting periods by providing information about the entity's intended actions.
40. Financial statement discussion and analysis may include quantitative analysis of significant positive and negative variances between:
 - (a) Actual results and the budget; and
 - (b) The prior year and current year, by explaining significant changes and highlighting trends.

Transition

41. **The provisions of this Standard shall be applied from the date of first adoption of this Standard, except in relation to items that have not been recognized in the financial statements as a result of transitional provisions under an IPSAS. The provisions of this Standard are not be required to apply to such items until the transitional provision in the IPSAS expires.**
42. **Financial statement discussion and analysis prepared for the current reporting period shall consider the previous period for which comparative information is presented in the financial statements. Comparative information is not required to be included in financial statement discussion and analysis in respect of the financial statements to which accrual accounting is first adopted in accordance with IPSASs.**
43. Notwithstanding the existence of transitional provisions under an IPSAS, entities that are in the process of adopting the accrual basis of accounting for financial reporting

purposes are encouraged to comply in full with the provisions of that other Standard as soon as possible.

Effective Date

44. **An entity shall apply this Standard for annual financial statements covering periods beginning on or after MM DD, YYYY. Earlier application is encouraged. If an entity applies this Standard for a period beginning before MM DD, YYYY, it shall disclose that fact.**
45. When an entity adopts the accrual basis of accounting as defined by IPSASs for financial reporting purposes subsequent to this effective date, this Standard applies to the entity's financial statement discussion and analysis covering periods beginning on or after the date of adoption.

Appendix A

Amendments to IPSASs

IPSAS 24 Presentation of Budget Information in Financial Statements

Paragraph 19 is amended as follows:

1. ~~Management~~ Financial statement 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.

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IPSAS XX (ED48).

Scope and Authority

- BC1. The IPSASB approved a project in March 2008 to address “narrative reporting”. In developing this Standard, the IPSASB clarified that the scope of the project is to address only those reports that provide discussion and analysis specifically pertaining to an entity’s general purpose financial statements, and not broader types of reports that may be considered general purpose financial reports as envisaged in the IPSASB’s Conceptual Framework.
- BC2. In undertaking this project, the IPSASB considered, under its *Criteria for Modifying IASB Documents*, whether to develop guidance that was converged with *Management Commentary*, an IFRS Practice Statement. The IPSASB did not consider this approach to be appropriate because:
- (a) The users identified in the Practice Statement are investors. The Exposure Draft for Phase 1 of the Conceptual Framework (CF—ED1, *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: Role, Authority and Scope; Objectives and Users; Qualitative Characteristics; and Reporting Entity*) identifies different users, which results in different information needs related to the financial statements.
 - (b) Additionally, in the private sector there is a strong influence from the securities exchanges and their regulators which help ensure and reinforce the information needs of the investors. In the public sector there is not a comparable regulator, which participates in the process of standardizing financial statement discussion and analysis, and therefore reliance on the private sector guidance may result in loss of accountability in the public sector.
- BC3. Financial statement discussion and analysis is intended to address similar matters to reports that may be termed “management discussion and analysis” and “management commentary” in various jurisdictions. However, the IPSASB did not consider those terms to accurately describe the nature of the report in relation to the financial statements. The IPSASB decided it was important to link financial statement discussion and analysis to the financial statements because the financial statement discussion and analysis is intended to complement and supplement the financial statements, and not to stand alone. The IPSASB considers the term “financial statement discussion and analysis” clearly defines the scope of applicability of this Standard and its close linkage to the financial statements.
- BC4. The IPSASB considered whether public sector entities that prepare reports in accordance with International Public Sector Accounting Standards (IPSAS) should be required to prepare financial statement discussion and analysis and whether it should be included as an integral part of the general purpose financial statements or in a separate general purpose financial report.
- BC5. In CF—ED1, the IPSASB recognized that general purpose financial reports provide additional information necessary to meet the objectives of financial reporting

- (accountability and decision-making) in response to user needs. Therefore, if such information is indeed necessary to meet the financial reporting objectives, it should be prepared on a mandatory basis. The IPSASB concluded that financial statement discussion and analysis should be prepared by all entities that prepare their financial statements in accordance with IPSASs for the reasons set out below.
- BC6. This Standard has been developed from a principles-based perspective that can be applied to all public sector entities. In addition, entities are encouraged to prepare financial statement discussion and analysis that meets their specific circumstances. Therefore, the IPSASB concluded that suitability is not a barrier to establishing requirements.
- BC7. Many jurisdictions already require public sector entities to prepare financial statement discussion and analysis. Current practice associated with this type of information for public sector entities that are issuing accrual-basis financial reports has moved beyond the stage of non-mandatory guidance.
- BC8. Further, in the private sector, guidance may be non-mandatory because securities regulators often impose a requirement for private sector enterprises to prepare the equivalent of financial statement discussion and analysis. The IPSASB has concerns that without specific reporting requirements many public sector entities will simply choose not to prepare the financial statement discussion and analysis that is needed by users of public sector financial reports.
- BC9. The IPSASB considered whether a requirement to issue financial statement discussion and analysis when an entity issues financial statements prepared in accordance with IPSASs would be an impediment to the adoption of IPSASs. In particular, in jurisdictions moving from the cash basis to an IPSAS-based accrual basis of accounting may not have sufficient resources to develop financial statement discussion and analysis. A public sector entity that issues general purpose financial statements in conformity with IPSASs shows that it has the capacity to present financial statement discussion and analysis with equal standing to the financial statements. Moreover, the IPSASB considers that the users of financial statements in such jurisdictions may even have a greater need for the benefit of financial statement discussion and analysis to help explain the financial statements.
- BC10. The IPSASB considers that in all cases, the benefits of providing financial statement discussion and analysis would outweigh the costs of preparing it, as the information is derived from the financial statements, and tailored to the specific circumstances of the entity. The IPSASB therefore concluded that financial statement discussion and analysis should be prepared by all entities that prepare their financial statements in accordance with IPSASs.
- BC11. IPSAS 1, *Financial Statement Presentation*, defines the scope of the financial statements. The IPSASB does not consider financial statement discussion and analysis to be part of the financial statements prepared in accordance with IPSASs despite its close link to the financial statements. The IPSASB did not, therefore, amend IPSAS 1 to include financial statement discussion and analysis as an integral part of the financial statements.

- BC12. The IPSASB noted the concern that, if this Standard were an IPSAS, it could be considered part of the financial statements and there could be confusion as to whether it would be subject to the same audit requirements as the financial statements. This could cause difficulties in some jurisdictions if the inclusion of financial statement discussion and analysis resulted in a qualified audit report on the financial statements. While the audit of financial statement discussion and analysis is desirable, the IPSASB considers that imposing an audit requirement on such information exceeds its mandate. However, it is noted that an audit of financial statements would not automatically require audited financial statement discussion and analysis. The term “financial statements” ordinarily refers to a complete set of financial statements as determined by the requirements of the applicable financial reporting framework. The financial reporting framework for public sector entities is described in IPSAS 1, and does not include financial statement discussion and analysis.
- BC13. To date, IPSASs have addressed only matters that pertain to the content of the financial statements themselves. The IPSASB considered whether it would be appropriate to allow for a new type of pronouncement that had equivalent authoritative status to the IPSASs. The IPSASB is of the view that introducing a new type of pronouncement would be confusing to its constituents. Accordingly, the IPSASB has decided that an International Public Sector Reporting Standard (IPSAS) is the appropriate type of pronouncement to apply to the financial statement discussion and analysis.

Links to the IPSASB Conceptual Framework

- BC14. The objective of financial statement discussion and analysis is to complement and supplement an entity’s general purpose financial statements. The IPSASB concluded that the objective and users of financial statement discussion and analysis should be the same as those identified for general purpose financial reports in the IPSASB’s CF—ED 1. The IPSASB also concluded that the information in financial statement discussion and analysis should possess the qualitative characteristics constraints of general purpose financial reports. Accordingly, IPSAS XX (ED 48) contains requirements that financial statement discussion and analysis contain information that is consistent with the qualitative characteristics in CF—ED 1. It also contains specific requirements for each of the qualitative characteristics. The IPSASB is of the view that these additional requirements are necessary to provide a common basis for determining the information to be provided in financial statement discussion and analysis.

Content of financial statement discussion and analysis

- BC15. The IPSASB noted that the content and format of presentation of financial statement discussion and analysis should be determined by the entity, in a way that best reflects its circumstances, noting that 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. The IPSASB wishes to avoid a checklist approach that may result in an entity reporting less relevant information. Accordingly, some flexibility is provided in the content and format. However, the Standard

contains certain essential required content that is important to all financial statement discussion and analysis.

- BC16. In determining the matters that should be required in financial statement discussion and analysis, the IPSASB reviewed and compared existing national standards, guidance, and regulatory requirements for financial statement discussion and analysis (or its equivalent) in the public sector. The existing approaches, identified in conducting the research, were used to help form the basis for the required content of financial statement discussion and analysis.
- BC17. The IPSASB noted that, in some cases, certain of the information specified for inclusion in financial statement discussion and analysis may be required financial statement disclosure in accordance with an IPSAS. In such cases, the IPSASB did not consider it necessary to duplicate the financial statement disclosure in the financial statement discussion and analysis and has accordingly provided guidance to that effect. However, in cases when an entity is permitted to provide certain disclosures in financial statement discussion and analysis that are also required under an IPSAS, this Standard does not address any auditing matters that relate to the location of those disclosures.

Implementation Guidance and Illustrative Example

- BC18. This Standard contains non-mandatory implementation guidance and an illustrative example to illustrate the types of information that may be provided to comply with the presentation requirements. In developing the Standard, the IPSASB weighed the need for flexibility against the need for comparability among entities. The IPSASB considered the view that there is a risk that undue emphasis could be placed on the implementation guidance in applying the presentation principles. Furthermore, the Board observed that such guidance or examples could be misinterpreted and thus reduce the flexibility in applying the Standard. On balance, the IPSASB concluded that providing high-level implementation guidance meets the need for consistent reporting among entities while still providing sufficient flexibility to tailor the report to an entity's specific circumstances.
- BC19. The Standard also includes an illustrative example to provide a starting point for entities to develop their financial statement discussion and analysis by showing one way in which the requirements of the Standard may be met.

Forward-looking information

- BC20. This Standard does not require the entity to disclose forward-looking information, such as forecasts or projections. However, the IPSASB noted that information in financial statements also has predictive ability about the entity's operations, and that financial statement and analysis could enhance that ability. For example, information about an entity's financial risk management policies, and trend analyses of significant financial statement items, may assist users in assessing the extent to which resources will be 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. The IPSASB has thus provided guidance on how such information could be included in financial statement discussion and analysis.

Implementation Guidance

This guidance accompanies, but is not part of, IPSAS XX (ED 48).

The purpose of this Implementation Guidance is to illustrate certain aspects of the requirements of IPSAS XX (ED 48).

Section A: Qualitative Characteristics of General Purpose Financial Reports – Applicability to Financial Statement Discussion and Analysis

- A1. Financial statement discussion and analysis complements and supplements the financial statements. It should, therefore, possess the same qualitative characteristics as for general purpose financial reports, namely:
- (a) Relevance;
 - (b) Faithful representation;
 - (c) Understandability;
 - (d) Timeliness;
 - (e) Comparability; and
 - (f) Verifiability.
- A2. Financial statement discussion and analysis should aim to achieve a balance between 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.
- A3. Application of the qualitative characteristics to financial statement discussion and analysis is set out in paragraphs A4 – A30.

Relevance

- A4. The matters that are relevant to an entity are also specific to that entity. Management of an entity has the detailed knowledge of the transactions, events, and conditions reflected in the entity's financial statements and of the policies that govern the entity's operations to best assess the matters that are important to understanding the entity's financial statements. This means that some items that are material to the financial statements, notes, and other sections of the financial statements may not necessarily be discussed in the related financial statement discussion and analysis. Further, when providing qualitative information, it is not generally possible to specify a uniform quantitative threshold above which a particular type of information becomes material. For example, a line-by-line analysis of the financial statements is not generally appropriate. Instead, financial statement discussion and analysis should summarize the most important items, explain the relevant causes and effects, and place them in

context. Inclusion of information about immaterial items could make the more important information difficult to find.

- A5. Generic or “boilerplate” information that does not relate to the specific operations, practices and circumstances of the entity is unlikely to be relevant and should not be included in financial statement discussion and analysis. When practicable, duplication of the disclosures made in the notes to its financial statements should be avoided. Financial statement discussion and analysis that recites financial statement information without analysis or explanations, or presents discussions that do not provide insight into the entity’s past performance is unlikely to provide information that is relevant to users of the financial statements, and may create an obstacle for users to identify and understand the most significant matters the entity faces. For example, commentary on the economy that relates specifically to the entity’s financial statements and expected impacts on the entity would be relevant information for users; general information about the state of the economy would not be relevant.
- A6. 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.
- A7. Financial statement discussion and analysis provides management perspective and insights about the financial statements, which increases the relevance of the information. 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.

Faithful representation

- A8. Financial statement discussion and analysis should be unbiased and neutral in discussing both positive and negative facts and views of management. Information that excludes negative facts is incomplete and thus could be biased.
- A9. To ensure financial statement discussion and analysis is not biased, the underlying assumptions and methods (including formulae) used to determine ratios and to prepare tables and charts included in financial statement discussion and analysis should be disclosed. In addition, the methodologies adopted in compiling the information, and the factors and circumstances that support a discussion of management’s perspectives and analyses, need to be transparent.
- A10. Information presented in financial statement discussion and analysis should be:
- (a) Based on, and consistent with, the underlying financial statements; and
 - (b) Unbiased in discussing both positive and negative facts and views of management.

- A11. It is important that information presented in the financial statement discussion and analysis is supported by information in the financial statements, and does not go beyond or contradict the information presented in the financial statements.
- A12. For example, if the financial statements include segment information, the information presented in the financial statement discussion and analysis should reflect that segmentation.
- A13. Information that excludes certain facts (e.g., negative) is incomplete and thus could be biased (not neutral). In cases when financial statement discussion and analysis 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

- A14. Information provided in financial statement discussion and analysis should be clear and concise to explain and interpret the complex transactions, events, and conditions in the financial statements in a readable and simple manner. Financial statement discussion and analysis is understandable when it uses descriptions that are not overly technical, does not provide excessive detail, and clearly describes those transactions, events, and conditions.

Timeliness

- A15. IPSAS 1 requires financial statements to be prepared at least annually. Some entities may prepare financial statements on a more frequent basis. However, this Standard only requires financial discussion and analysis to accompany an entity's annual financial statements.
- A16. Financial statement discussion and analysis relates to the current financial statements. In doing so, it may be useful in helping to predict future results by explaining significant changes and highlighting trends. Financial statement discussion and analysis may, for example, include an analysis of trends in financial performance that provides information that is useful beyond the date of the financial statement discussion and analysis.

Comparability

- A17. Financial statement discussion and analysis should be presented on a basis consistent with that in prior years.
- A18. 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 is 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 financial statement discussion and analysis. In addition, disclosure

of those principles and practices, including underlying assumptions and formulae, is useful in interpreting the analyses.

- A19. Paragraph 42 of IPSAS 1 requires the presentation and classification of items in the financial statements to be retained from one period to the next unless:
- (a) It is apparent, following a significant change in the nature of the entity's operations or a review of its financial statements, that another presentation or classification would be more appropriate having regard to the criteria for the selection and application of accounting policies in IPSAS 3; or
 - (b) An IPSAS requires a change in presentation.
- A20. Enhancing the inter-period comparability of information assists users in making and evaluating decisions, especially by allowing the assessment of trends in financial information for predictive purposes. In some circumstances, it is impracticable to reclassify comparative information for a particular prior period to achieve comparability with the current period. For example, data may not have been collected in the prior period(s) in a way that allows reclassification, and it may not be practicable to recreate the information.

Verifiability

- A21. Information in financial statement discussion and analysis is verifiable when it is consistent with the financial information reported in the financial statements and based on:
- (a) Currently-known facts, decisions, or conditions; and
 - (b) Verifiable and supportable assumptions.
- A22. 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 financial statement discussion and analysis, such information would be less verifiable than, for example, a ratio calculated from information provided in the financial statements.
- A23. Financial statement discussion and analysis complements and supplements the related financial statements for the reporting period. Accordingly, it is important that it contain information specific to the entity and related to that reporting period. While the information provided in financial statement discussion and analysis may reflect information outside of the financial statements (e.g., economic indicators such as changes in the tax base or the employment base), that information should be related to the reporting period and should be from a reliable source.

- A24. Verifiability of financial statement discussion and analysis is enhanced when the principles and practices used for such items as determining ratios and preparation of tables and charts included in financial statement discussion and analysis, including 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 a discussion of management's perspectives and analyses, should be transparent. Disclosure of this information permits users to assess the reliability of the information provided.
- A25. Assumptions should be mutually compatible. Assumptions are mutually compatible when they reflect economic relationships in the jurisdiction (e.g., interest rates, employment rates, GDP). For example, all assumptions that depend on the tax base for a given future period would assume the same tax base level in that period.
- A26. While the information provided in financial statement discussion and analysis may reflect information outside of the financial statements (e.g., economic indicators such as changes in the tax base or the employment base), that information should be related to the same reporting period as that covered by the financial statements and should be from a reliable source.
- A27. Financial statement discussion and analysis should clearly describe the basis for how the information is reported, including the unit of measurement. For example, in cases when financial statement discussion and analysis 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. Thus, when financial statement discussion and analysis contains charts or graphs showing trends, disclosure of the unit of measurement is necessary to ensure such information can be properly interpreted. When such information is presented, the scale of such illustrations should be on a basis that faithfully represents the relationships of the items being analyzed.
- A28. 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 strategy and risk management are described in financial statement discussion and analysis, such information would be less verifiable than, for example, a ratio calculated from information provided in the financial statements.
- A29. This Standard does not require the entity to disclose forward-looking information, such as forecasts or projections. However, management possesses informed expectations regarding the entity's future operations based on its detailed knowledge of the entity's current operations that may be relevant to users. In the context of this Standard, forward-looking 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. For example, a summary or overview of the entity's objectives, significant transactions, events, and conditions that affected the financial statements (e.g., significant changes, unplanned events), provides the starting point for assessing the

entity's financial performance and trends for the future. In addition, identification of the main events, trends, and conditions in the current reporting period, may help identify potential impacts on future reporting periods by providing information about the entity's intended actions.

- A30. To ensure such information is not biased, financial statement discussion and analysis should describe the underlying methods and assumptions used to develop the information.

Section B: Examples of Information about the Entity's Financial Statements

B1. Paragraph 11 requires financial statement discussion and analysis to include information about all significant financial statement items, transactions, and events presented in the financial statements that are most relevant to assisting users to understand the financial statements. This Implementation Guidance includes guidance on the type of information an entity may provide in its discussion and analysis to satisfy that requirement.

Financial Position

B2. Information about the financial position 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.

Financial assets

B3. Financial statement discussion and analysis may include the following information pertaining to an entity's financial assets:

- (a) Changes in financial assets to illustrate volatility in the sources of funds;
- (b) Provisions for loan losses;
- (c) The rates of return on investment;
- (d) Composition of investments;
- (e) A government's investment in GBEs as a percentage of the total financial assets;
- (f) Taxes receivable to total tax revenues; and
- (g) Restricted and designated assets set aside for specific purposes.

Property, Plant and Equipment

B4. Financial statement discussion and analysis may include the following information pertaining to an entity's property, plant and equipment:

- (a) An analysis of required maintenance, including future expenditure requirements for maintenance and replacement, to allow users to make informed decisions regarding the ability of the capital assets to sustain and provide services in the future;

- (b) An analysis of the change in the net book value of property, plant, and equipment by major class and an explanation of what the net book value and changes in it mean (e.g., a description of why the net book value has increased or decreased is useful in understanding asset replacement and usage);
 - (d) The average age and average useful life for each category of property, plant, and equipment; and
 - (e) An assessment of the assets' physical condition carried out by a technical expert in such assessments.
- B5. Asset management systems may contain information about an asset's physical condition, but the absence of an asset management system does not necessarily preclude reporting on the physical condition.
- B6. Asset condition assessment methodologies and frequency of assessments can be different for major classes of property, plant, and equipment. For example, they could be different for bridges when compared to buildings.
- B7. It may not be possible to complete a physical examination of all items of property, plant, and equipment. However, the physical condition could be estimated based on a combination of factors including, for example, age, construction materials and methods, breaks per kilometer, geological, and soil conditions.
- B8. Financial statement discussion and analysis may provide the average age and either the average remaining useful life or estimated average useful life of property, plant, and equipment in each major class. Information about the average age and the useful life allows users to assess the timing of rehabilitation and replacement expenditures.
- B9. Financial statement discussion and analysis may contain a description and the quantity of the major components of property, plant, and equipment in each major class of asset. Providing this information gives users an understanding of the nature and extent of the stock of property, plant, and equipment.
- B10. The quantity could be based on a unit of measurement that represents the common characteristics of the class of property, plant, and equipment being assessed or components thereof (e.g., lanes or kilometers for roads, kilometers of pipes for sewer for water systems, or the number of water treatment plants). This summary level unit of measure provides users with a reference that is useful in assessing the magnitude of the classes and components of items of property, plant, and equipment.

Other Assets

- B11. The information required to promote a better understanding of an entity's property, plant, and equipment extends beyond reporting information in the financial statements alone. Reporting on the physical condition of property, plant, and equipment assists users when assessing:
- (a) The effects on service potential of past resource allocation and funding decisions;
 - (b) The trends in the physical condition;
 - (c) The adequacy of existing maintenance, replacement and renewal funding; and

- (d) The extent of current and future revenues needed to maintain, renew, and replace property, plant, and equipment.
- B12. Financial statement discussion and analysis may include the following information pertaining to an entity's other assets, to the extent they are material (e.g., inventories of supplies—see IPSAS 12, *Inventories*, and prepaid expenses):
- (a) The nature, extent and purpose of inventories of supplies (e.g., maintenance materials, strategic stockpiles, and land/property held for resale); and
 - (b) The nature, extent, purpose, and timing of any prepaid items such as insurance.

Liabilities

- B13. Financial statement discussion and analysis may include the following information pertaining to an entity's liabilities:
- (a) A breakdown of the entity's debt by domestic issues versus foreign issues.
 - (b) A description of the entity's debt management policies and strategies, and the general terms and conditions associated with the debt, including whether the entity has complied with any debt covenants.
 - (c) An analysis of the entity's total debt. Specific ratios or indicators may also be useful to highlight the magnitude of the entity's 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 entity may be provided. The impact of the debt servicing cost, expressed as public debt charges to revenues, may also be included. 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.
 - (d) An analysis of revenues that are not earned at the end of the period including the terms and conditions (e.g., commitments) associated with them. The entity is not entitled to these revenues until it performs specific actions as outlined in the terms and conditions of the related contract or agreement. For example, in the case of service concession arrangements in which the operator is compensated by the entity granting it the right to earn third-party revenues, there may be substantial liabilities of this type.
 - (e) The nature of financial liabilities under service concession arrangements.
 - (f) An analysis of any sinking funds available for the discharge of long-term liabilities.

Net assets/equity

- B14. An analysis of net assets/equity provides users with information relevant in assessing the entity's overall financial position, and whether it has improved or deteriorated. Providing significant explanations and a trend analysis related to the net assets/equity provides users with an indication as to whether the entity's liabilities are growing and allows them to make assessments about whether current levels of taxes or other charges are sufficient to maintain the volume and quality of services currently

provided or to undertake any planned enhancements. For example, explanations and a trend analysis related to the assets/equity may indicate to users that while debt is growing, the entity is accumulating resources, such as property, plant and equipment.

Financial Performance

- B15. Information about the financial performance 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.
- B16. Any currently-known conditions that have significantly affected revenues or expenses in the current period, as well as those that may impact future revenues or expenses, should be disclosed to assist users in determining trends.

Revenues

- B17. Financial statement discussion and analysis may include the following information pertaining to an entity's revenues:
- (a) An overview of total revenues by major source to indicate trends and dependencies on specific sources.
 - (b) Ratios may also be provided to highlight the level of dependence the entity has on particular sources of revenues, for example:
 - (i) Public-to-public transfers to revenues generated by the entity (e.g., taxes, user fees, licences); and
 - (ii) Revenues generated by the entity as a percentage of total revenues.
 - (c) The impact of GBE activities on the entity as a whole, which may be relevant especially if there are restrictions placed on the use of a GBE's net assets.
 - (d) An analysis of the change in revenues by major source.

Expenses

- B18. Financial statement discussion and analysis may include the following information pertaining to an entity's expenses:
- (a) An overview of total expenses by nature (e.g., depreciation, purchases of materials, transport costs, employee benefits, and advertising costs).
 - (b) An overview of total expenses by function.
 - (c) An analysis of debt servicing costs as a percentage of total expenditures, which helps to highlight the magnitude of expenses that is required to service past obligations and thus reduces the amount of funds that can be directed to various programs. Alternatively, debt servicing costs as a percentage of revenues could be provided.
 - (d) An analysis of significant changes in expenses by nature and function.

Surplus or Deficit for the Period

- B19. An analysis of the surplus or deficit for the period provides users with information relevant in determining whether the entity was able to raise enough revenues in the period to cover its costs and spending and whether the trend is likely to continue in the future.
- B20. Financial statement discussion and analysis may include the following information pertaining to an entity's surplus or deficit for the period:
- (a) An analysis of net revenues or expenses by nature (for example, depreciation, purchases of materials, transport costs, employee benefits, and advertising costs);
 - (b) A comparison of direct / identifiable program revenues to expenses by function, to illustrate the amount of program spending funded through taxation; and
 - (c) Analyses of specific, significant non-recurring transactions or events such as:
 - (i) Write-downs of inventories to net realizable value or of property, plant, and equipment to recoverable amount or recoverable service amount as appropriate, as well as reversals of such write-downs;
 - (ii) Restructurings of the activities of an entity and reversals of any provisions for the costs of restructuring;
 - (iii) Disposals of items of property, plant, and equipment;
 - (iv) Privatizations or other disposals of investments;
 - (v) Discontinuing operations;
 - (vi) Litigation settlements; and
 - (vii) Other reversals of provisions.

In these cases, the nature of the revenue or expense and a discussion of its impact on future operations would be disclosed.

Cash flows

- B21. Information about the cash flows 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.
- B22. Financial statement discussion and analysis may include the following information pertaining to an entity's cash flows from operating, investing, and financing activities:
- (a) An analysis of the cash flows arising from operating activities such as:

- (i) The gross cash receipts and payments arising from the normal operations of the entity (e.g., the gross cash receipts from taxation, user fees or transfers from other entities).
- (ii) Significant cash requirements or payments made during the period (e.g., payments to and on behalf of employees).
- (b) An analysis of cash flows arising from investing activities such as:
 - (i) Expenditures made to acquire resources (e.g., property, plant and equipment, investment property, and intangible assets) intended to generate future cash flows and service potential; and
 - (ii) Significant changes in such investments, including any additions or disposals during the current year
- (c) An analysis of financing activities, which provides information relevant in assessing future cash flow requirements due to debt financing arrangements. This analysis may highlight cash proceeds from debt issues or redemptions. It may also highlight significant changes in capital leases. Further, it may be helpful in explaining the need for borrowing even though the entity has reported a surplus in its statement of operations.
- (d) Analysis of whether the entity has complied with any spending mandates expressed in cash flow terms.
- (e) Trend analyses of operating, investing and financing cash flows, or components thereof.

Commitments, Contingencies, and Events after the Reporting Date

- B23. Where they are significant to the entity, information may be required pertaining to events occurring after the reporting date and planned future events, such as those described in paragraph B13(c), but which did not occur in the reporting period, and are therefore not reflected in the entity's financial statements. Such information assists users in assessing future revenue requirements of the entity.
- B24. Financial statement discussion and analysis may include the following additional information:
- (a) A subsequent issue of debenture debt;
 - (b) Litigation;
 - (c) Capital and operating leases;
 - (d) Service concession arrangements; and
 - (e) Various types of guarantees.

Although such disclosures are required to be provided in the notes to the financial statements in accordance with various IPSASs, further elaboration of such transactions and events may be necessary to provide greater insight as to how such events may affect the entity's future operations.

Section C: Examples of Information about Variances and Trends

- C1. Paragraph 18 requires financial statement discussion and analysis to include information variances and trends. This Implementation Guidance includes guidance on the type of information an entity may provide in its discussion and analysis to satisfy that requirement.

Actual-to-budget variances

- C2. Paragraph 29(b) of IPSAS 24, *Presentation of Budget Information in Financial Statements*, requires that explanations of material differences between actual and budget amounts to be included in the 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.
- C3. In cases where the comparison of actual results to budget information is included in financial statement discussion and analysis, IPSAS 24, *Presentation of Budget Information in Financial Statements*, requires a cross-reference to the financial statement discussion and analysis.

Year-to-year variances and trends

- C4. Financial statement discussion and analysis may include an analysis of trends in financial performance that provides information that is useful beyond the date of the financial statement discussion and analysis. For example:
- (a) Analysis of changes in the nature and extent 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) Analysis of changes in revenues by major source may indicate trends and dependencies on specific revenue sources (e.g., government business enterprises (GBEs), transfers, or royalties).
 - (c) Analysis of changes in 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 changes in commitments, contingencies, and subsequent events assists users in assessing future revenue requirements of the entity.
- C5. 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 more due to external factors (e.g., a downgraded credit rating, 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.

- C6. Trend analysis may cover several prior years if the information is available and can be presented in a consistent manner. In such cases, the source of information related to periods not covered by the comparative information in the financial statements to which the financial statement discussion and analysis pertains would be disclosed.
- C7. In cases where the presentation of the underlying financial statements has changed in accordance with paragraph 42 of IPSAS 1, the presentation of any information in the financial statement discussion and analysis based on the changed financial statements should also change.
- C8. In some cases, historical information may not be readily available on which to base trend analyses for some or all of the entity's operations. In such cases, the entity may do trend analysis with information it possesses that meets the qualitative characteristics and disclose in the financial statement discussion and analysis that historical information is not readily available. When the data is available for only part of the reporting entity, the financial statement discussion and analysis should clearly describe the scope of information including the fact that information related to certain activities is not available.
- C9. Other changes may affect the trend analysis. For example, when an entity restructures its operations or chooses an alternative method of service delivery, this may affect certain trends. In cases where such changes have significantly affected a trend, the financial statement discussion and analysis should describe the reasons for the changes in the trend.

Illustrative Example

This example accompanies, but is not part of, IPSAS XX (ED 48).

The purpose of this example is to illustrate the information that an entity may include in its financial statement discussion and analysis. This example is one illustration of the format and content of information an entity could disclose in order to meet the requirements set out in this Standard. However, this illustration is not intended to be a template for financial statement discussion and analysis. Entities are encouraged to report financial statement discussion and analysis in a way that best informs readers about their own significant matters related to their specific circumstances, including the use of diagrams, charts, and graphs.

GOVERNMENT OF COUNTRY A (“the Government”) FINANCIAL STATEMENT DISCUSSION AND ANALYSIS

This section of the Government of Country A’s (“the Government”) annual financial report presents our discussion and analysis of the entity’s financial position and financial performance during the year ended December 31, 20X9 [*if the entity is required to provide financial statement discussion and analysis by way of legislation or regulation, it may state the relevant requirements here*]. This Financial Statement Discussion and Analysis has been prepared in accordance with IPSAS XX (ED 48), *Financial Statement Discussion and Analysis*.

This Financial Statement Discussion and Analysis is not part of the Government’s financial statements; however it should be read together with the Government’s financial statements on pages XX to XX of this report.

OVERVIEW OF THE FINANCIAL STATEMENTS

Financial statements are prepared for the Government as a whole as specified in the *Government of Country A Public Sector Finance Act 2000* (PFA). The PFA also requires this financial statement discussion and analysis, which explains the significant items, transactions, and events presented in the financial statements and the trends and factors that influenced them, to accompany the Government’s financial statements.

Parliamentary and state sector entities and organizations for which statements are prepared include: Ministries, Departments, Offices of Parliament, state-owned enterprises, and the Government of Country A Reserve Bank. A full list of government reporting entities can be found in the Supplementary Information section of this financial report as at December 31, 20X9 (see “Government Reporting Entity”).

Our report consists of the financial statement discussion and analysis (this section) and the financial statements. The financial statements consist of:

- *A Statement of Financial Position* – which provides information about the accumulated deficit—the difference between the entity’s total liabilities and total assets. It provides information about:
 - The extent to which resources are available to support the Government’s future service delivery objectives; and

- The amounts and timing of future cash flows necessary to service and repay existing claims to the Government’s resources
- A *Statement of Financial Performance* – which measures the net surplus or deficit— the difference between revenues and expenses. It provides information about:
 - Costs of service delivery; and
 - The amounts and sources of cost recovery (e.g., through taxes, user charges, contributions and transfers, or by increasing the level of indebtedness)

The annual surplus or deficit is presented on an accrual basis of accounting, recognizing revenue in the period it is earned and expenses when incurred, regardless of when the associated cash is received or paid.

- A *Statement of Changes in Net Assets/Equity* – which highlights the sources of changes in Government of Country A’s overall financial position, including:
 - Gains and losses that directly affect the Government’s total assets less liabilities;
 - Changes due to the surplus or deficit for the period.
- A *Cash Flow Statement* – which provides information about the Government of Country A’s liquidity and solvency, including:
 - 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; and
 - The cash received through taxes and investments and the cash transfers made to, and received from, other entities, government agencies, and international organizations.

In contrast to the Statement of Financial Performance, the Government’s net cash flow measures the difference between cash coming in to the Government and cash going out.

ABOUT THE GOVERNMENT²

Country A has a small open economy which operates on free market principles. It has sizable manufacturing and service sectors complementing a highly efficient agricultural sector. Country A is highly dependent on the primary sector with commodities accounting for around half of total goods exports. Exports of goods and services account for around one third of GDP.

Exhibit 1 and Exhibit 2 show breakdowns of the GDP by production group and by industry group respectively.

² This section addresses relevant information from the “Overview of the Entity” requirement. Since the Government of Country A is a government and not a sub-entity of a government, some details (e.g., mission and vision and organization chart) are not addressed in this example. In addition, some of the details in this section pertain to risks and uncertainties due to global risks.

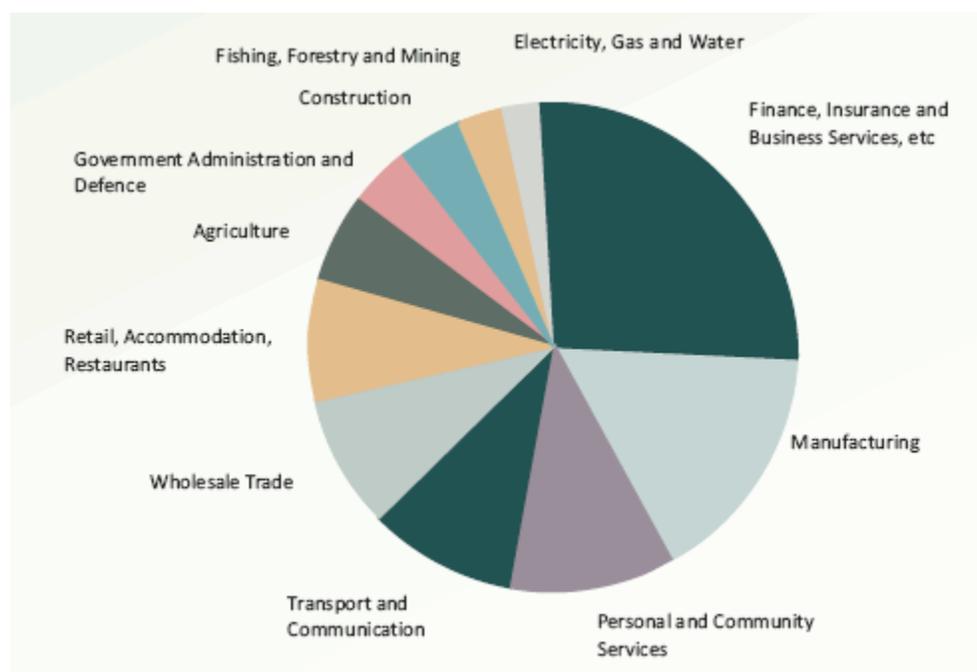
Exhibit 1 – Gross Domestic Product by Production Group³

The following table shows Gross Domestic Product by major industries:

	GDP (millions of Currency Units)					20X9 % of Total
	20X5	20X6	20X7	20X8	20X9	
Finance Insurance & Business Services	326,150	339,960	350,250	362,280	367,930	27.6%
Manufacturing	195,730	196,840	185,970	185,970	176,120	13.2%
Personal & Community Services	148,220	151,240	152,160	155,040	159,470	11.9%
Transport & Communication	129,030	133,870	135,360	143,040	143,340	10.7%
Retail, Accommodation, Restaurants	94,060	98,260	100,980	104,100	100,420	7.5%
Wholesale Trade	98,240	100,770	100,900	105,230	99,730	7.5%
Govt Administration & Defence	52,010	54,920	59,540	63,740	66,730	5.0%
Agriculture	61,430	65,040	66,470	64,720	63,100	4.7%
Construction	61,900	65,010	63,310	65,920	60,100	4.5%
Fishing, Forestry, Mining	26,340	27,550	27,090	34,190	33,350	2.5%
Electricity Gas & Water	25,260	24,410	26,020	25,090	25,220	1.9%
Gross Domestic Product	1,263,930	1,303,830	1,315,000	1,353,670	1,334,860	100.0%
Annual Average % change	3.7%	3.2%	0.9%	2.9%	(1.4%)	
Primary Industries	88,660	93,590	94,510	100,510	98,010	7.3%
Goods Producing Industries	283,230	286,510	276,790	278,330	263,050	19.7%
Services Industries	843,700	875,050	896,090	928,980	935,040	70.0%
Gross Domestic Product	1,263,930	1,303,830	1,315,000	1,353,670	1,334,860	100.0%

³ 20X9 data estimated. Prior year's data revised.

Exhibit 2 – Gross Domestic Product by Industry Group



Throughout 20X8 and into early 20X9, the global economy continued its recovery from the deepest and most synchronized recession since the 1930s. During this time, global financial market conditions improved and commodity prices rebounded.

Reflecting Country A’s solid economic and fiscal fundamentals, together with the impact of its *Economic Action Strategy* (EAS – see details below)⁴ and monetary policy stimulus, Country A’s economy has recovered more strongly from the recession more than all of the employment lost during the downturn.

Growth in Country A’s economy has been fuelled by a strong rebound in domestic activity. Growth in real consumer spending on goods and services averaged more than 3 percent per quarter in 20X8. Business investment in machinery and equipment was even stronger, growing on average by more than 17 percent per quarter. In the first half of 20X9, domestic demand in Country A remained strong, with consumption and business investment continuing to expand. In particular, business investment in machinery and equipment grew by more than 16 percent. The strength of the domestic economy, however, has been dampened by weak demand for Country A’s exports, particularly from its largest trading partner, Country B.

The economic recovery has underpinned a strong rebound in Country A’s labor market. By August 20X9, the economy had created about 600,000 jobs relative to its trough in July 20X0—more than offsetting the jobs lost during the global economic downturn of that period. Furthermore, most of the jobs created over the recovery have been full-time and in relatively high-wage industries.

⁴ In Budget 20X0, the Government introduced its EAS in response to the worst economic and financial crisis since the 1930s. To learn more about individual elements visit the EAS web site.

The level of economic activity in 20X8 was considerably higher than in 20X0. Real GDP increased by 3.2 percent in 20X8. Nominal GDP (the broadest single measure of Country A's tax base) increased by 6.3 percent as a result of the increase in real GDP together with a significant rebound in global commodity prices.

However, in more recent months, the global economic recovery has become uneven and more fragile and downside risks have become more significant. Weakening global economic growth, particularly in the U.S. and Europe, combined with ongoing concern about sovereign debt in Europe, have led to increasing volatility in global equity, bond and foreign exchange markets. Country A will not continue to be immune from these external developments.

Real GDP contracted slightly in the second quarter of 20X9—the first quarter of negative growth since mid-20X0. The outlook for Country A looking forward is for positive but modest growth. However, risks remain to this outlook, given the recently renewed uncertainty surrounding the global economic situation.

OBJECTIVES AND STRATEGY⁵

Economic Action Strategy

The Government of Country A's *Economic Action Strategy* (see Exhibit 3 for highlights) is directed towards lifting the performance of the economy and achieving higher living standards for citizens of Country A. It helped lay the foundation for long-term prosperity by supporting key drivers of economic growth—innovation, business investment, families, communities, education and training—in a responsible manner that preserves Country A's fiscal advantage.

Exhibit 3 – Highlights of the Economic Action Strategy

HIGHLIGHTS OF THE EAS

As a short-term strategy, the EAS was designed to support economic growth and job creation, and its implementation has been effective at shielding citizens from the worst impacts of the global recession. The EAS has:

- Reduced tax rates.
- Helped the unemployed through enhanced benefits and training programs.
- Prevented layoffs by enhancing the work-sharing program.
- Made significant investments in infrastructure.
- Provided support to the housing sector through the Residence Renovation Tax Credit.
- Advanced Country A's knowledge economy by improving infrastructure at colleges and universities and supporting research and technology.
- Supported industries and communities most affected by the global downturn.
- Improved access to and the affordability of financing for Country A households and businesses.

⁵ This section addresses relevant information from the "Information About the Entity's Strategy" requirement.

These measures have been implemented across a large number of departments, agencies and state-owned corporations, often in partnership with other levels of government.

Because the stimulus in the EAS was designed to provide temporary support to the economy, the vast majority of initiatives announced in Budget 20X9 ended as planned on December 31, 20X8. In order to provide additional flexibility to the Government's partners, the completion deadline for four state and municipal infrastructure programs was extended to September, 20X9. As a result of this decision, the economic benefits and job creation impact of stimulus projects were continued for an additional construction season.

Sustained and steady growth in citizens' incomes is a central means of improving their living standards. Economic growth enables choices by individuals and provides the means to acquire many of the things we value. It also gives the Government choices; this includes how it funds education, health, environmental protection, physical and social infrastructure, and assistance to those in need.

Higher living standards also incorporate elements that are broader than increases in consumption and income. These determinants of an individual's well-being are likely to include such things as good health, a satisfying job, and a high-quality natural environment. And beyond individual well-being, most citizens of Country A also place a high value on social inclusion, freedom, security, democracy, equality of opportunity, and our physical environment. These dimensions of well-being are clearly important in their own right, and some are also important contributors to economic performance.

To that end, the next phase of Country A's Economic Action Strategy will take steps to advance the Government's long-term objective of building a stronger economy that generates high-wage jobs.

The next phase is centered on four strategic areas:

- **Supporting Job Creation:** Creating the right environment for businesses and entrepreneurs to invest in Country A and succeed in the global economy, leading to higher rates of productivity growth, more and better-paying jobs for citizens of Country A, and a higher standard of living.
- **Supporting Families and Communities:** Ensuring that all citizens of Country A can enjoy a high quality of life and benefit from the opportunities that long-term growth creates.
- **Investing in Innovation, Education and Training:** Promoting the research and development that will give our firms a competitive advantage in global markets and providing citizens of Country A with the opportunity and incentives to acquire the education and skills needed for increasingly complex, high-wage jobs.
- **Preserving Our Fiscal Advantage:** Maintaining a strong environment for growth by ensuring the Government will return to fiscal balance in the medium term, providing confidence and certainty to citizens and businesses of Country A.

By focusing on the drivers of growth, the next phase of the Economic Action Strategy will help individuals, entrepreneurs and businesses create the wealth Country A needs to invest in health care, infrastructure and other services that promote vibrant communities and maintain

our high quality of life. Budget 20X9 introduced a number of targeted measures to support these objectives.

However, subsequent to the issuance of the Budget, the global economic crisis has further deepened and The Government of Country A is now considering amendments to the EAS to respond to these new challenges.

Strategic Reviews

The Government of Country A conducts reviews of its strategic reviews of its existing spending on a four-year cycle to:

- **Increase efficiency and effectiveness.** Change the way the Government delivers programs and services to be more effective and efficient.
- **Focus on core roles.** Focus on providing programs that are consistent with federal roles and responsibilities, and ensure services are delivered by those best positioned to do so.
- **Meet the priorities of citizens of Country A.** Align federal activities with the needs and priorities of citizens of Country A and eliminate programs that are no longer necessary.

The second and third of these goals are not addressed directly in the general purpose financial statements⁶.

Budget 20X10 delivers over CU500 million in new ongoing savings from the 20X9 round of strategic reviews, which were undertaken to ensure that programs are achieving their intended results, are effectively managed, and are appropriately aligned with the priorities of citizens of Country A and federal responsibilities. When combined with the previous three rounds of reviews, the strategic review process has provided more than CU2.8 billion in ongoing savings.

Responsible Fiscal Management

Fiscal policy is one tool for achieving a government's economic and social objectives. The PFA requires the Government to outline its fiscal policy intentions in the annual *Fiscal Strategy*. This fiscal strategy is undertaken through the setting of long-term fiscal objectives relating to expenses, revenue, the operating balance, debt and net worth over a period of at least 10 years.

The PFA requires the Government to pursue its policy objectives in accordance with the following principles of responsible fiscal management:

- Maintaining debt at a prudent level by ensuring that, on average, over a reasonable period of time, total operating expenses do not exceed total operating revenue.
- Achieving and maintaining net worth at levels which provide a buffer against factors which may adversely impact on net worth in the future.
- Managing prudently the fiscal risks facing the Government.
- Pursuing policies which are consistent with a reasonable degree of predictability about the level and stability of taxes for future years.

⁶ Such information would be reported in other general purpose financial reports of the Government such as those on service performance and long-term fiscal sustainability.

The PFA also requires the Government to present, in each financial year, two reports outlining government's fiscal policy: the *Budget* and the *Fiscal Strategy*. The *Annual Budget* has a short run focus setting out policy goals that will guide the Government's Budget decisions and priorities. The *Fiscal Strategy* is presented with the *Budget* and must state the Government's long-term objectives for fiscal policy over a period of at least 10 years and the Government's short-term intentions for fiscal policy over a period of three years.

The *Fiscal Strategy* must also provide projections of fiscal variables to show progress towards meeting the long term objectives.

In addition, the Government Treasury is required to publish, at least every four years, a *Report on Long-Term Fiscal Sustainability*. This has a horizon of at least 40 years and identifies how demographic and other changes may impact the fiscal position.

Fiscal Strategy of the Government

The current government's fiscal strategy—set out in *Budget 20X10*—aims to deliver a fiscal position that is sustainable in the long term, contributes to economic stability and advances key priority policies.

The Government has sought to strengthen its fiscal position so that it is well placed to respond to future challenges such as those associated with population ageing.

The strategy aims to provide certainty to households, businesses and investors by keeping taxes and core government expenses around current levels. By keeping finance costs low, it will ensure flexibility in meeting future fiscal pressures by maintaining a low level of debt.

Budget 20X10 set out a three-point plan for returning to balanced budgets over the medium term by:

- Winding down the stimulus provided in the Government of Country A's *Economic Action Strategy* as the economy recovers.
- Implementing targeted measures to restrain growth in direct program spending.
- Undertaking a comprehensive review of government administrative functions and overhead costs.

The Government of Country A has been clear and consistent that it will not raise taxes or cut transfers to persons, including those for seniors, children and the unemployed, or transfers to other levels of government in support of health care and social services, equalization payments, and the gas tax transfer to municipalities.

The emphasis on the careful management of direct program spending reflects the Government's fundamental belief that the private sector will continue to be the engine of growth and wealth creation.

Planned Borrowing Activities for 20X9-20X10

The *Debt Management Strategy* (see Exhibit 4 for highlights) sets out the Government of Country A's objectives, strategy and plans for the management of its domestic and foreign debt, other financial liabilities and related assets. Borrowing activities support the ongoing refinancing of government debt coming to maturity, the execution of the budget plan, and other financial operations of the Government, including investing in financial assets needed

to establish a prudent liquidity position and borrowing on behalf of some state-owned corporations.

The *Financial Administration Act* requires that the Government table in Parliament, prior to the start of the fiscal year, a report on the anticipated borrowing to be undertaken in the year ahead, including the purposes for which the money will be borrowed. This legislative requirement was fulfilled with the tabling of the 20X10–20X11 *Debt Management Strategy*.

For 20X9–20X10, the aggregate borrowing limit that was approved by Parliament to meet updated Budget 20X9 financial requirements and provide a margin for prudence was CU300 billion, the same amount requested and approved for 20X8–20X9.

Actual borrowing and uses of funds compared with those forecast will be reported in the 20X9–20X10 *Debt Management Report*, and detailed information on outcomes will be provided in the 20X11 *Public Accounts of the Government of Country A*. Both documents will be tabled in Parliament in Q4 of 20X10.

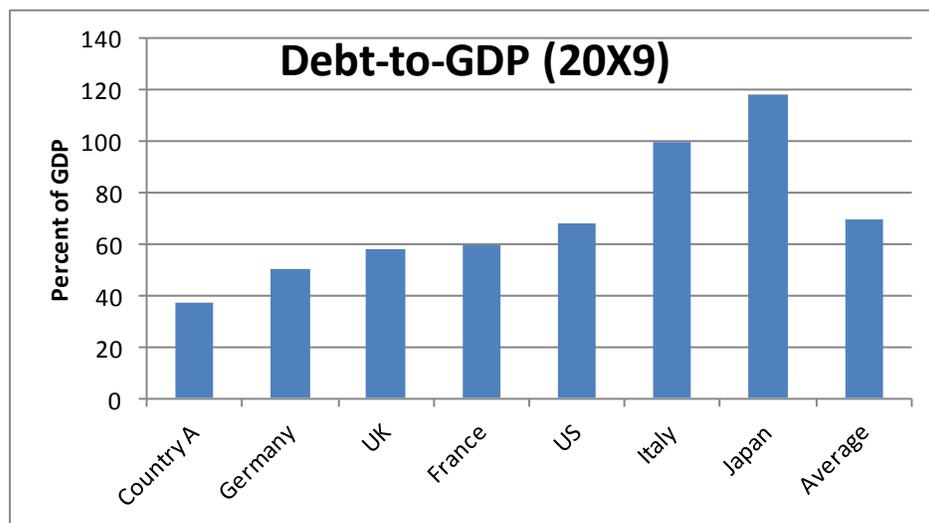
Exhibit 4 – Highlights of the Debt Management Strategy

HIGHLIGHTS OF THE DEBT MANAGEMENT STRATEGY

- Updated Budget 20X10 financial requirements for 20X10-20X11 are projected to be higher than in 20X9-20X10 at CU47 billion versus CU36 billion.
- The debt program for 20X10-20X11 has been developed in the context of a new medium-term debt management strategy focused on stability and reduced financing risk.
- For 20X10-20X11, gross issuance of domestic marketable bonds is planned to be approximately CU102 billion. At the end of 20X10-20X11, the stock of marketable bonds is projected to be CU461 billion.
- Four new maturity dates have been introduced to reduce rollover risk. These new dates are expected to greatly reduce single-day rollover of maturing debt, with noticeable improvements beginning as early as 20X11-20X12.
- Benchmark target range sizes in the 2-, 3- and 5-year sectors have been increased to facilitate the transition to the adjusted maturity dates in those sectors.
- Regular bond buyback program operations are planned to be CU8 billion in 20X10-20X11, about CU3 billion higher than in 20X8–20X9. For 20X10-20X11, buyback operations on a cash basis will be reintroduced for longer-dated bonds.
- By the end of 20X9–20X10, the treasury bill stock is projected to be CU150 billion, about CU13 billion higher than the year-end level for 20X8–20X9.
- To improve prudential liquidity management, over the next three years, the Government will borrow an additional amount of CU35 billion to safeguard its ability to meet payment obligations in situations where normal access to funding markets may be disrupted or delayed. This financing activity will have no material impact on the federal debt as the cost of the additional borrowing will be offset by a corresponding increase in returns on interest-bearing assets.

According to the Organisation for Economic Co-operation and Development (OECD), Country A's total government liabilities-to-GDP⁷ ratio stood at 36.9 percent in 20X9 (see Exhibit 5). This is the lowest level among G7 countries, which the OECD estimates will record, on average, a debt-to-GDP ratio of 71.4 percent for that same year.

Exhibit 5 – Debt-to-GDP (20X9)



FINANCIAL STATEMENT HIGHLIGHTS

- Overall, net assets increased by CU142,250,000 (17%), mainly due to an increase in the surplus for the period.
- The Government of Country A's total current assets decreased by CU13,860 (2%). This resulted from a decrease of CU10,500,000 (2%) in its most liquid assets—cash and cash equivalents and receivables, which was offset by a increases in inventories and other current assets. Current liabilities decreased by CU139,320 (30%). The entity's short-term liquidity, as measured by the change in current assets—current liabilities, improved by CU125,460,000.
- The increase in the 20X9 surplus over the 20X8 surplus of CU55,750,000 (85%) was largely due to increased revenues from taxes, fees and transfers from other governments, as well as modest decreases in overall expenses for the period of CU6,383,000 (1.9%). The Government of Country A introduced measures to reduce costs during 20X9, and it is expected that for 20X10 further cost savings will be realized.
- The growth in tax revenues of CU24,400,000 (9.3%) was mainly due to the increase in personal tax revenues, which was caused by strong growth in wages and employment during the year. Recent data published by the government's Statistics Department suggests that this growth will not continue due to lower employment figures and wage increases resulting from a weakening economy.

⁷ 20X9 GDP was CU1,705,017 (millions).

- The Government of Country A's long-term borrowing position improved overall by CU40,000,000 (25%). Its total liabilities, which are a claim on future resources, also decreased by CU199,950,000 (29%).

FINANCIAL RISKS AND UNCERTAINTIES

A large proportion of the risks and uncertainties around the outlook for Country A relate to the global economic outlook, especially around global financial markets and international commodity prices. If global growth falters and credit conditions tighten again, both businesses and households will be adversely affected. Country A's performance through the crisis has, however, demonstrated a degree of resilience, with no major bank failures, only a moderate fall in GDP from peak to trough, and with modest growth resuming from Q2 20X10. Risks remain around a resumption in domestic demand in the near term, particularly if the labour market deteriorates more rapidly than anticipated. The path taken by the exchange rate is an additional source of uncertainty.

Debt Management Strategy

The fundamental objective of debt management is to raise stable and low-cost funding to meet the financial needs of the Government of Country A. An associated objective is to maintain a well-functioning market in Government of Country A's securities, which helps to keep debt costs low and stable.

Foreign Currency Strategy

The purpose of the Exchange Fund Account (EFA) is to aid in the control and protection of the external value of the Country A currency unit (CU). Assets held in the EFA are managed to provide foreign currency liquidity, support market confidence, and promote orderly conditions for the Country A CU in the foreign exchange markets, if required.

The Government has access to a range of direct sources of funding for its foreign currency assets, including a short-term U.S.-dollar paper program, medium-term note issuance in various markets, international bond issues, purchases and sales of Country A CUs in foreign exchange markets, and cross-currency swaps involving the exchange of domestic liabilities for foreign-currency-denominated liabilities.

As part of the planned increase in prudential liquidity and ongoing International Monetary Fund commitments, the level of foreign exchange reserves will increase by about CU10 billion by the end of 20X9–20X10. The mix of funding sources used to finance this increase will depend on a number of considerations, including relative cost, market conditions, and the objective of maintaining a prudent foreign-currency-denominated debt maturity structure. The medium-term debt strategy assumes that all foreign liabilities maturing during the year will be refinanced. However, the amount of foreign currency funding may vary from the plan, depending on market conditions and government foreign currency needs.

Further information on managing foreign currency reserves and funding objectives is provided in *Management of Country A's Official International Reserves*, which is available on the Government Treasury website.

VARIANCES AND TRENDS⁸

Budget 20X9 Restraint Measures Are On Track

Budget 20X9 implemented targeted measures to restrain direct spending growth and close tax loopholes that are expected to generate savings of CU17.6 billion over five years. The Government is on track to meet this spending restraint commitment as:

- The Department of National Defence is on track to achieving the savings required to meet the commitment to restrain growth in defence spending.
- In 20X8–20X9, The Government of Country A fulfilled its commitment to double international assistance. International Assistance funding has now been capped at CU5 billion.
- Savings of CU300 million in 20X8–20X9 have been achieved as departments and agencies absorbed the 1.5 percent wage increase for the federal public administration.
- The operating budgets of departments remain frozen at their 20X8–20X9 levels for two years.

Building On Budget 20X9 Restraint Actions

Budget 20X10 builds on the actions taken in *Budget 20X9* by announcing the following measures that could achieve an additional CU17.2 billion in savings over five years:

- Delivering on the 20X9 round of strategic reviews.

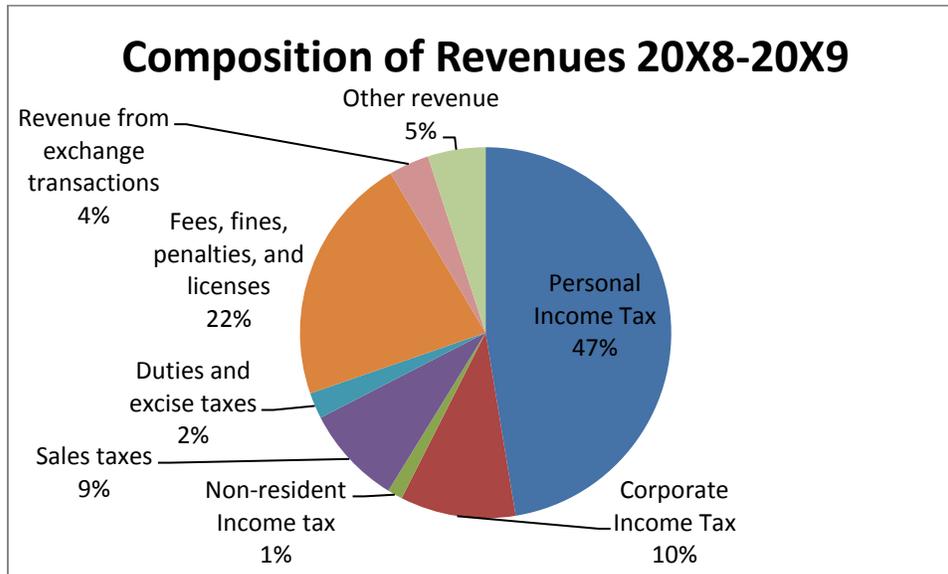
⁸ It is assumed that detailed actual-to-budget comparisons are reported elsewhere and are thus not duplicated in the financial statement discussion and analysis.

- Taking action to close tax loopholes.
- Launching a comprehensive one-year Strategic and Operating Review aimed at improving the efficiency and effectiveness of government operations and programs to ensure value for taxpayer money.

Revenues

Revenues totalled CU228.8 billion in 20X8–20X9. Exhibit 6 illustrates the composition of revenues for 20X8–20X9.

Exhibit 6 – Composition of Revenues 20X8-20X9



The largest overall source of revenues is income taxes. Personal income taxes accounts for 47 percent of total revenues. Revenues from this source increased 7.8 percent from 20X7–20X8, reflecting higher employment, even though average personal tax rates were reduced. Corporate income taxes also increased, by 8.3 percent from 20X7–20X8 reflecting higher corporate profits.

Sales taxes also increased from 20X7–20X8 due to increased consumer spending on goods and services.

This trend of increased tax revenues from all sources is not expected to repeat in 20X9–20X10 due to the expected impact of the global recession on Country A.

Exhibit 7 shows the changes in significant revenue sources from 20X8.

Exhibit 7 – Change in Revenues

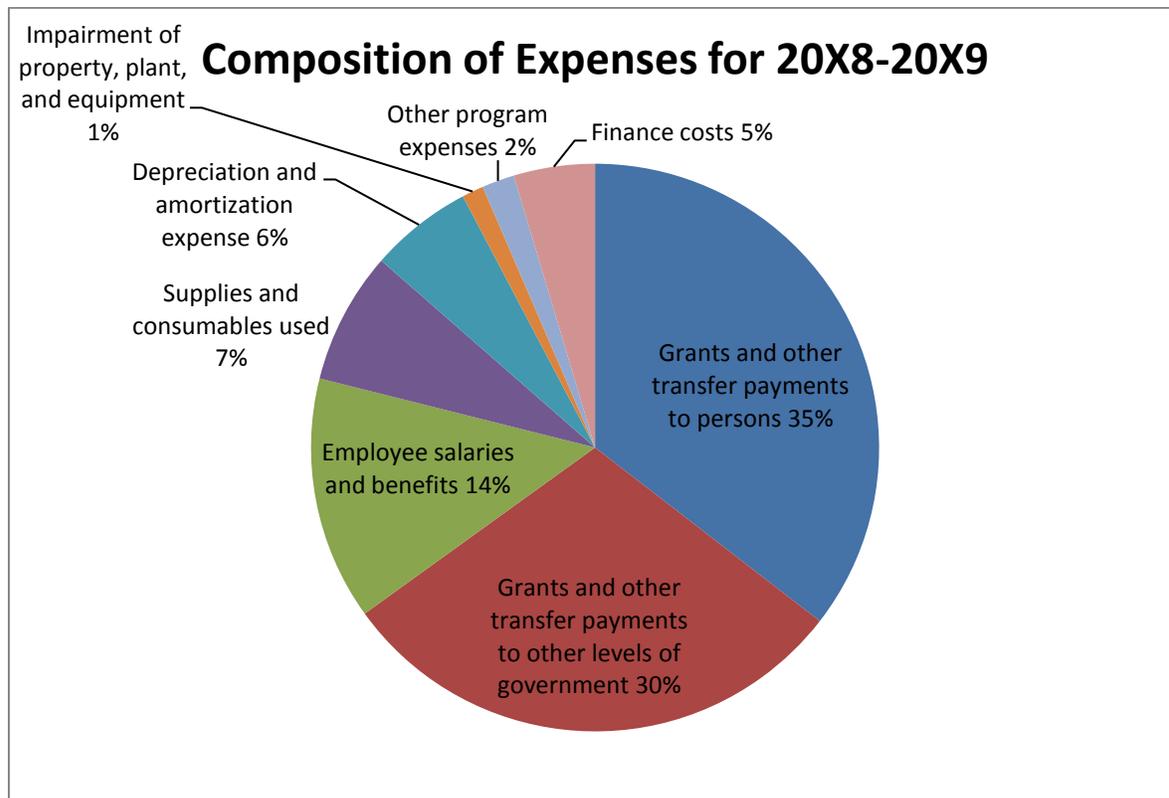
(in millions of currency units)

Revenues	20X9	20X8	Net Change (CU)	Net Change (%)
Income Taxes				
Personal	194,684	180,532	14,152	7.8
Corporate	41,333	38,141	3,192	8.3
Non-resident	5,361	5,524	-163	-3.0
Other taxes and duties				
Sales taxes	35,500	30,932	4,568	14.8
Duties and excise taxes	9,322	6,671	2,651	39.7
Total Tax Revenues	286,200	261,800	24,400	9.3
Fees, fines, penalties, and licenses	89,400	80,600	8,800	10.9
Revenue from exchange transactions	14,400	12,600	1,800	14.3
Other revenue	20,667	11,300	9,367	82.9
Total Revenues	410,667	366,300	44,367	12.1

Expenses

Expenses totalled CU228.8 billion in 20X8–20X9. Exhibit 8 illustrates the composition of expenses for 20X8–20X9.

Exhibit 8 – Composition of Expenses 20X9-20X9



Expenses consist of transfer payments, program expenses and public debt charges. In 20X8–20X9, expenses amounted to CU324.5 billion, down CU6.38 billion, or 1.9 per cent, from 20X7–20X8.

Major transfers to persons (income supplements, social security payments, and children’s benefits) and to other levels of government (the Health Transfer, the Social Transfer, fiscal arrangements, and transfers to cities and communities) were the two largest components of expenses in 20X8–20X9, representing 35 percent and 30 percent of expenses, respectively.

Transfers to persons increased 6.7 percent from 20X8 due to increased spending under the EAS on:

- Helped the unemployed through enhanced benefits and training programs.
- Prevented layoffs by enhancing the work-sharing program.
- Provided support to the housing sector through the Residence Renovation Tax Credit.

Transfers to other levels of government increased 4.3 percent for:

- Investments in infrastructure (e.g., by improving infrastructure at colleges and universities, expansion of the subway system in Country A’s largest municipality, rehabilitation of the transnational highway).

- Advancement of Country A's knowledge economy by supporting research and technology investment.
- Support of industries and communities most affected by the global downturn.

After major transfers to persons and to other levels of government, the next largest component of expenses was the cost of programs and services provided by government departments and agencies, excluding National Defence, at 18.4 per cent. Program costs include items such as salaries and benefits, facilities and equipment, and supplies and travel.

The largest increase in this category from 20X8 was in consumables and supplies. This was due to printing of forms and brochures related to new programs (e.g., Residence Renovation Tax Credit). Employee salaries and benefits increased by 4.7 percent mainly due to new collective agreements with unions covering the largest group of public servants.

Public debt charges amounted to 5 percent of expenses in 20X8-20X9. This is expected to increase in the coming year due to future borrowing requirements resulting from the impacts of the global recession, as discussed previously.

The Exhibit 9 shows the changes in significant expenses from 20X8.

Exhibit 9 – Change in Expenses

(in millions of currency units)

Expenses	20X9	20X8	Net Change (CU)	Net Change (%)
Grants and other transfer payments to persons	115,100	107,900	7,200	6.7
Grants and other transfer payments to other levels of government	96,000	92,000	4,000	4.3
Costs of programs and services				
Employee salaries and benefits	45,000	43,000	2,000	4.7
Supplies and consumables used	24,417	17,000	7,417	43.6
Depreciation and amortization	19,000	17,000	2,000	11.8
Impairment of property, plant, and equipment	4,000	–	4,000	–
Other expenses	6,000	5,500	500	9.1
Finance costs	15,000	18,000	-3,000	-16.7
Restructuring costs	–	30,500	-30,500	–
Total Expenses	324,517	330,900	-6,383	-1.9

Objective

To analyze the appropriateness of issuing an IPSAS (i.e., mandatory standard) on financial statement discussion and analysis.

Background

At the June 2011 IPSASB meeting, the IPSASB tentatively agreed the pronouncement should be mandatory for entities that prepare financial statements on an IPSAS basis. The IPSASB confirmed this position at the September 2011 meeting.

In the draft ED, staff has proposed that an IPSAS be issued and the Basis for Conclusions supports that approach.

Nevertheless, a question was raised as to whether the final pronouncement could be an IPSAS, given that the financial statement discussion and analysis is not part of the financial statements, but is intended to accompany the financial statements. To date, IPSASs have only addressed the financial statements themselves.

The IPSASB therefore directed staff to consider whether public sector entities that prepare reports in accordance with International Public Sector Accounting Standards (IPSAS) should be required to prepare financial statement discussion and analysis and whether it should be included as an integral part of the general purpose financial statements or in a separate general purpose financial report.

Alternatives

The following alternatives were considered by staff:

- 1. Issue a mandatory IPSAS (arguments presented in the Basis for Conclusions in the draft ED)**
 - (a) In CF—ED1, the IPSASB recognized that general purpose financial reports provide additional information necessary to meet the objectives of financial reporting (accountability and decision-making) in response to user needs. Therefore, if such information is indeed necessary to meet the financial reporting objectives, it should be prepared on a mandatory basis.
 - (b) Staff notes that the draft ED has been developed from a principles-based perspective that can be applied to all public sector entities. In addition, entities are encouraged to prepare financial statement discussion and analysis that meets their specific circumstances. Staff does not consider that “suitability” of the required content to individual entities’ circumstances is a barrier to establishing requirements.
 - (c) Many jurisdictions already require public sector entities to prepare financial statement discussion and analysis. Current practice associated with this type of information for public sector entities that are issuing accrual-basis financial reports has moved beyond the stage of non-mandatory guidance.
 - (d) Further, in the private sector, guidance may be non-mandatory because securities regulators often impose a requirement for private sector enterprises to prepare the equivalent of financial statement discussion and analysis. Staff considers that without specific reporting requirements many public sector entities will simply choose not to

prepare the financial statement discussion and analysis that is needed by users of public sector financial reports.

- (e) Staff also considered a concern whether a requirement to issue financial statement discussion and analysis when an entity issues financial statements prepared in accordance with IPSASs would be an impediment to the adoption of IPSASs. In particular, in jurisdictions moving from the cash basis to an IPSAS-based accrual basis of accounting may not have sufficient resources to develop financial statement discussion and analysis. A public sector entity that issues general purpose financial statements in conformity with IPSASs shows that it has the capacity to present financial statement discussion and analysis with equal standing to the financial statements. Moreover, staff considers that the users of financial statements in such jurisdictions may even have a greater need for the benefit of financial statement discussion and analysis to help explain the financial statements.
- (f) Staff considers that in all cases, the benefits of providing financial statement discussion and analysis would outweigh the costs of preparing it, as the information is derived from the financial statements, and tailored to the specific circumstances of the entity. The IPSASB has previously tentatively concluded that financial statement discussion and analysis should be prepared by all entities that prepare their financial statements in accordance with IPSASs.
- (g) IPSAS 1, *Financial Statement Presentation*, defines the scope of the financial statements. Staff does not consider financial statement discussion and analysis to be part of the financial statements prepared in accordance with IPSASs despite its close link to the financial statements. Staff does not propose to amend IPSAS 1 to include financial statement discussion and analysis as an integral part of the financial statements.
- (h) Staff noted the concern that, if this Standard were an IPSAS, it could be considered part of the financial statements and there could be confusion as to whether it would be subject to the same audit requirements as the financial statements. This could cause difficulties in some jurisdictions if the inclusion of financial statement discussion and analysis resulted in a qualified audit report on the financial statements. While the audit of financial statement discussion and analysis is desirable, staff considers that imposing an audit requirement on such information exceeds its mandate. However, it is noted that an audit of financial statements would not automatically require audited financial statement discussion and analysis. The term “financial statements” ordinarily refers to a complete set of financial statements as determined by the requirements of the applicable financial reporting framework. The financial reporting framework for public sector entities is described in IPSAS 1, and does not include financial statement discussion and analysis.
- (i) Staff also notes (but has not included this matter in the Basis for Conclusions) that the nature of the material reported in financial statement discussion and analysis is based on the financial statements. As a result, the IPSASB would not be seen to usurp the role of other professional groups with expertise in this area, as is the concern with the long-term fiscal sustainability and service performance reporting projects.

Staff proposal

- (j) Staff has followed this approach in preparing the draft ED because the practice of financial statement discussion and analysis is further developed than this type of reporting, so mandatory guidance is appropriate. Further, staff notes that this approach is the most onerous one to propose, which is appropriate for an ED, and the draft ED specifically elicits comments on this issue.

2. Issue a non-mandatory IPSAS (IPSAS 22 approach)

- (a) Paragraph 2 of IPSAS 22, *Disclosure of Financial Information about the General Government Sector*, requires that:

“A government that prepares and presents consolidated financial statements under the accrual basis of accounting and elects to disclose financial information about the general government sector shall do so in accordance with the requirements of this Standard.”

- (b) The reason cited in paragraph BC5 of IPSAS 22 for not issuing a mandatory standard is that:

“... the IPSASB is not persuaded that the benefits of making such disclosures may be significantly greater than their costs in those jurisdictions where financial statements prepared in accordance with statistical bases of financial reporting are not routinely prepared and made publicly available.”

- (c) Staff considers that in the case of financial statement discussion and analysis, the benefits of providing the information would outweigh the costs of preparing it, as the information is derived from the financial statements, and tailored to the specific circumstances of the entity.

Staff view

- (d) Staff does not support this alternative because, as noted, the benefits of providing financial statement discussion and analysis are expected to be greater than the costs of preparing it.

3. Issue non-mandatory guidance – Recommended Practice Guideline

- (a) The IPSASB’s long-term fiscal sustainability project proposes a new pronouncement, “Recommended Practice Guideline (RPG)”.

- (b) The rationale set out in the Basis for Conclusions for the LTFS ED for this approach is as follows:

“The IPSASB did not consider it appropriate to make firm recommendations on best practice because (a) the scope of the RPG includes all public sector entities and practice that is appropriate at one level of government may not be suitable elsewhere in the public sector, (b) while reporting on long-term fiscal sustainability has become a feature of financial management in an increasing number of jurisdictions it is at an early stage of development and (c) it is not the intention of the IPSASB to usurp the role of other professional groups with expertise in this area.”

- (c) A Member dissented with the proposed approach for the following reasons:

“AV1. This member believes that the public sector entities that prepare reports in accordance with International Public Sector Accounting Standards (IPSAS) should be required to present fiscal sustainability information within general purpose financial statements, including note disclosures, or in a separate general purpose financial report. This member believes that current

practice associated with this type of information for public sector entities that are issuing accrual-basis financial reports has moved beyond an “early stage for development” and the need for “good practices.” A public sector entity that issues general purpose financial statements in conformity with IPSAS also has demonstrated that it has the capacity to present fiscal sustainability information of equal standing.

- AV2. This member notes that the IPSASB, in the Exposure Draft on Phase 1 of the Conceptual Framework project, recognized that the presentation of information about prospective financial information is necessary to meet the objectives of financial reporting (accountability and decision-making) in response to user needs. Therefore, this member concludes that if prospective financial information is truly necessary to meet the financial reporting objectives it should be required.
- AV3. This member believes that the recommendations presented have been developed from a principles-based perspective that can be applied to all public sector entities without significant modifications. Therefore, this member concludes that suitability is not a barrier to establishing requirements. This member is concerned that without specific reporting requirements many governments will simply choose not to report fiscal sustainability information that is needed by users of public sector financial reports.”
- (d) Staff considers this alternative is not appropriate for financial statement discussion and analysis because practice has moved beyond an early stage of development in many jurisdictions. In addition, staff notes the information presented in financial statement discussion and analysis is within the scope of the IPSASB’s expertise, as it directly relates to the financial statements. Indeed, guidance for financial statement discussion and analysis (and similar reporting that goes by alternate names) is generally issued by professional accounting bodies. Thus, there is no concern of usurping other professional bodies’ responsibilities.
- (e) Staff considers that the alternative view presents valid arguments in favor of issuing mandatory requirements for financial statement discussion and analysis, and has incorporated them in the arguments for a mandatory pronouncement in alternative 1 above.

Staff view

- (f) Staff does not support issuing either a RPG or another form of pronouncement because the practice of financial statement discussion and analysis is further developed than this type of reporting, so recommended practice is less supportable in this project.

4. Issue Another Form of Mandatory Guidance

- (a) To date, IPSASs have addressed only matters that pertain to the content of the financial statements themselves. However, as shown above, this does not preclude other forms of reporting related to the financial statements to be addressed in an IPSAS.
- (b) Staff also considered whether it would be appropriate to allow for a new type of pronouncement that had equivalent authoritative status to the IPSASs.
- (c) Staff is of the view that introducing a new type of pronouncement would be confusing to its constituents. Further it is not necessary to introduce another type of authoritative pronouncement to address financial statement discussion and analysis (see arguments in alternative 1).

Staff view

- (d) Staff does not support this view because it is not necessary to introduce another type of authoritative pronouncement. IPSASs can apply to other forms of GPFRs, without becoming part of the GPFSs on which an audit opinion is provided.