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EPSAS issue paper on a principled approach to disclosures

*Paper by PwC on behalf of Eurostat
- for discussion*



**Principled approach to disclosures
with a view to financial reporting
requirements under the future
European Public Sector Accounting
Standards (EPSAS)**

March 2018

Final draft

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1. Objectives of the issue paper

The aim of this issue paper is to analyse and summarize the most important and most burdensome disclosure requirements in at least three Member States (MSs), as well as the requirements under the existing international financial reporting frameworks (IPSAS, IFRS, and the EU AR), with a view to devising a principled approach to optimising the need for disclosures, against the background of the IPSAS conceptual framework or national public sector GAAPs, given that some disclosure requirements are seen as burdensome by the preparers. The paper develops an approach for organising the future discussion on a principled approach to disclosures for EPSAS.

Based on the request from Eurostat, the issue paper will address the following questions:

- What could be the typology of disclosures (i.e. how could disclosures be categorised)?
- What are the main accounting areas of IPSAS, EU Accounting Rules and national accounting standards in EU MSs and in IFRS where the disclosure requirements may be seen as a concern? How have these disclosure requirements been addressed in these frameworks?
- What purposes do those requirements serve?
- How have those requirements been implemented in the MSs?
- What are the advantages and disadvantages of the approaches to disclosures under the existing standards (IPSAS, EU Accounting Rules, national financial accounting standards in EU MSs and IFRS)?
- How might possible alternative principled approaches to disclosures be developed in the European context taking into account the conceptual framework of IPSAS? What are their advantages and disadvantages?
- What way forward would PwC recommend in addressing disclosure requirements in the context of the future EPSAS standards?
- What could be the (potential) impact of the reporting innovation (e.g. XBRL, structured data) on the alternative principled approaches to disclosures?

The scope of this issue paper is limited to the primary financial statements and the notes that compose general purpose financial statements, it does not cover other types of information that could be found elsewhere in public documents (e.g. statistical reports, debt management reports, information on service performance, on the long-term sustainability of public finances, etc.).

Based on the results of the analysis, a first approach for organising the future discussion on disclosure requirements in the Member States with the EPSAS stakeholders is developed.

2. Background

The question of improving disclosures in the notes to the financial statements is an essential component of a better communication in financial reporting. In the current context, IPSAS as well as IFRS financial reports and disclosure requirements are frequently considered too complex. This is being driven by several factors:

- the ‘checklist’ approach taken by many current accounting standards, which lists detailed disclosures rather than relying on broad disclosure objectives;
- relevant information being obscured by large amounts of standing data and boilerplate disclosures;
- a strong focus on completeness of disclosures by auditors and regulators alike, which discourages preparers from considering materiality and relevance when preparing their financial statements.

In addition, the Disclosure Initiative launched by the International Accounting Standards Board (IASB) has recently highlighted that the absence of clear disclosure objectives in IFRS standards can make it difficult for entities to:

- understand the purpose of some disclosure requirements;
- apply judgement in deciding what information to disclose and in tailoring disclosures to their own circumstances, as the long lists of prescriptive disclosure requirements reinforce the perception that financial statements are compliance documents.¹

The PwC study from 2014 reported that “...compliance with the extensive disclosure requirements is one of the areas that have been identified by the Member States as requiring the most significant efforts”.² A few of them indicated that IPSAS contain too detailed disclosure requirements and the usefulness of these is sometimes questionable. A limited number of comments have been expressed specifically in relation to the following standards³:

- IPSAS 18 ‘Segment reporting’ (three comments):
 - i. the information required by the standard is not useful,
 - ii. it is difficult to identify segments.
- IPSAS 20 ‘Related party disclosures’ (three comments): application of the standard is too complex for governments.
- IPSAS 22 ‘Disclosure of information about the General Government Sector’ (one comment): the standard is not useful.

¹ See IASB Discussion Paper DP/2017/1, Disclosure Initiative—Principles of Disclosure, March 2017, p. 14

² See PwC, Collection of information related to the potential impact, including costs, of implementing accrual accounting in the public sector and technical analysis of the suitability of individual IPSAS standards, 2013/S 107-182395, 1 August 2014, p. 96-97.

³ See PwC, Collection of information [...], p. 124, 130.

- IPSAS 24 ‘Presentation of budget information in the financial statements’ (one comment):
 - i. it is difficult to reconcile cash budgets with accrual accounts,
 - ii. EPSAS does not deal with budgetary rules, consequently a reconciliation of the budgetary result (actual amounts) with the EPSAS result should be sufficient.
- IPSAS 30 ‘Financial instruments: disclosures’ should be adapted as it is based on the IFRS equivalent that was developed for banks and insurance companies.

The PwC study suggested possible solutions to address the comments regarding specific disclosure standards⁴:

- IPSAS 18 ‘Segment reporting’ - the requirements of the current IPSAS standard (based on the old IAS 14 standard) have not been considered as useful.

The PwC study recommends that the appropriateness of a (partial) alignment of the IPSAS standard on segment reporting on IFRS 8 be explored, in that it capitalises on information already available that fits the entity’s reporting/accountability structure, rather than on IAS 14 (the old IFRS standard on segment reporting).

Segment reporting is also one topic that has been selected in the series of issues paper developed for discussion in the context of the EPSAS project. In this paper, EY proposes that an approach be discussed whereby only segment revenue and expenses (and segment assets and segment liabilities) would be reported based on the COFOG classification, a classification of the functions of governments used for statistical reporting purposes.⁵

Segment reporting has been identified by the IPSASB as a potential project to put on its work plan for the period 2019-2023. ‘There are two aspects to this potential project. Firstly, IPSAS 18 is based on IAS 14 ‘Segment Reporting’ and this has been superseded by IFRS 8 ‘Operating Segments’. Secondly, the need for this project has been raised by constituents who have identified concerns with the quality and usefulness of IPSAS 18. These constituents urged the IPSASB to consider convergence with IFRS 8 and its applicability to public sector entities, as well as the potential to increase the usefulness of information for GFS.’⁶ In its ‘Strategy and work plan 2019-2023’ document, the IPSASB therefore highlights the two same issues that have been proposed for discussion in the PwC study from 2014 and in the EY issue paper of March 2017.

- IPSAS 20 ‘Related party disclosures’ - applying the standard can be very complex and burdensome for governments. The PwC study suggests that the relevance of the disclosure requirements with regard to European needs be analysed and that guidance may be issued to help users identify what information is relevant and should be disclosed, taking materiality into account.

⁴ See PwC, Collection of information [...], p. 124, 130.

⁵ See EY, EPSAS issue paper ‘Segment reporting under the future European Public Sector Accounting Standards (EPSAS)’, 17 March 2017, p.24

⁶ IPSASB proposed strategy and work plan 2019-2023, p14.

- IPSAS 22 ‘Disclosure of information about the GGS’ - the usefulness of the standard was questioned. Based on IPSASB feedback, IPSAS 22 is not widely applied, and the IPSASB is currently considering whether the standard should be withdrawn, replaced with guidance that might be more useful or whether it should be revised. The standard only applies to those governments that elect to present information about the GGS in their consolidated financial statements.

The PwC study considers reconciliation of EPSAS figures with the ESA reporting as useful, especially in respect of the net assets, debt and surplus/deficit, considering that a major objective of the EPSAS project is to build reliable accrual accounting data at entity level that can be used for the ESA reporting. Discussions during the EPSAS standard-setting process may help identify what information is useful in the European context.

- IPSAS 24 ‘Presentation of budget information in the financial statements’ - one (out of 28) Member State questioned the appropriateness of providing a comparison of budget and actual amounts in financial statements.

The PwC study highlights that presentation of budget information provides useful information, especially when budgets and financial statements are not prepared on a comparable basis, and that reconciliation between budgeted and actual amounts is useful with respect to the accountability and transparency objectives of financial statements. Some may however wish to discuss this as part of the standard-setting process.

- IPSAS 30 ‘Financial instruments: disclosures’ - some Member States express the view that the detailed disclosure requirements of IPSAS 30 go beyond the needs of public sector entities.

The PwC study says that, when material transactions are concluded that involve major risks for governments, appropriate disclosure should be given on these transactions and on the exposure these have created for the public sector entity. Judgment is required in determining information that is relevant for a proper understanding of the transactions and their (potential) impact on the financial position, performance and cash flows of the entity. Keeping these sound principles in mind, the study suggest that a review of (some of) the disclosure requirements of IPSAS 30 might be envisaged in view of the European needs and/or that additional guidance on how to apply these might be provided.

Regarding the specific case of small and less risky entities (SLREs), however not in relation to disclosures only but to accounting and reporting rules in general, the report from the Commission on the suitability of IPSAS for the Member States published in March 2013 emphasized the need for specific consideration to be given to such entities; ‘the way forward should be selective and take particular account of the perspective of small and medium-sized entities and the aspect of materiality.’⁷

⁷ See Report From The Commission To The Council And The European Parliament, Towards implementing harmonised public sector accounting standards in Member States, The suitability of IPSAS for the Member States, March 2013, p.10

In response to the above concern and based on the comments received from Member States, the PwC study from 2014⁸ notes that indeed materiality and pragmatism should be considered in applying the new EPSAS requirements to smaller and less risky entities. The study mentions two options that could in theory be envisaged to deal with a differentiated approach for such entities, also referring to the practices in some countries:

- separate accounting rules that are designed specifically for smaller and less risky entities; or
- specific guidance that is provided on how to apply the rules that are applicable to all entities, with specific consideration of the materiality aspects.

In addition to this, an EPSAS paper has been developed on the topic to discuss if and how financial reporting requirements could be relaxed for SLRE. The paper suggests that reducing the set of disclosures, either through a simplification approach or through separate standard-setting process, could make SLREs' financial statements more transparent and by that better address the needs of users of these financial statements.⁹

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⁸ See PwC, Collection of information [...], p. 163.

⁹ See EY, EPSAS issue paper 'Relief for smaller and less risky entities from financial reporting requirements under the future European Public Sector Accounting Standards (EPSAS)', 16 June 2016, pp 15-16

3. Description of accounting guidance available in international accounting frameworks

We summarize below the disclosure requirements included in various accounting/reporting frameworks/rules:

- in international accounting standards applicable to the public sector (IPSAS) (see 3.1) and the private sector (IFRS) (see 3.3); and
- in EAR (see 3.2).

We also address under 3.3.2 the Disclosure Initiative currently conducted by the IASB as part of the wider initiative on better communication in financial reporting.

ESA 2010 rules serve a different purpose (i.e. statistical reporting at the macro-economic level) and are not discussed here.

Although these do not constitute accounting guidance per say, we also present in this chapter under section 3.4 some additional initiatives around better financial reporting which may be useful in developing a principled approach to disclosures under EPSAS:

- the thinking developed by Accountancy Europe around the future of corporate reporting, and in particular the so-called ‘Core and More’ concept;
- the study carried out by the OECD on better addressing users’ needs in fiscal reporting;
- the ‘Future Digital’ project carried out by the Financial Reporting Council Reporting Lab.

3.1. International Public Sector Accounting Standards (IPSAS)

We successively address below the general guiding principles included in the IPSASB Conceptual Framework and the main disclosure requirements included in IPSAS standards.

3.1.1. Guiding principles in the IPSASB Conceptual Framework

The IPSASB Conceptual Framework¹⁰ includes useful principles that provide additional guidance on how to apply the principles relating to disclosures included in the standards themselves.

At first, Chapter 3 of the conceptual framework describes the qualitative characteristics of information included in general purpose financial reports (GPFs), that is the attributes that make that information useful to users and support the achievement of the accountability and decision-making objectives of financial reporting.

¹⁰ See The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities, IPSASB, October 2014.

Key attributes are the following:

- **Relevance.** Financial and non-financial information is relevant if it is capable of making a difference in achieving the objectives of financial reporting. Financial and non-financial information is capable of making a difference when it has confirmatory value, predictive value, or both.
- **Faithful representation.** Faithful representation is attained when the depiction of the phenomenon is complete, neutral, and free from material error. Information that faithfully represents an economic or other phenomenon depicts the substance of the underlying transaction, other event, activity or circumstance - which is not necessarily always the same as its legal form. An omission of some information can cause the representation of an economic or other phenomenon to be false or misleading. For example, a complete depiction of the item “plant and equipment” will include a numeric representation of the aggregate amount of plant and equipment together with other quantitative, descriptive and explanatory information necessary to faithfully represent that class of assets.
- **Understandability.** It is the quality of information that enables users to comprehend its meaning. GPFRs of public sector entities should present information in a manner that responds to the needs and knowledge base of users, and to the nature of the information presented.
- **Timeliness.** Timeliness means having information available for users before it loses its capacity to be useful for accountability and decision-making purposes. A lack of timeliness can render information less useful.
- **Comparability.** Comparability is the quality of information that enables users to identify similarities in, and differences between, two sets of phenomena.
- **Verifiability.** It is the quality of information that helps assure users that information in GPFRs faithfully represents the economic and other phenomena that it purports to represent.

Constraints on information included in financial reports include:

- **Materiality.** Information is material if its omission or misstatement could influence the discharge of accountability by the entity, or the decisions that users make on the basis of the entity’s GPFRs prepared for that reporting period. Materiality depends on both the nature and amount of the item judged in the particular circumstances of each entity. Consequently, it is not possible to specify a uniform quantitative threshold at which a particular type of information becomes material. Assessments of materiality will be made in the context of the legislative, institutional and operating environment within which the entity operates and, in respect of prospective financial and non-financial information, the preparer’s knowledge and expectations about the future.

The IPSASB recently published a podcast on its website discussing how materiality can be applied when preparing financial statements. The podcast summarizes the accounting requirements for materiality.¹¹

- **Cost-benefit.** Application of the cost-benefit constraint involves assessing whether the benefits of reporting information are likely to justify the costs incurred to provide and use the information. When making this assessment, it is necessary to consider whether one or more qualitative characteristic might be sacrificed to some degree to reduce cost.
- **Balance between the qualitative characteristics.** The relative importance of the qualitative characteristics in each situation is a matter of professional judgment. The aim is to achieve an appropriate balance among the characteristics in order to meet the objectives of financial reporting.

In addition to this, chapter 8 of the conceptual framework 'Presentation in general purpose financial reports' includes interesting principles relating to the disclosure of information.

Presentation is the selection, location and organisation of information that is reported in GPFRs, i.e. either in the primary statements or in the notes of the general purpose IPSAS financial statements, or in other GPFRs outside the financial statements. The framework gives guidance on what information should be selected for presentation, as well as where (what location) and how to present it.

The chapter also discusses principles applicable to information organisation, reviewing the relationships between information (in one GPFR, in several GPFRs, or links to information outside GPFRs) and whether information is for display or disclosure.

Information selected for display communicates key messages in a GPFR. It is kept to a concise and understandable level and is presented prominently, using appropriate presentation techniques such as clear labelling, borders, tables and graphs. Developing requirements for the display of line items and totals involves balancing the standardization of displayed information, which facilitates understandability, with information that is tailored for entity-specific factors. The aim of both standardised display requirements and entity-specific information is to ensure that information necessary to meet the objectives of financial reporting is available for all entities, while allowing information to be displayed in a manner that reflects the nature and operations of specific entities.

For the financial statements, displayed information is shown on the face of the appropriate primary statement, while disclosures are in the notes. Information selected for disclosure makes displayed information more useful by providing detail that will help users understand the displayed information. The level of detail provided by disclosed information thus contributes to achievement of the objectives of financial reporting, without being excessive.

The focus is on the presentation of both financial and non-financial information.

¹¹ See IPSASB staff podcast on materiality: <http://www.ifac.org/news-events/2017-06/ipsasb-staff-podcast-materiality>

3.1.2. Disclosure requirements in IPSAS standards

Disclosure requirements are included in the IPSAS standards at various levels:

- General requirements relating to disclosures, included under IPSAS 1 ‘Presentation of financial statements’.
- Disclosure requirements in respect of specific topics included in other standards dealing with these specific topics (and addressing recognition, measurement, presentation and disclosure requirements in the same standard). For example, disclosure requirements that are specific to items of property, plant and equipment are included in IPSAS 17 ‘Property, plant and equipment’, disclosure requirements that are specific to inventories are included in IPSAS 12 ‘Inventories’, etc.
- Disclosure requirements in respect of specific topics included in standards dealing only with these disclosure requirements. The disclosure standards include IPSAS 18 ‘Segment reporting’, IPSAS 20 ‘Related party disclosures’, IPSAS 22 ‘Disclosure of information about the General Government Sector’, IPSAS 24 ‘Presentation of budget information in the financial statements’, IPSAS 30 ‘Financial instruments: disclosures’ and IPSAS 38 ‘Interests in other entities’.

In the context of the present issue paper, only general requirements relating to disclosures are further discussed below.

Paragraphs 59 and 60 of IPSAS 1 ‘Presentation of financial statements’ specify that IPSASs require particular disclosures on the face of the statement of financial position, statement of financial performance and statement of changes in net assets/equity, and require disclosure of other line items either on the face of those statements or in the notes.

Disclosures are also required by other IPSASs; unless specified to the contrary elsewhere in IPSAS 1, or in another Standard, such disclosures are made either on the face of the statement of financial position, statement of financial performance, statement of changes in net assets/equity or cash flow statement (whichever is relevant), or in the notes.

Paragraph 29 of IPSAS 1 states that a fair presentation also requires an entity to provide additional disclosures when compliance with the specific requirements in IPSASs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity’s financial position and financial performance. However, inappropriate accounting policies are not rectified either by disclosure of the accounting policies used, or by notes or explanatory material.

When it comes to the structure of the notes, paragraph 127 of IPSAS 1 indicate that the notes shall:

- a. Present information about the basis of preparation of the financial statements and the specific accounting policies used in accordance with IPSAS 1 paragraphs 132-139 (e.g. measurement basis used in preparing the financial statements);

- b. Disclose the information required by IPSASs that is not presented on the face of the statement of financial position, statement of financial performance, statement of changes in net assets/equity or cash flow statement; and
- c. Provide additional information that is not presented on the face of the statement of financial position, statement of financial performance, statement of changes in net assets/equity or cash flow statement, but that is relevant to an understanding of any of them.

As per paragraphs 128 and 129 of IPSAS 1, notes shall be presented, as far as practicable, in a systematic manner. Notes are normally presented in the following order, which assists users in understanding the financial statements and comparing them with financial statements of other entities:

- a. A statement of compliance with IPSASs;
- b. A summary of significant accounting policies applied;
- c. Supporting information for items presented on the face of the statement of financial position, statement of financial performance, statement of changes in net assets/equity or cash flow statement, in the order in which each statement and each line item is presented; and
- d. Other disclosures, including contingent liabilities (see IPSAS 19), and unrecognised contractual commitments; and non-financial disclosures, e.g. the entity's risk management objectives and policies.

In addition, paragraph 140 of IPSAS 1 requires an entity to disclose in the notes information about the key assumptions concerning the future, and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

3.2. European Union Accounting Rules (EAR)

EAR 1 'Financial statements' states that the purpose of the annex is to give an additional contribution to the presentation of a true and fair view, in addition to the information presented in the statement of financial position, statement of financial performance, statement of changes in net assets/liabilities and cash flow table.

The information disclosed in the annex to the financial statements covers information about the basis of preparation of the financial statements, specific accounting policies, and the disclosure of information that is not presented elsewhere and of additional information. The structure of the annex of the consolidated annual accounts of the European Union is as follows:

- General information about the entity.
- Information in compliance with the applicable accounting regulation.
- Information on the accounting policies and criteria applied.
- Additional information on financial statement items.
- Non-financial information.

Concerning accounting policies and criteria as well as general information, the objective is to review, which information is already given to avoid repetition; and to ensure that only additional information is provided. Moreover, each accounting rule foresees specific disclosure requirements based on IPSAS disclosure requirements, e.g. EAR 6 'Intangible assets' gives an overview of IPSAS disclosure requirements which must be disclosed in the consolidated annual accounts of the European Union for each class of intangible fixed assets.

Finally, EAR 1 identifies as one of the constraints on relevant and reliable information the need for a balance between benefit and cost: the benefits derived from information should exceed the cost of providing it, however the evaluation of benefits and costs is substantially a matter of judgment.

3.3. International Financial Reporting Standards (IFRS)

3.3.1. Current IFRS disclosure requirements

Similar to IPSAS, the IFRS framework includes disclosure requirements included in the standards themselves and guiding principles included in its conceptual framework.

Disclosure requirements included in the IFRS standards also comprise:

- General requirements relating to disclosures, included under IAS 1 'Presentation of financial statements'.
- Disclosure requirements in respect of specific topics included in other standards dealing with these specific topics (and addressing recognition, measurement, presentation and disclosure requirements in the same standard).
- Disclosure requirements in respect of specific topics included in standards dealing only with these disclosure requirements.

The IFRS framework also includes qualitative characteristics that describe key attributes that information included in IFRS financial statements should have to provide useful information to its readers.

As the guiding principles for disclosure requirements are similar in both sets of rules (with the notable exception that IFRSs are designed for private companies and IPSASs for public sector entities), they are not repeated here. Rather we present below an outline of the recent developments at IASB level that are relevant for the EPSAS discussion on a principled approach to disclosures.

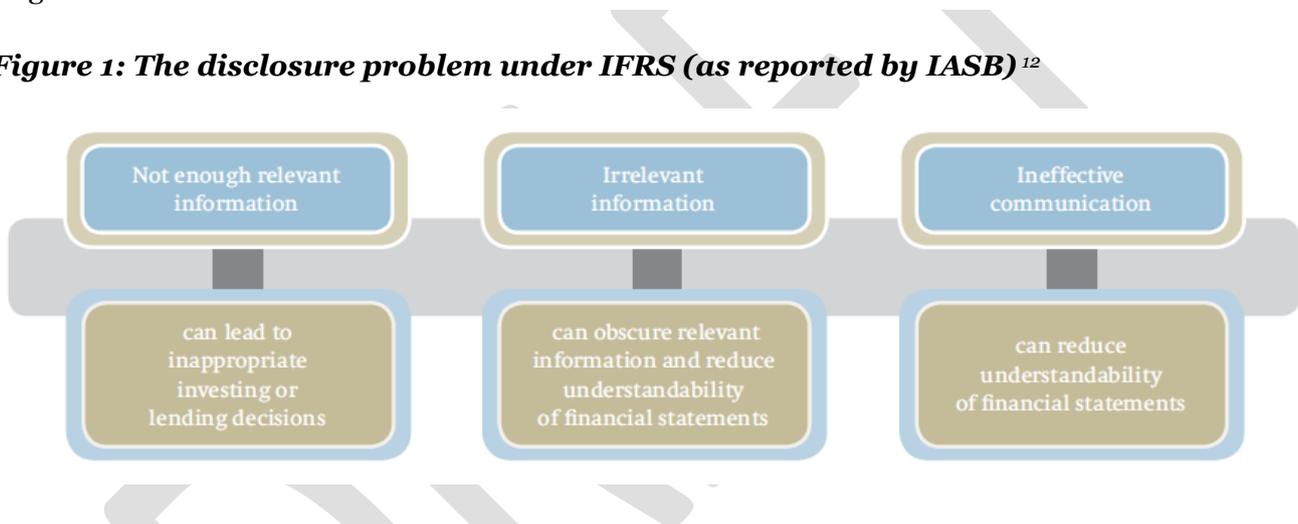
3.3.2. IASB developments

Under its initiative 'Better communication in financial reporting', the International Accounting Standards Board (IASB) is currently working on a number of major projects regarding the reporting and presentation of financial information, as investors have asked the Board to refocus its activities on initiatives designed to make financial information more relevant and to improve the communication of that information.

The Board has identified various areas supporting better communication, including ‘Primary Financial Statements’ (e.g. structure and content, interaction between the primary financial statements), ‘Principles of Disclosure’ (improving disclosure effectiveness), definition of the term ‘Material’ (improving consistency in the application of that concept) and ‘Materiality Practice Statement’ (non-mandatory statement helping preparers, auditors and regulators to use judgement when applying the concept of materiality) and ‘IFRS taxonomy’ (e.g. wider impact technology may have on the relevance of the standards and the IFRS Taxonomy).

As part of this initiative, the Board is developing presentation and disclosure principles that apply across all IFRS Standards. The purpose of these principles would be to help the Board set better disclosure requirements and to enable preparers to make better judgements about disclosures. The Board may also consider making targeted improvements to existing disclosure requirements. As part of this project, the Board published a Discussion Paper (DP) on the Principles of Disclosure in March 2017. The DP sought feedback on disclosure issues identified by the Board and on the Board’s preliminary views on how to address them and was open for comment until 2 October 2017. On 20 February 2018 the Board discussed the comments received on the DP. No decisions were made at this stage.

Figure 1: The disclosure problem under IFRS (as reported by IASB)¹²



The IASB has identified three main concerns about disclosures in the financial statements, collectively termed the ‘disclosure problem’¹³:

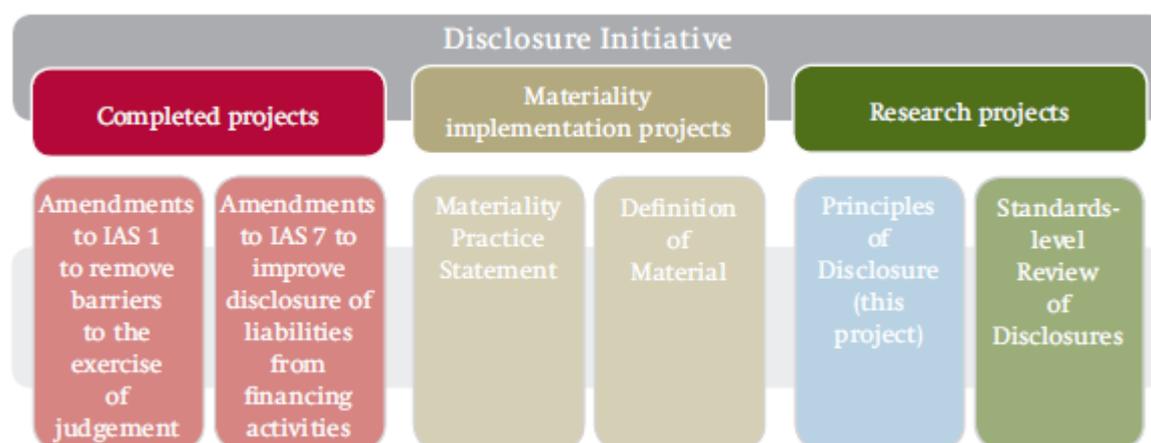
- **Not enough relevant information:** information is relevant if it is capable of making a difference in the decisions made by the primary users of financial statements. If financial statements do not provide enough relevant information, their users might make inappropriate investing or lending decisions.
- **Too much irrelevant information:** irrelevant information is undesirable because:
 - it clutters the financial statements so that relevant information might be overlooked or hard to find, making financial statements difficult to understand; and
 - it can add unnecessary ongoing cost to the preparation of the financial statements.

¹² See IASB Discussion Paper DP/2017/1, Snapshot: Disclosure Initiative-Principles of Disclosure, March 2017, p.4

¹³ See IASB Discussion Paper DP/2017/1, Disclosure Initiative—Principles of Disclosure, March 2017, p. 13

- **Ineffective communication of the information provided:** if information is communicated ineffectively, it makes the financial statements hard to understand and time-consuming to analyse. Additionally, users of the financial statements may overlook relevant information or fail to identify relationships between pieces of information in different parts of the financial statements.

Figure 2: IASB Disclosure Initiative¹⁴



The Board is considering whether to develop an Exposure Draft of proposals to amend or replace parts of IAS 1 ‘Presentation of financial statements’. In that context, it should be noted that the IASB already issued amendments to IAS 1 under the Disclosure Initiative (with effective date 1 January 2016), which clarify, among others, that entities have flexibility when designing the structure of the notes, and that materiality considerations apply to the primary statements, notes and any specific disclosure requirements in IFRSs, i.e. disclosures specifically required by IFRSs need to be provided only if the information is material.

The Board believes that the development of clear principles governing what, how and where information should be disclosed in the financial statements will improve the information provided to users of financial statements. It will do so by helping companies communicate their disclosures more effectively and by assisting the Board in improving disclosure requirements in IFRS standards.

Some of the Board’s preliminary views presented in the DP are summarized below.

At first, a general disclosure standard should include disclosure principles that:

- identify, and describe the role of, the primary financial statements and the implications of that role;
- describe the role and content of the notes;
- describe when an entity can provide information that is necessary to comply with IFRS standards outside the financial statements;
- describe when an entity can provide information that is identified as ‘non-IFRS information’, or by a similar labelling, within the financial statements;

¹⁴ See IASB Discussion Paper DP/2017/1, Snapshot: Disclosure Initiative—Principles of Disclosure, March 2017, p.2

- e) describe how performance measures can be fairly presented in financial statements;
- f) clarify which accounting policies are required to be disclosed; and
- g) identify and describe centralised disclosure objectives.

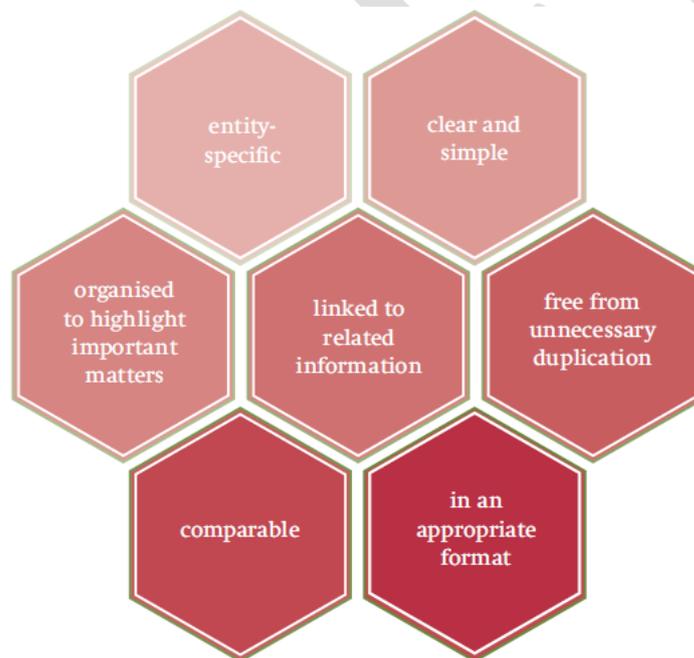
Guidance about the following matters should then be provided, either in a general disclosure standard or in non-mandatory guidance, for example, in educational material:

- a) principles of effective communication that entities should apply when preparing financial statements (Section 2); and
- b) the location of accounting policy disclosures.

Finally, the Board’s preliminary view is also that non-mandatory guidance on use of formatting in the financial statements should be developed.

The graph below depicts seven principles of effective communication, which could be included in a general disclosure standard or described in non-mandatory guidance.

Figure 3: Principles of effective communication in Financial Statements¹⁵



The seven principles of effective communication are further commented upon below.

- a) entity-specific, since information tailored to an entity’s own circumstances is more useful than generic, ‘boilerplate’ language or information that is readily available outside the financial statements;
- b) described as simply and directly as possible without a loss of material information and without unnecessarily increasing the length of the financial statements;
- c) organised in a way that highlights important matters—this includes providing disclosures in an appropriate order and emphasising the important matters within them;

¹⁵ See IASB Discussion Paper DP/2017/1, Snapshot: Disclosure Initiative-Principles of Disclosure, March 2017, p.6

- d) linked when relevant to other information in the financial statements or to other parts of the annual report (see Section 4 *Location of information*) to highlight relationships between pieces of information and improve navigation through the financial statements;
- e) not duplicated unnecessarily in different parts of the financial statements or the annual report;
- f) provided in a way that optimises comparability among entities and across reporting periods without compromising the usefulness of the information; and
- g) provided in a format that is appropriate for that type of information - for example, lists can be used to break up long narrative text, and tables may be preferable for data-intensive information, such as reconciliations, maturity analysis etc.

In the context of the Disclosure initiative, the IASB published in October 2017 a report including case studies describing a few companies' journeys towards improving the way they communicate information in their financial statements.¹⁶

Hans Hoogervorst, IASB Chair, says: 'The companies featured in this report tell us their external and internal stakeholders' value the changes introduced because their financial statements have become easier to read and understand. The financial statements are easier to read and understand because the companies identified what information is relevant to their investors, prioritised it appropriately and presented it in a clear and simple manner. In some cases, this resulted in companies including additional information that is useful for investors and, in other cases, removing information that is immaterial'.

Technology as an enabler for effective communication

Moreover, as mentioned here above, another area which may support enhanced communication towards stakeholders relates to the wider impact technology may have on the relevance of the standards and the IFRS Taxonomy. To support the move towards structured electronic reporting, the IFRS Foundation issues a yearly IFRS Taxonomy™, which is a translation of IFRSs into XBRL (eXtensible Business Reporting Language), and is considered as a (non-mandatory) global standard to mark up electronic IFRS financial statements.

A taxonomy is a classification system designed to accurately reflect the presentation and disclosure requirements of IFRS standards as issued by the IASB. Its content also includes elements from the accompanying materials to IFRS standards (Implementation Guidance and Illustrative Examples) and elements for disclosures that are not required, but that are commonly reported in practice by entities. The IFRS Taxonomy updates occur throughout the year in line with the publication of new or amended standards issued by the IASB. Updates may also be released as a result of common practice projects or technology updates. Each year an annual compilation of all updates is produced (the Annual IFRS Taxonomy).¹⁷

¹⁶ See IASB, 'Better communication in financial reporting - Making disclosures more relevant',

¹⁷ See IFRS Foundation website <http://www.ifrs.org/XBRL/IFRS-Taxonomy/Pages/IFRS-Taxonomy.aspx>

3.4. Other initiatives around better financial reporting

3.4.1. Accountancy Europe - The 'Core and More' concept

Accountancy Europe published in March 2017 a follow-up paper to the 2015 Accountancy Europe Cogito paper 'The Future of Corporate Reporting - creating the dynamics for change'.¹⁸ It presents a summary of the responses received to the paper in writing as well as during several public and private events. Respondents are stakeholders including preparers, users, auditors, regulators, academics, and policy makers from across Europe.

Overall, respondents and attendees at the events indicated that although there is a growing audience for corporate reporting, investors are still seen as the primary users of such reporting, and that financial reporting is not losing absolute relevance: it still has significant confirmatory value, and as such, should be as timely as practicably possible.

However, respondents and attendees at the events also emphasised that:

- the CORE & MORE concept that was developed in the Cogito paper should be clarified, redefined, and further fine-tuned and explained how it relates to integrated reporting;
- one party (or parties) should take(s) firm ownership of a global principles-based non-financial information reporting framework to ensure a certain level of quality and discipline in non-financial information reporting;
- technology will significantly change the preparation and presentation of corporate reporting going forward.

We further develop below the CORE & MORE concept and the importance of technology in the future of corporate reporting. Non-financial information is not in the scope of the present issue paper.

The CORE pillar is envisaged as a short and concise report, covering relevant and material key information of the entity, important to all involved stakeholders. More detailed information (e.g. country-by-country reporting, detailed sustainability information, etc.) would be captured in the MORE reports which have a more specific audience.

A digital report making the use of hyperlinks would enable stakeholders to access more detailed information (the MORE reports) via drilling down vertically.

CORE & MORE would just be a presentation model; it would not determine the content. Interconnected financial and non-financial information would be covered in the CORE & MORE report. One of the additional benefits with the CORE& MORE model is that it allows for information to be presented as soon as it is available.

On the impact and opportunities of technology, respondents and participants anticipate that corporate reporting will, amongst other things, be web-based in the future; meaning that we expect to gradually move away from the traditional paper/PDF format. Technology can enhance both the preparation and presentation of reports. Innovation could for instance result in a better overview of

¹⁸ See Accountancy Europe, Follow-up paper, The Future of Corporate Reporting - creating the dynamics for change, Cogito Series, March 2017

the information (structured reporting) and greater user-friendliness. Technology as such can be both a driver and enabler of change in corporate reporting.

Although the Cogito paper is addressing corporate reporting, the CORE & MORE concept might also be interesting for public sector entities.

3.4.2. OECD - Better addressing users' needs in fiscal reporting

Drawing on case studies of four countries (Australia, Canada, France and the United Kingdom) that adopted accruals more than a decade ago, the OECD (Organisation for Economic Cooperation and Development) undertook a study aiming at discussing current fiscal reporting practices and issues identified by users and putting forwards government innovations for fiscal reporting¹⁹ to evolve in a way that keeps pace with users' expectations and addresses their needs.²⁰

The starting point of the study is that there is a consensus on the benefits of accrual accounting with regards to transparency and accountability, but financial statements have limited readership and no clear impact on fiscal policy decision making.

The recommendations of the OECD study are as follows:

Current practices	Recommendations
<i>Providing greater clarity</i>	
Use of both cash and accrual bases. Reports with different structures.	Alignment projects. Bridge tables.
Disclosures sometimes unclear, redundant or immaterial.	Simplification projects. Assistance to parliamentarians.
Use of hard copies and pdf. Limited access to data.	Excel or csv files for data underpinning tables and charts. Open database.

¹⁹ Fiscal reports are defined for the purpose of this study as the budget documents and financial reports that are submitted to parliament and/or published as part of the budget cycle. The study does not discuss specific reports such as debt management reports or state-owned enterprises reports.

²⁰ See OECD, Better addressing users' needs, Lessons learnt from Australia, Canada, France and the United Kingdom, 17th annual meeting of OECD senior financial management officials, 2-3 March 2017

Current practices	Recommendations
<i>Supporting scrutiny and decision making</i>	
Information scattered in different reports. Limited performance information.	Integrated reporting (spending, performance, accountability).
Movements on balance sheet little understood and analysed. No linkage with fiscal policy.	Analysis of assets and liabilities management, fiscal risks and linkage with sustainability assessment.
Reports are not sequenced appropriately... or not timely.	Faster closure. Assessing trade-off between completeness, audit and timeliness.
<i>Achieving quality assurance</i>	
Budget documents are dense, complex.	Commentary and analysis by the parliamentary budget office.
Concerns over the reliability of financial reports.	Financial audit. Verification of performance information.
Limited transparency on some financial operations.	Independent standard setters and advisory councils.

Although the scope of the study addresses all sorts of fiscal reports and not only financial statements, some of the concepts are useful in the context of the design of a principled approach to disclosures for EPSAS financial statements.

3.4.3. The Financial Reporting Council Reporting Lab - Future Digital project

The Financial Reporting Council (FRC) Reporting Lab is currently undertaking research in the area of reporting (for the private sector) as highlighted in its May 2017 publication 'A framework for future digital reporting'.²¹ This publication is part of a wider 'Future Digital' project. The project is designed to identify what benefits the new mediums and technologies should offer, consider which technologies might do this and how companies can make the most of the digital opportunity. Some of the ideas developed there may provide a source of inspiration for the public sector too.

The FRC Lab produced a second report in December 2017 'XBRL deep-dive: digital future of corporate reporting'²² which explains the importance of the XBRL technology for corporate reporting.²³ See also page 19 for more information on XBRL.

²¹ See https://www.frc.org.uk/getattachment/fd3054ee-b0f3-4968-8b20-d5bb262c4c54/Digital-Future_final.pdf

²² See <https://www.frc.org.uk/getattachment/9279091c-a4e9-4389-bdd6-d8dc5563b14a/DigFutureXBRLDec.pdf>

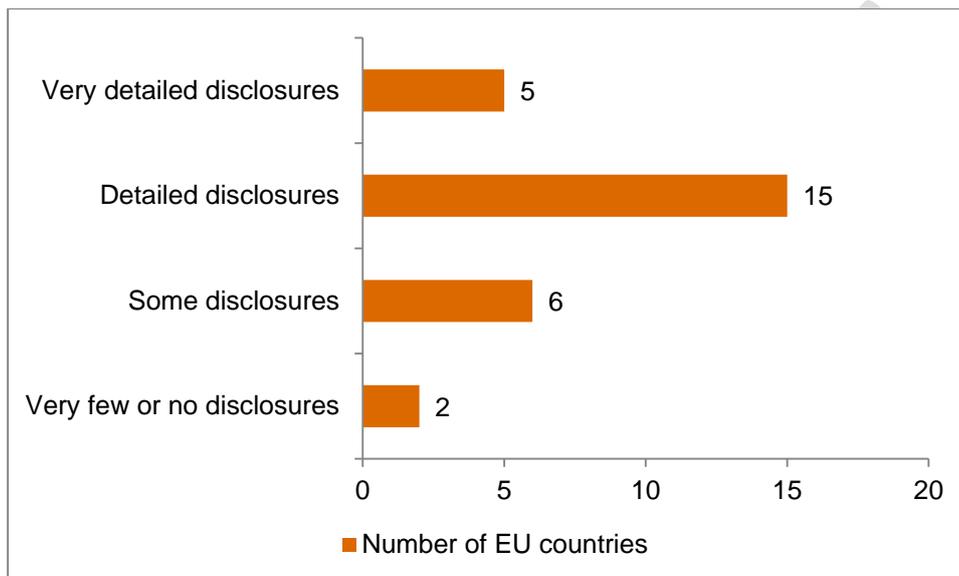
²³ For more information on XBRL, see also PwC, EPSAS issue paper 'Member States' approaches to harmonising charts of accounts for national purposes with a view to financial reporting requirements under the future European Public Sector Accounting Standards (EPSAS)', September 2017, pp 13-14

4. Main types of disclosures in selected Member States governments (France, Finland and the City of Hannover (Germany))

4.1. Overall accounting maturity for disclosures in the EU

The graph below is extracted from the 2014 PwC study and indicates how Member States assess the level of details in the information they currently provide in the financial statements.²⁴

Figure 4: Disclosures included in the government's financial statements²⁵



The volume of information presented as disclosures in the notes to the financial statements varies widely from country to country. It is interesting to note that 20 central governments declare to report detailed (15) or very detailed (5) disclosures. These governments are likely to be better prepared (better data availability, etc.) for future EPSAS compliance than those which declare providing no or only some disclosures in their financial statements.

4.2. Selection of countries

The present section provides an overview of the most important and most burdensome disclosure requirements in three EU Member State governments: the central governments of France and Finland and the City of Hannover (Germany).

The selection of countries was based on the following assumptions:

- France: next to having a high accounting maturity as reported in the 2014 PwC study (central level), the accounts of the French central government include very detailed disclosures.

²⁴ See PwC, Collection of information [...], p. 96-97.

²⁵ See PwC, Collection of information [...], p. 97.

- Finland: the central government's financial statements include detailed disclosures as reported in the 2014 PwC study (central level) and the accounting maturity is assessed as high. Moreover, one of Finland's key concerns related to the adoption of EPSAS in the 2014 PwC study was linked to the possibility that required disclosures might become too burdensome.
- City of Hannover (Germany): the City of Hannover is one of governments in Germany that publishes detailed information in its financial statements since the transition to the accrual basis of accounting.

In addition, we also looked at certain initiatives developed in the United Kingdom and New Zealand, two countries among those having the highest accounting maturity worldwide.

4.3. Methodology

To analyse main types of disclosures in selected Member States, PwC led semi-structured interviews based on a questionnaire. Respondents to the questionnaire were government representatives (France, Finland and City of Hannover). They were first asked to provide an overview of main disclosures provided, and of the areas considered as heavy or burdensome. In a second step, they were asked for the specific areas in which there is a departure from IPSAS or IFRS disclosure requirements in the national financial reporting requirements, and the main reasons for it. The following questions focused on the approach taken in simplifying disclosure requirements when applicable.

A summary of the results of the interviews is presented country by country below. In addition, we looked at the main types of disclosures provided in the United Kingdom and New Zealand Governments' accounts on the basis of publicly available information.

4.4. France

4.4.1. General

Since 2006, the Central Government accounts are prepared in accordance with the provisions of the Central Government Accounting Standards Manual (Recueil des normes comptables de l'État, RNCE, available for consultation at the following address: www.economie.gouv.fr/cnocp/recueil-des-normes-comptables-letat), adopted by an order of the French Minister for the Economy and Finance dated 21 May 2004, published in the Official Journal on 7 July 2004 and subsequently modified.

As a matter of principle, the accrual accounts of public entities are based on the accounting rules applicable to business entities except for features specific to public action. A precise definition of such features is necessary in order to provide a conceptual basis for their accounting treatment and may lead to the development of specific requirements. A Conceptual framework was on purpose designed to establish the link between the concepts applicable to business entities and public entities and the concepts specific to the latter. It provides the public sector standard-setter with a basis for determining the circumstances in which it is appropriate to adopt or adapt a rule applicable to business entities or whether an innovative conceptual approach is required to reflect the specific features of public action in the financial statements. This is the reason why focus has been placed on

considering the specific features of public action and their sources rather than on what may be considered as “generally accepted accounting principles” with which the reader is likely to be more familiar and to which reference may be made in the documents mentioned above.

Thus the Conceptual framework presents and clarifies the concepts underlying accounting standards, which are:

- either generally accepted accounting concepts derived from business accounting if the transactions are similar to those of businesses, in which case the accounting standards based on these concepts will be convergent with those of business entities;
- or concepts required by the specific features of public action. In this case, accounting standards will be developed specifically to address the specific characteristic of public action.

4.4.2. Disclosure requirements

The central government financial statements comprise four components: the central government balance sheet, the central government income statement, the cash flow statement and the notes to the financial statements. The notes comment and complete the financial statements and present all the information necessary to an understanding of the quantified data and changes therein and provide more in-depth analysis of certain headings of the Central Government General Accounts.²⁶

The 2016 French Central Government General Accounts (‘Le Compte Générale de l’Etat’) comprise 288 pages and very detailed disclosures (around 280 pages).

Most of the disclosures required by IPSASs are presented in the notes to the Central Government General Accounts, with certain exceptions such as IPSAS 22 ‘Disclosure of Financial Information about the General Government Sector’ and IPSAS 24 ‘Presentation of Budget Information in Financial Statements’.

In addition to IPSAS-based disclosure requirements, Standard 13 ‘Accounting rules and methods applicable to central government off-balance sheet commitments’ further specifies the four categories of central government commitments to be disclosed in the notes when it comes to the central government off-balance sheet commitments²⁷:

- commitments given under the terms of clearly defined agreements (debt guarantees, guarantees relating to general interest missions, liability guarantees and central government financial commitments);
- commitments arising from the central government’s role as economic and social regulator;
- commitments stemming from the invoking of the central government’s liability; and
- commitments resulting from obligations recognised by central government.

²⁶ See Modernization of the public accounting systems in France, Accounting scope, principles and methods, République Française, p.4

²⁷ See Modernization of the public accounting systems in France, Accounting scope, principles and methods, République Française, p.18

State off-balance sheet commitments are presented in the notes to the central government accounts but do not impact either the State balance sheet or net income. Disclosure notes related to the central government off-balance sheet commitments at 31 December 2016 are presented below.

Figure 5: Change in principal State off-balance sheet commitments (France, Central Government, 2016 accounts)²⁸



4.4.3. Recommendations

The French standard setter, the CNOCP (Conseil de normalisation des comptes publics), has performed an analysis of the IPSAS standards based on their applicability in France. CNOCP recommendations are as follows:

- IPSAS 18 'Segment reporting': the CNOCP recommends introducing more flexibility in the way segment reporting has to be published and inspire from IFRS 8 which takes a management approach in applying segment reporting.
- IPSAS 20 'Related party disclosures': the CNOCP suggests to adapt the standard to make it more relevant to public sector entities.
- IPSAS 22 'Disclosure of Financial information about the General Government Sector': the CNOCP suggests not to apply the requirements of this standard, including due to the difficulties in determining the consolidation scope.
- IPSAS 24 'Presentation of budget information in financial statements': the CNOCP believes this information should not be given because budgets are out of the scope of financial statements.
- IPSAS 'Financial instruments - disclosures': the CNOCP suggests to further adapt the accounting treatment next to the disclosure requirements.²⁹

²⁸ See Modernization of the Public Accounting Systems in France, overview of the approach using the 2015 accounts, République Française, p.18

²⁹ See Classement des normes de l'IPSAS Board par le CNOCP, Note de synthèse, 6 January 2014, CNOCP

4.5. Finland

4.5.1. General

Central government

The budgetary central government is comprised of 66 separate reporting entities (e.g. ministries or government agencies). Financial statements for the budgetary central government are based on the accounting information provided by the reporting entities.

Financial statements for government agencies

The Finnish Government Shared Services Centre for Finance and HR prepares most of the financial statements/disclosures of government agencies. The service centre is partly responsible for the validation of the information. Agencies are responsible for preparing the following statements/disclosures: statement on Budget Authorities (commitment appropriations), disclosure on off balance sheet guarantees and liabilities, disclosure on accounting principles and comparability, disclosure on changes in government debt, disclosure on maturity and duration for government debt and disclosure on other additional information required to provide a true and fair view.

Financial statements for budgetary central government

The State Treasury prepares the financial statements for the budgetary central government on the basis of government agencies' accounts. The Service Centre delivers the accounting data and the financial statements and disclosures for the State Treasury. The State Treasury further validates and compiles the information for the financial statements for the budgetary central government. During the fiscal year, the State Treasury issues regulations and instructions and provides guidance in order to ensure the uniformity of accounting.

Applicable rules

Application of the accrual basis of accounting by the central government follows national standards (Budget Act and Budget Decree) and is mainly inspired by private sector national accounting standards. However, there are certain differences, for instance regarding the valuation and recognition principles and the format of financial statements.

Local governments

There are 300 autonomous municipalities and 136 joint-municipal bodies in Finland, i.e. local government entities.

FAS (Finnish Accounting Standards) have inspired the financial reporting requirements of Finnish local authorities. As FAS are aimed at private companies, the rules for municipalities have been adapted by the Finnish Accounting Standards Board, Local Government Section. The main requirements are also included in the Local Government Act.

Pension funds

All the pension funds running the statutory earnings-related pension system are included in the general government sector in the ESA national accounts. They form a subsector of their own (as part

of social security funds) in the accounts. There are seven big pension funds (value of assets over two billion EUR) and 25 smaller pension funds running the statutory earnings-related pension system. Five of the funds run the pension system of the public sector employees or manage the corresponding assets. Private sector funds have a status based on a treaty between the European Union and the Republic of Finland, agreed upon when Finland joined the Union.

4.5.2. Disclosure requirements

Central Government

The central government disclosure requirements have been partly inspired by the national private sector requirements. Between years 2005 and 2008, the Central Government Accounting Board conducted an impact assessment analysis of the IPSAS standards. The board concluded that the national central government accounting standards were sufficient to give a true and fair view of budgetary central government finances.

The format of the central government financial statements is standardised, which supports the comparability of statements between periods. However, if a specific topic is not applicable to a certain reporting entity, it is not disclosed in its financial statements. In addition, disclosures of financial statements for central government agencies foresee some flexibility for smaller entities³⁰ concerning the following disclosures: depreciation methods, detailed breakdown of depreciation and financial expenditure and income.

As the State Treasury issues regulations and instructions and provides guidance in order to ensure the uniformity of accounting, the need for simpler disclosure requirements is considered as low. In addition, the fact that the Finnish Government Shared Services Centre for Finance and HR prepares most of the financial statements/disclosures of government agencies is found to be a very cost-effective solution, which reduces the need for simpler disclosure requirements.

The Budget Decree requires that information on central government financial risks and their significance be provided in the government's annual report. Moreover, the Ministry of Finance publishes an annual overview of the central government risks and liabilities, e.g. description of risks associated with macroeconomic development, government liabilities and assets.

Moreover, the government's annual report provides information on general government expenditure and income, general government financial accounts and general government EDP deficit and EDP debt (ESA 2010 statistical information). The government's annual report also provides information on service performance and effectiveness, as well as on the long-term sustainability of public finances; this information is based on central government financial statements and government finance statistics.

When it comes to budget information, the following information is presented: budget outturn account, amending budget information, and overrun of appropriations. The Government's annual report includes analysis of budget outturn.

³⁰ Materiality thresholds may be used for certain disclosure requirements.

Local governments

Municipalities use a standard format for financial statements, which is based on law and described in the Finnish Accounting Standards Board, Local Government Section. The standard form makes it possible to compare different municipalities, the format and the relevant guidance have been developed over a long period of time. The format is suitable both for Finnish local authorities and statistics. It is also cost effective and very clear e.g. for auditing purposes.

Bigger municipalities have complex structure (the whole group including daughter companies etc.), which makes the financial reporting burdensome in some cases. However, this is not considered as a major issue. It should be noted that there are no specific or simpler disclosure requirements for smaller or less risky entities at local level.

Statistical information (ESA 2010) is included in the financial statements and in “The Public Administration Recommendations”. Moreover, the Executive Board is obliged to report on service performance in the annual report.

When it comes to budget information, the financial statements prepared by the Finnish municipalities include a budget comparison. This requirement is included in the guidance given by the local government section of the Finnish Accounting Standards Board.

Pension funds

The format of pension funds’ financial statements is prescribed by law. There are simpler requirements for smaller entities. The size differences between pension funds can be huge, and it would not be considered as reasonable to have equal requirements for all.

Financial obligation and risks as well as significant judgments are properly and comprehensively reflected and disclosed in the financial statements and their notes and annexes.

Disclosure requirements of private sector funds are based on the directives and national laws regulating the financial statements of private undertakings in general, with specific characteristics for the insurance undertakings. In addition to financial statements and notes, the funds have to disclose their solvency indicators by the national solvency regulation. In a broad sense, disclosure requirements are inspired by IFRS and Solvency II, though due to national social security and its financing legislation (especially the rules for pension liabilities), it is not possible to follow international accounting frameworks such as IFRS in detail.

4.5.3. Main comments regarding the cost and complexity of preparation

As for the central government, preparation of the disclosures is seen in general as a fairly smooth process. Some burden may be related to the preparation of disclosures relating to information not recorded in the accounting system or which require professional judgment. For example, preparing the disclosure on off balance sheet guarantees and liabilities is considered fairly burdensome and there has been a need for revision with regard to this disclosure. In order to certify the quality and timeliness of the information, guarantees are reported in a shared IT system since fiscal year 2016.

In addition to the above, the only disclosures whose preparation is considered a costly/burdensome relate to the following accounting areas: consolidation, financial instruments and provisions and accruals, and only in relation to pension funds.

The 2017 financial statements for budgetary central government are 97 pages long.

4.5.4. Main comments relating to the usefulness of disclosures

Disclosure on off balance sheet guarantees and commitments attracts questions from stakeholders due to the significance of the off balance sheet amounts. Disclosure on changes in government debts also attracts attention. Changes in financial liabilities have a significant effect on the financial position and are therefore considered one of the most useful information in financial statements/disclosures.

With regard to the disclosure requirements which are considered as less useful, disclosures related to inventory and employee benefits are perceived as not useful. It should also be noted that there are no requirements to disclose information concerning segment reporting, related parties and reconciliation with budget (as per IPSAS 24) in the Finnish Central Government legislation.

In addition, the fact that the Finnish Government Shared Services Centre for Finance and HR prepares most of the financial statements/disclosures of government agencies is found to be a very cost-effective solution, which reduces the need for simpler disclosure requirements.

Disclosure requirements that are considered as most useful at local government level include significant accounting policies and disclosures related to consolidation, fixed assets, intangible assets, inventory, financial instruments and PPPs/concession arrangements are perceived as very useful. Moreover, the statement of financial performance and related disclosures raise the biggest number of questions.

The “Finnish Accounting Standards Board, Local Government Section” gives guidance and advice to local authorities on many issues related to financial reporting, including disclosure requirements, which is considered as a very cost-effective solution. The current project led by the Ministry of Finance requires that Finnish municipalities use a common ICT-infrastructure (XBRL language) to report all financial information required. This means that the information will be quickly available, reliable and cost-effective.

When it comes to the disclosure requirements that are considered as most useful at the level of pension funds, disclosures related to fixed assets, financial instruments and revenue are seen as very useful. The most interesting issues from the point of view of stakeholders include the value of assets, performance measures (e.g. the rate of return on investments vs the running costs, especially the salaries and fees paid to the management) as well as solvency disclosures.

Disclosures which are seen as not useful for pension funds include disclosures related to consolidation, inventory, segment reporting, as well as the reconciliation with budgetary information.

4.6. City of Hannover

4.6.1. General

The public accounting reform at the local level in Germany involved a move from cash to accrual accounting for many cities/municipalities. The cost of implementation was high but transparency of financial statements significantly improved. For example, a comprehensive inventory of the City's fixed assets (e.g. streets, bridges, properties, railroad tracks) is now reported in consolidated financial statements.

4.6.2. Disclosure requirements

The information included in the annual financial statements of the City of Hannover is very detailed (more than 350 pages) in order to cover legal requirements. About 40% of the documentation relates to the split between programmes and sub-programmes. Moreover, information on the long-term sustainability of public finances is presented in the annual report.

4.6.3. Main comments regarding the cost and complexity of preparation

Accounting areas for which preparation of disclosures is seen as costly/burdensome include: consolidation, revenue, segment reporting, related parties and reconciliation with budget.

4.6.4. Main comments relating to the usefulness of disclosures

The presentation of information related to debts is considered as crucial, as it is particularly relevant for politicians. Investors primarily focus on equity and debt capital, interest and personnel expenses, property, plant and equipment, the annual result and medium-term financial planning.

Additional accounting areas for which disclosure of information is considered as useful include: significant accounting policies, consolidation, employee benefits, provisions and accruals as well as revenue.

The usefulness of disclosures is assessed as low in relation to inventory and segment reporting.

4.6.5. Recommendations

The annual accounts increase the transparency of the financial information and contribute to better management (better data quality for the planning process of future financial years). In order to facilitate the understanding of the financial statements by key stakeholders, the City of Hannover recommends highlighting and summarising key information which is relevant to users in the financial reports.

4.7. Additional illustrative examples: United Kingdom and New Zealand

Certain initiatives undertaken in the United Kingdom and New Zealand are also interesting in the context of the present EPSAS paper and are presented below.

4.7.1. United Kingdom

In the United Kingdom, departments year-end financial reports were simplified since the 2013 initiative ‘Simplifying and Streamlining Accounts’.³¹ The reforms aimed at restructuring the presentation of the statutory annual reports and accounts produced individually by departments so as to better meet the needs of users, structure them more logically and remove unnecessary or irrelevant material. The project has led to a restructuring of the traditional presentation of annual reports and accounts into three sections combining all reporting requirements³²:

- a. Performance i.e. “telling the story”, which gives users a short summary that provides them with sufficient information to understand the organisation, its purpose, the key risks to the achievement of its objectives and how it has performed over the year.
- b. Accountability, which aims at meeting key accountability requirements to Parliament. It is the section where departments demonstrate compliance with norms and specific codes of good corporate governance.
- c. Financial statements under IFRS (as adapted for the public sector).

In addition, Whole-of-Government Accounts, or WGA, are published as part of the accountability to Parliament procedure and for transparency purposes. These go a step further than Departmental Annual Reports and Accounts by consolidating not only all of the central government departments and arm’s length bodies, but also local authorities - that is over 6,000 entities across the public sector. They provide a comprehensive, accounts-based picture of the financial position of the UK public sector. WGA also include non-financial information, amongst others the Overview, Remuneration Report and Comparison to the National Accounts (which is an alternative, economic measure of overall spending following the ESA 2010 standards). HM Treasury is also looking at possible reforms to the presentation of the WGA, including reviewing the content of the accounts to determine whether the disclosures are proportionate and focussed on the material items in the accounts.³³

The government Financial Reporting Manual (FReM) reminds preparers of financial statements that, in accordance with IAS 1 ‘Presentation of Financial Statements’, applying the concept of materiality means that a specific disclosure requirement in a standard or in an interpretation need not be satisfied if the information is not material (disclosures should be limited to those necessary for an understanding of the entity’s circumstances). For the avoidance of doubt, preparers are reminded that they do not need to develop accounting policies, or provide disclosure notes, in relation to accounting standards that do not apply to their circumstances or are immaterial. However, additional commentary may be provided if it is helpful to the user and can be included in the accounting policy note or next to an individual disclosure note.

The financial statements included in the WGA publication relating to financial year ended 31 March 2016 only comprise 64 pages.³⁴

³¹ See 17th Annual Meeting of OECD Senior Financial Management Officials [...], p.10

³² OECD, based on information from Her Majesty’s Treasury and HM Treasury (2014), Simplifying and streamlining statutory annual reports and accounts, United Kingdom

³³ See 17th Annual Meeting of OECD Senior Financial Management Officials [...], p.10

³⁴ See https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/627535/Whole_of_Government_

Specifically in relation to IFRS disclosures, the Financial Reporting Council issued in 2012 FRS 101, 'Reduced disclosure framework', which contains various exemptions from IFRS disclosures, for private sector entities that are not required to use IFRS but wish to use its recognition and measurement requirements. The main exemptions cover, among others, some (but not all) of the following standards:

- IFRS 7 'Financial instruments: disclosures' and IFRS 13 'Fair value measurement' for disclosure of financial instruments and fair values;
- IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors' for disclosures in respect of new standards and interpretations that have been issued but which are not yet effective;
- IAS 24 'Related Party Disclosures' for disclosure of key management personnel compensation and for related party transactions entered into between two or more members of a group (for wholly-owned subsidiaries).

4.7.2. New Zealand

In recent years, the New Zealand Accounting Standards Board (NZASB) has been developing simplified accounting standards applicable to smaller public benefit entities. The simplification concerns both the content and the way in which transactions and balances are reported.

In New Zealand there are four tiers of standards, from Tier 1, which applies to the largest public benefit entities, to Tier 4, which applies to the very smallest.³⁵ The simplification concerns both the content and the way in which transactions and balances are reported. "Public benefit entities" are defined as: *"Reporting entities whose primary objective is to provide goods or services for community or social benefit and where any equity has been provided with a view to supporting that primary objective rather than for a financial return to equity holders."* Both public sector entities and not-for-profit entities may be PBEs. Although different suites of standards have been issued (or are in the process of being issued) for public sector entities and not-for-profit PBEs, the suites for each tier are almost identical.³⁶

As part of a wider disclosure initiative, PBE IPSAS 1 was amended in July 2015 to clarify the existing requirements that relate to materiality, order of the notes, subtotals, accounting policies and disaggregation, in line with the IASB disclosure initiative for the private sector. The amendments aim to encourage public sector entities to apply professional judgment in determining what information to disclose in their financial statements.

In addition, the main features of the approach that has been developed by NZASB staff for drafting disclosure objectives and requirements in IFRS Standards, are as follows:

Accounts_2015_to_2016_WEB.pdf

³⁵ See Proposals for the New Zealand Accounting Standards Framework, Approved by the Minister of Commerce in accordance with Section 34C of the Financial Reporting Act 1993, on 2 April 2012, New Zealand External reporting Board

³⁶ See Standards for smaller and less risky government entities (Item 5 of the Agenda), Task Force EPSAS standards, Luxembourg, 12 February 2014

- an overall disclosure objective for each Standard, and more specific disclosure sub-objectives to support that overall objective;
- the division of disclosure requirements into two tiers:
 - summary information disclosed by all entities, subject to a materiality assessment; and
 - additional information to meet sub-objectives;
- emphasis on the need for entities to apply judgement when deciding how and what to disclose to meet the disclosure objectives; and use of less prescriptive wording in disclosure requirements.

The financial statements of the Government of New Zealand for the year ended 31 June 2017 is made up of 90 pages.³⁷

4.8. Key findings from the country comparison

As interesting key take away from this country comparison in the context of informing the debate on a principled approach to disclosures to be included in the future EPSAS standards, we highlight the following:

- Some government financial statements, including disclosures, are prepared based on / inspired by international standards (UK, New Zealand) while they are based on national rules for others (Finland, City of Hannover). Preparation of the French government financial statements is inspired by both national and international standards.
- The financial statements of the government of Finland and City of Hannover follow a standardised format (prescribed by national rules) while the format of the government financial statements in the UK, New Zealand and also France are based / mostly inspired by international rules.
- The length of government financial statements can vary a lot from one government to another. It is worth noting that the length of the UK WGA is only 60 pages and the financial statements of the New Zealand government is not more than 90 pages long. These two governments follow IFRS (as adapted for the public sector) and IPSAS respectively. Both in the UK and New Zealand, there is a focus on the relevance of the information to be presented in the notes with regard to their materiality. The length of the financial statements of the French central government and of the City of Hannover are 288 pages and over 350 pages respectively. The PwC study from 2014 also highlighted that 20 central governments declared to report detailed (15) or very detailed (5) disclosures.
- In New Zealand, simplified accounting and disclosure requirements apply to smaller and less risky entities. In Finland, a simpler format of financial statements applies to smaller pension funds.

³⁷ See <http://www.treasury.govt.nz/government/financialstatements/yearend/jun17>

5. Difficulties/issues arising when preparing financial statements disclosures

The main difficulties/issues encountered when preparing financial statement disclosures are explained below.

5.1. Cost and complexity of preparation versus benefits

The cost and complexity of compliance with the extensive disclosure requirements is one of the areas that has been identified by the Member States as requiring the most significant efforts as per PwC study of 2014. A few Member States indicated that IPSAS contain too detailed disclosure requirements and a limited number of comments have been made in relation to some specific standards: IPSAS 18 'Segment reporting', IPSAS 20 'Related party disclosures', IPSAS 22 'Disclosure of information about the General Government Sector', IPSAS 24 'Presentation of budget information in the financial statements' and IPSAS 30 'Financial instruments: disclosures'.

Looking at the current government practices, the PwC study of 2014 notes that the volume of information presented in the notes varies widely from country to country and that 20 central governments (out of 28) declare to report detailed (15) or very detailed (5) disclosures.

Two different situations should be considered in assessing the cost and complexity of disclosure preparation:

- the cost and complexity relating to the preparation of the disclosures included in the first EPSAS financial statements;
- the cost and complexity relating to the preparation of the disclosures included in the EPSAS financial statements on an ongoing basis after first-time implementation.

The PwC study of 2014 revealed that significant costs may need to be incurred upon first-time implementation of EPSAS. This is mostly likely to be the case for governments still applying cash accounting or with hybrid accounting practices (modified cash or modified accrual), as these governments currently do not have the required systems and processes in place nor often sufficient knowledge in their teams to support the move to accrual accounting based on best international practices.

The debate should therefore only focus on the level of recurring cost and complexity involved in the preparation of the disclosures or certain types of disclosures in an accrual accounting environment.

Cost and complexity, which are most often cited by preparers as a hurdle in the production of disclosures required by international standards, should never be assessed in isolation. The benefits that the users of financial statements will derive from the information that is published is of utmost importance as financial statements should provide information which is useful for accountability and decision making.

Information should be disclosed when the benefits of reporting it are likely to justify the costs incurred to produce it. Disclosure requirements as included in international accounting frameworks, when properly applied, provide useful information to the users of financial statements.

When making the cost-benefit assessment, the overall accountability and decision-making objectives of financial statements should be kept in mind. This cost-benefit assessment requires the exercise of judgment and therefore involves some degree of complexity. This matter is further discussed under 5.2 below.

5.2. Assessment of materiality and relevance

As a reminder, the IPSASB conceptual framework describes information included in financial statements to be material if its omission or misstatement could influence the discharge of accountability by the entity, or the decisions that users make on the basis of the entity's financial statements. Information is relevant if it is capable of making a difference in achieving the objectives of financial reporting. There is therefore a clear link between materiality and relevance.

It is important to consider materiality and relevance of the information to be provided, i.e. information should be provided if it is important for a proper understanding of the government's assets, liabilities, income, expenses, cash flows and risks. A specific disclosure requirement in a standard need not be satisfied if the information is not material. However additional disclosures should be given to allow for a proper understanding of a public sector entity's assets and liabilities, performance and cash flows even if the information is not explicitly required by a standard.

Many preparers have the tendency to consider preparation of the notes to the financial statements as a tick-the-box exercise where all the information required by the applicable standards need to be given. The difficulty consists in moving away from such a pure compliance exercise to a situation where information that really matters is the primary focus. This difficulty may also be reinforced by the attitude of government auditors who can strictly follow their disclosure checklist and stick to the requirements of the standards when performing their audit.

Materiality also depends on both the nature and amount of the item judged in the particular circumstances of each entity. Consequently, there is no uniform quantitative threshold that can be applied in assessing materiality. For example, a public sector entity with significant related party transactions may need to place information on those items more prominently. This adds to the complexity when assessing which information is material and should be disclosed or not.

5.3. Providing clarity to users

Information needs should be analysed primarily from the perspective of the users (citizens, finance providers, parliamentarians, public administration, media, etc.), not only from the preparers' perspective. Therefore, providing clarity to users of government financial statements and making financial statements easily understandable by them is essential. Understandability is one of the qualitative characteristics of financial information as per IPSASB conceptual framework, which stipulates that information should be presented in a manner that responds to the needs and knowledge base of users, and to the nature of the information presented.

Clarity is first provided to users if all useful information is given to them, information which is relevant in the particular context of the entity whose financial statements are prepared and takes into account materiality considerations (too much immaterial information would obscure the reading of the financial statements and make them less clear and understandable). These considerations are addressed under sections 5.1 and 5.2 above.

Clarity may also be enhanced if a user-friendly format of financial statements is used. IPSAS 1 'Presentation of financial statements' and its IFRS equivalent provide guidelines as to the structure of the notes to the financial statements. Paragraphs 128 and 129 of IPSAS 1 recommend that notes be presented, as far as practicable, in a systematic manner and in a certain order. The objective is to assist users in understanding the financial statements and comparing them with financial statements of other entities.

Different ways to structure the notes may be followed. Notes can be presented in the order of the balance sheet, statement of financial performance, cash flow statement and other items or based on other criteria. Other ways of presentation may lead to related items being disclosed together (for example, information about financial assets and financial liabilities is disclosed in one section, and information about non-financial assets and non-financial liabilities in another section) or to present first and more prominently disclosures which is considered key to allow a proper understanding of the government financial statements, and other disclosures afterwards. The use of modern information design can help in this.

Finding the best way to structure the information to be disclosed in the notes requires the exercise of judgment and therefore entails some complexity.

Other topics which, strictly speaking, go beyond the scope of the present EPSAS paper but might be useful to address here include the communication strategy that is followed by governments to present their financial statements in a user-friendly way by a wide range of users and the link with other types of financial or fiscal reports provided to government stakeholders. As reported by Delphine Moretti in a recent OECD study, the adoption of accruals has provided more financial information, but also increased the complexity of the information provided to parliaments.³⁸

In addition, as reported in a synopsis of discussions jointly organised by ICAEW-PwC between public finance stakeholders, the differences that exist between the three major frameworks for analysing public finances - budgetary, statistical and financial reporting - and the reasons why they present different pictures are not always understood.³⁹ This is due to a combination of factors, including a lack of financial literacy from users of government financial reports (including citizens), a terminology used by politicians which is often confusing (for example the term accounting is often used to talk about statistical reporting) and last but not least often as well to a lack of proper and efficient communication by governments on the purpose of the various financial reports and the differences between them.

This context creates additional challenges for governments.

5.4. Ensuring comparability of government financial statements

Comparability is one of the key objectives of the EPSAS project. It is an objective not only at the EU level but also at the national level between the various levels of governments. Comparability can be achieved through the application of harmonised accounting policies combined with the use of a

³⁸ See 17th Annual Meeting of OECD Senior Financial Management Officials, "Better Addressing Users' Needs - Lessons learned from Australia, Canada, France and the United Kingdom", OECD Headquarters, Paris, France, 2-3 March 2017, p.9

³⁹ See ICAEW-PwC, Sustainable Public Finances: EU Perspectives, Better government finances - The role of information design, Synopsis of discussions on 8 November 2016

harmonised presentation format for the EPSAS financial statements. A harmonised presentation format may be envisaged for the primary statements and potentially as well for the notes.

Entities sometimes have difficulties exercising judgement about what information to present in the primary financial statements and what information to disclose in the notes. It should be reminded that the role of the primary financial statements is to provide a structured and comparable summary of an entity's recognised assets, liabilities, equity, revenue and expenses, whereas the role of the notes is to explain and supplement the primary financial statements.

Setting up the right balance between a standardised format of disclosures and allowing for departure from this standard format to allow more tailored and relevant information to be provided may prove to be difficult.

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6. Discussion of matters relevant for a European harmonisation and PwC's insights

The main objective of the present issue paper is to organise the discussion around a principled approach to disclosures. Therefore specific disclosure requirements included in IPSAS standards or other regulations are not discussed here. We refer to 'Chapter 2. Background' for more information on the comments raised by some Member States on specific IPSAS disclosure requirements and how these were addressed in the PwC study from 2014 which analysed the suitability of IPSAS standards as a basis for developing EPSAS.

The discussion between Member States on a principled approach to disclosures could be structured as follows:

1. Assessing the qualitative characteristics (QC) of financial information and related constraints that are particularly relevant for the preparation of disclosures.
2. Discussing how proper application of the four key QC suggested for information which is disclosed may help address stakeholders' concerns both about what information is given (content) and how it is presented and communicated.

6.1. Assessing the qualitative characteristics (QC) of financial information and related constraints that are particularly relevant for the preparation of disclosures

The EPSAS cell on Principles related to EPSAS standards reviewed the qualitative characteristics (QC) of financial information and related constraints that are included in IPSAS and other conceptual frameworks and confirmed the following as being relevant for use in the European context:

QC	Relevance, reliability or faithful representation, completeness, prudence, neutrality, substance over form, understandability, timeliness, comparability, verifiability.
Constraints	Materiality, cost-benefit and balance between the qualitative characteristics.

All QC and related constraints are important however we believe some of them are particularly important with respect to the preparation of disclosures. These are the following⁴⁰:

- **Relevance.** The IASB Disclosure Initiative revealed that investors and users of financial statements believe that not enough relevant information yet too much irrelevant information is given in financial statements. Relevance is about providing information which is useful for accountability and decision-making purposes and should be at the heart of the discussions about the design of a principled approach to disclosures.
- **Understandability.** The role of information which is disclosed in the notes to the accounts is to provide information in addition to the primary statements (statement of financial position, statement of financial performance, cash flow statement and statement of changes in equity) which complements and helps better understand the information displayed in the primary statements. Understandability is thus a key objective in the preparation of

⁴⁰ We also refer to 3.1.2. Guiding principles in the IPSASB Conceptual Framework for a definition of each of these QC.

disclosures. The IASB Disclosure Initiative also revealed that how information is presented and communicated may be improved to help users better understand financial statements. Understandability thus has to do with both the content and format of the disclosures.

- **Comparability.** Comparability of financial information presented by Member States and within Member States is a key objective of the EPSAS project. It should be part of the key disclosure objectives as well.
- **Materiality.** Materiality is a very important concept which, when appropriately applied, can add to the relevance of financial information which is disclosed and facilitate the understanding of the financial statements as a whole. It can in addition help address the concern raised by many Member States that preparation of disclosures under IPSAS is burdensome.

We summarize schematically below how each of the four key QC could help adequately address the main difficulties/issues encountered by governments when preparing financial statement disclosures (see chapter 5).

Difficulty/issue	QC1 Relevance	QC2 Understandability	QC3 Comparability	QC4 Materiality
Cost and complexity of preparation versus benefits				√
Assessment of materiality and relevance	√	√		√
Providing clarity to users	√	√		
Ensuring comparability of government financial statements			√	

Developing a set of EPSAS disclosure objectives which greatly capitalises on the above four QC would contribute to developing more harmonised and consistent disclosures across Member States.

Developing EPSAS disclosure principles could encourage governments to better apply judgement and communicate information more effectively to users of the financial statements. Focus should be placed on those disclosures that are relevant for a good understanding of the entity's financial position (main assets and liabilities), performance (main sources of revenue and expenses), major cash flows and risks. Common sense should be applied and materiality should be considered in making this assessment.

When developing EPSAS disclosure principles, principles of effective communication as identified by the IASB in its Disclosure Initiative can provide a useful source of inspiration. In certain cases, applying EPSAS disclosure principles may require a trade-off between some of these principles to maximise the usefulness of information for users of the financial statements. For example, making information entity specific might mean it is relevant and easier to understand, but could reduce comparability between entities and between accounting periods.

The appropriateness of assessing each of the above four QC against disclosure requirements included in the IPSAS standards could be evaluated too.

This would confirm the general support for disclosure requirements included in the IPSAS standards, as part of the general support for taking the IPSAS standards as a primary source of inspiration for developing the EPSAS standards, however applying them in a way which is adapted to the European context.

6.2. Properly applying selected key QC of financial information to disclosures

In a second stage, Member States could discuss how proper application of the four key QC suggested for information which is disclosed may help address stakeholders' concerns both about what information is given (content) and how it is presented and communicated.

Possible actions to address stakeholders' concerns in this respect are presented below.

6.2.1. Addressing materiality and approach to smaller and less risky entities

International accounting frameworks disclosure requirements may sometimes be perceived as heavy or burdensome. However, as pointed out in chapter 5, a cost/benefit analysis should be undertaken at entity level as a systematic approach to estimating the benefits in terms of transparency versus costs of preparing specific disclosure requirements. Disclosures should be limited to those necessary for an understanding of the entity's circumstances. There is no need to develop accounting policies, or provide disclosure notes, in relation to accounting issues that do not apply to an entity specific circumstances (and are therefore irrelevant) or are immaterial.

Examples of government financial statements in the UK and New Zealand

By considering the materiality concept in the preparation of their consolidated financial statements and limiting the production of disclosures to that information that is considered as most relevant for the users, the UK government could limit the length of its WGA to 60 pages and the government of New Zealand could limit the length of its consolidated financial statements to 90 pages.

Despite their (rather) limited size, it is generally accepted that the financial statements published by both the UK and the New Zealand governments are of a high quality and provide useful information to the readers.

In addition to this, a good practice can consist in presenting the information that is more critical to understand the operations of the government prominently.

Approach to smaller and less risky entities

The report from the Commission on the suitability of IPSAS for the Member States published in March 2013 highlighted the need for specific consideration to be given to smaller and less risky entities in order to limit the implementation costs for them. ‘The way forward should be selective and take particular account of the perspective of small and medium-sized entities and the aspect of materiality.’ When talking about the expected way forward, the report stated: ‘It is also to be expected that the extent of implementation for smaller entities would be limited, or at least that the more important entities would be prioritised, taking into account their materiality.’

Examples of approaches to SLREs: specific requirements for SLREs in New Zealand and materiality thresholds applied in the UK

A good example comes from New Zealand: the New Zealand Accounting Standards Board has developed simplified accounting standards for smaller public benefit entities (PBEs). The simplification concerns both the content and the way in which transactions and balances are reported. As mentioned here above, four tiers of standards are developed, from Tier 1 which applies to the largest PBEs, to tier 4 which applies to the smallest PBEs. Simplifying the requirements also impacts preparation of the disclosures.

Based on the UK experience, all entities apply IFRS as adapted for the public sector but materiality is considered in determining reporting requirements. Very small entities are excluded from the consolidation scope (WGA) and entities not exceeding certain thresholds are exempted from certain disclosure requirements.⁴¹ This scope exclusion also applies to the preparation of disclosures.

The IPSASB identified the topic of ‘Differential Reporting’ as one of the priority projects to be included in its work plan for the period 2019-2023. The IPSASB justified this choice as follows: ‘Some constituents advocate the development of a less complex set of requirements for small and medium sized public sector entities, with generally simple transactions, for which full IPSAS requirements are too onerous. The lack of differential reporting options may be increasing the cost of adopting IPSAS and therefore creating a barrier to adoption. From a public interest perspective, consideration of the issue of differential reporting is one that may help alleviate capacity issues of governments adopting and implementing IPSAS. However, this needs to be considered in the context of the nature of the public sector, because even small and medium sized entities need to be accountable to constituents for their use of public funds’.

To structure the discussion between Member States, the following matters could be addressed:

1. Whether the principles around materiality included in IPSAS conceptual framework, supplemented by IPSASB staff podcast on the same topic, could be considered as sufficient in a European context, or whether specific additional guidance should be provided, either general guidance or guidance that is specific to certain (disclosure) topics.

⁴¹ See PwC, Collection of information related to the potential impact, including costs, of implementing accrual accounting in the public sector and technical analysis of the suitability of individual IPSAS standards, 2013/S 107-182395, 1 August 2014, p.163-164

2. What approach should be adopted for smaller and less risky entities:

- a. Either separate disclosure principles are designed specifically for smaller and less risky entities.

It should be noted that this approach would require to define what types of entities are considered as 'smaller and less risky'. The situation and the reporting structure for government entities vary in each Member State. The size and the nature of the activities of these public sector entities that are part of the general government sector can also differ significantly from country to country. We therefore believe that particular attention would need to be paid to the specific characteristics of government entities in each Member State when determining the rules that define what entities are considered as smaller and less risky entities and the rules that are applicable to them.

- b. Or the principles and possibly the guidelines about materiality developed for all entities are applied to smaller and less risky entities too.

Given SLRE are smaller and less risky, these principles and/or guidelines about materiality are likely to be applicable to them to a greatest extent in the context of the preparation of consolidated accounts. Granting scope exclusion or relaxation of certain rules on the basis of materiality thresholds (to be defined) may constitute a suitable approach.

Smaller and less risky entities that are not considered as material to the government as a whole could be either removed from the EPSAS scope or EPSAS reporting requirements could be limited to what is needed for the purpose of the EU budget surveillance. If certain entities are individually insignificant, these can be left out of the consolidation scope, only if all excluded entities, taken together, are also immaterial in the total consolidated figures. If some relaxation rules are decided, these should take into account the overall consolidated picture. This consolidated picture may need to be determined at several levels, for example at the local government level and at the level of the WGA if such accounts are prepared for the country.

It should be noted that smaller entities generally enter into simple and routine transactions, the accounting complexity of their activities is supposed to be much less than that of larger governments. If these entities however enter into risky transactions that can have a significant impact on their financial position and performance, these should be properly reflected in the financial statements.

As the EPSAS project aims to embed good accounting practices in the whole general government sector, governments are encouraged to set up good accrual accounting practices for all government entities at the individual level, including smaller ones, as this enhanced discipline is likely to produce a positive impact on the management of public finances.

6.2.2. Making EPSAS disclosures clearer and more understandable

Making EPSAS disclosures clearer and more understandable is crucial as this objective would greatly help in meeting the overall accountability and decision-making objectives of financial statements. Addressing appropriately the materiality issue and adopting a user-friendly format of financial statements are part of the solution.

Ensuring a good understanding of government financial statements is also somewhat linked to providing clarity as to the links and the differences between the various financial and fiscal reports that are made available to parliamentarians and the wider public.

Government initiatives that assist non-accountants (including parliamentarians, the media and the wider public) understanding key information included in published financial statements should be encouraged. Transparency is not just about providing information, it is also about making it understandable by those concerned by the provided information. This should trigger a greater focus on the demand side of information, which is crucial to ensure democratic accountability.

For example, next to the financial statements, governments can prepare a 'snapshot' of the annual financial statements of the government, which is a high-level presentation of key facts and figures for the financial year, intended to make the financial statements more user-friendly and accessible. Governments are also encouraged to organise proper communication around such publication. Citizens and other stakeholders are more likely to read this snapshot than the full financial statements.

To best address these challenges, certain governments have undertaken certain initiatives in order to ensure efficient and tailored communication to the various stakeholders (staff, politicians, media, citizens, etc.).

Examples of initiatives to help users of government financial statements understand them

France publishes highlights of the year in a four-page document, providing an overview of the State financial situation, the result of the State activity, as well as State commitments.⁴²

As part of the accounting reform, the UK also undertook the Clear Line of Sight (Alignment) project which was introduced in 2011-12. Prior to the project there was significant misalignment between the different bases on which financial information was presented to Parliament for approval, used by HM Treasury to manage overall public spending, and then publicly reported via entity level annual accounts. These financial documents were published in different formats, on a number of different occasions during the year, making it difficult to understand the links and inter-relationships between the bases on which the financial information was presented. A simpler system, with a single set of numbers, which is more transparent, more comprehensible and easier to use, and which improves public debate and understanding through enhanced scrutiny of government spending, was introduced through Clear Line of Sight.⁴³

⁴² See https://www.performancepublique.budget.gouv.fr/sites/performance_publique/files/files/documents/budget/comptes/2016/CGE-plaquette2016.pdf

⁴³ See PwC, Collection of information related to the potential impact, including costs, of implementing accrual accounting in the public sector and technical analysis of the suitability of individual IPSAS standards, 2013/S 107-182395, 1 August 2014

Certain concepts, as the CORE & MORE concept currently developed by Accountancy Europe, may also be used as a source of inspiration by governments in structuring the way information included in financial statements is communicated and the way it is linked to information included in other financial or fiscal reports.

Finally, it seems appropriate to also consider the reporting issues arising in a digital environment and the opportunities offered by technology in the discussions about how information can be produced, communicated and analysed/used.

Discussions on this topic between Member States could include:

1. Whether mandatory or optional guidelines should or not be developed on how to make financial statements clearer and more understandable for a wide range of users. This discussion should be linked with the discussion proposed under 6.2.3 below.

In its response to the IASB DP 'Disclosure Initiative: Principles of Disclosure', the EFRAG questions the likely effectiveness of non-mandatory guidance. Such guidance might not drive the behaviour of all concerned by the financial reporting chain: preparers, auditors, regulators, etc.

2. And/or whether sharing of best practices can be further encouraged and organised, and how, without necessarily the need to develop guidelines on the topic. Sharing of best practices, including feedback from financial statement users, could provide a basis for a search for continuous improvement in the communication to the EPSAS stakeholders.
3. With a forward-looking perspective, to what extent technology could/should help in producing, communicating and analysing/understanding financial information in a digital environment.

6.2.3. Ensuring comparability of information

Another critical aspect to the European harmonisation debate relates to the comparability of disclosure requirements. A principles-based approach (such as international accounting frameworks) allows for more flexibility in comparison with a rules-based approach; however this may undermine comparability to a certain extent.

Comparability may be enhanced if a standardised format of disclosures, which supports a standardised presentation of the information included in the primary statements, be developed. The appropriateness of developing such a standardised format would however in our view need to include at the same time the appropriateness of developing a standardised format of primary statements as well, given the link between the information provided in the primary statements and the information disclosed in the notes.

The use of a standard format of EPSAS financial statements would enhance comparability of government financial statements within the European Union. Opponents of such an initiative could however argue that it could impair the freedom of Member States to present their financial statements in the manner they believe best reflects their economics and is most appropriate to their

own situation. The opportunity to impose or recommend the use of a standard format of EPSAS financial statements (including disclosures), may be discussed between Member States. Such a standard format would mostly be useful and could serve as practice aid to governments that do not publish accrual accounts inspired by best international practices yet. If a harmonised format of financial statements is developed but its use is not made mandatory, more diversity will exist in practice and the impact on comparability will be less. The format of EPSAS financial statements may also only be developed when the EPSAS standard setting is finalised or about to be finalised and key decisions regarding the recognition and measurement principles of financial statement elements are known.

Similarly, developing clear disclosure objectives may also contribute to achieving better comparability, as proposed by the International Accounting Standards Board (IASB) as part of the IASB Disclosure initiative. The fact that certain IPSAS/IFRS standards presently do not contain disclosure objectives can make it difficult for entities and other stakeholders to understand the purpose of some of the disclosure requirements in those standards, and therefore to exercise judgement in deciding what information should be disclosed. Some stakeholders say that the absence of disclosure objectives, coupled with lists of prescriptively written disclosure requirements, encourages entities to apply those disclosure requirements mechanically as a checklist for the preparation of the financial statements rather than focusing on what information to communicate to users of the financial statements.

In order to address this issue, the IASB considers developing centralised disclosure objectives, which could be used as an underlying basis (or framework) for developing and organising disclosure objectives and requirements in standards that are better linked to the objective of financial statements and the role of the notes. As an illustration of a possible approach to developing disclosure objectives and requirements that would contribute to better comparability, the staff of the New Zealand Accounting Standards Board (NZASB staff) have developed an approach to drafting disclosure requirements which includes the development of disclosure objectives and sub-objectives to explain why users want particular types of information. Another proposed approach may consist in redrafting similar disclosure requirements that are currently spread across several standards and combine them under a centralised disclosure objective.⁴⁴

Discussions between Member States could include:

1. The appropriateness of developing a standardised format of disclosures to ensure consistency of the nature and the format of disclosed information. Such a standardised format would however in our view not be useful if at the same time the appropriateness of a standardised format of primary statements would also not be discussed.

Standardised formats of financial statements increase comparability, but to some extent at the cost of relevance of information which is published as it is less entity-specific. They also restrict the freedom of governments to tailor their financial statements according to their specific needs.

⁴⁴ See IASB Discussion Paper DP/2017/1, Disclosure Initiative—Principles of Disclosure, Section 7 – Centralised disclosure objectives, March 2017, p.68

Illustrative EPSAS financial statements could also be developed which could serve as a useful reference to governments who would wish to use them.

2. The appropriateness of defining disclosure objectives that are specific to each standard and/or additional disclosure guidelines that can help preparers assess the types of disclosures to be provided and in which circumstances.

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