



28 July 2016

Lyn Provost

Warren Allen
Chief Executive
External Reporting Board
PO Box 11250
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Dear Warren

Exposure Draft NZASB 2016-6 Service Performance Reporting

We appreciate the opportunity to comment on Exposure Draft NZASB 2016-6 Service Performance Reporting (the exposure draft).

We are pleased that the New Zealand Accounting Standards Board (NZASB) has produced the exposure draft, and is looking to issue a standard on service performance reporting. It is an important topic in the public sector, and I would like to think that a standard will help to drive the quality of performance information that is reported.

Although we broadly support the exposure draft, we consider that it is overly prescriptive by focusing on an outputs, outcomes, and impacts framework. In our view, it should focus on the principles underpinning service performance reporting, and recognise that there are a number of different frameworks.

We support the high-level principles identified in the exposure draft for reporting performance information. But we suggest that the dimensions of service performance be expressed more generally and that the standard focus on entities providing appropriate, meaningful information.

In our view, if a principles-based standard is in place, guidance documents or other material can be developed for particular types of public benefit entities (PBEs). That material would demonstrate the application of the principles to the circumstances of those types of entities.

We also think that further clarity is needed regarding the scope of the standard.

Our detailed responses to the Questions for Respondents outlined in the *Invitation to Comment* are attached. Please note that our comments primarily focus on PBEs in the public sector.

Our comments on the exposure draft are a result of collaboration between my staff at Audit New Zealand and the Office of the Auditor-General.

If you have any questions about our submission, please phone Todd Beardsworth, Assistant Auditor-General, Accounting and Auditing Policy on 021 244 0727 or email him at todd.beardsworth@oag.govt.nz.

Yours sincerely

Lyn Provost
Controller and Auditor-General

Our responses to the questions in the Invitation to Comment

1 Do you agree that the dimensions of service performance in the ED are a useful way of identifying the information to be reported by public benefit entities? If not, why not? (paragraphs 12–13)

No, we do not agree with the dimensions of service performance. In our view, there are a number of problems with the stated dimensions.

The three dimensions do not represent three different elements of performance

The three dimensions proposed do not represent three different elements of performance. The first dimension “what did the entity do” (i.e. outputs, often referred to as the goods and services produced and delivered to third parties) is a separate element. However, the second and third dimensions “why did the entity do it” (outcomes) and “what impact did the entity have” are essentially the same element of performance. Impacts simply refers to first-order outcomes (a view supported by the ED’s definition of outcomes).

The difference between outcome and impacts does not signify different performance dimensions; the difference is that of “before” and “after”. “Why did the entity do it” refers to the effect of service delivery from an ex ante perspective, while “what impact did the entity have” refers to the effect of service delivery from an ex post perspective.

Performance reporting is broader than outputs and outcomes/ impacts

More importantly, we consider that confining the dimensions of performance to outputs and outcomes/impacts would not achieve the goals the reporting standard needs to achieve.

In our view, a reporting standard for service performance should not only help improve the discipline of performance reporting but also should help lead the way to better and richer performance reporting.

Current developments in service performance reporting are towards a more comprehensive framework for reporting for accountability purposes. This is evident in the private sector in moves towards integrated reporting, where the elements of resources (capitals), inputs, and processes are wrapped around the more conventional reporting on outputs and outcomes. Integrated reporting identifies the effect of the production process on the capitals as one aspect of outcomes to be reported (along with the effect on customers and the effect on shareholders). In this way, it seeks to identify how value is added throughout the process in which goods and services are generated.

A broader approach to performance reporting is also evident in the public sector. This can be seen in the flexibility provided by the state sector public finance reforms (specifically changes to the Public Finance Act 1989), as well as an evolving requirement for asset-intensive agencies to report on asset performance (one of the “capitals” identified in the integrated reporting framework).

In our view, the reporting standard needs to not only accommodate current legislation and evolving practice, it should embrace and support them.

The challenge is, how the Standard encourages rich and diverse performance reporting without imposing onerous, voluminous, or narrow and restrictive measurement and disclosure requirements?

The Standard needs to clearly distinguish between service performance information and service performance indicators that need to be reported

We agree with the principle that service performance information (along with the financial statements) should enable users to make assessments of the entity's performance. However, assessment of service performance cannot be achieved in an information vacuum. Users cannot properly assess entity performance solely by examining selected performance indicators. Those users need to understand the entity's environment, strategy, value proposition, and business model to make sense of the performance indicators. Essentially, users need to understand the entity's business model or "performance framework".

In our view, the reporting standard needs to require reporting entities to provide a sufficient amount of information to explain or illustrate their performance frameworks. The reported frameworks should be flexible to provide users context by which to assess performance.

All entities produce or provide something (a good or service) and do it for a reason. At the very least, all entities should be required to explain what they provide and why. But we do not think that necessarily means the Standard should require performance indicators for, or restrict performance indicators to, these elements.

We think that in mandating the content of service performance reports, the standard should balance the need of entities to have flexibility in terms of describing their performance frameworks, with a non-prescriptive or non-restrictive approach to reporting performance indicators for external accountability purposes.

We recommend that the reporting standard require the following:

(a) Information for understanding

The standard should require sufficient information to be provided to enable the user to understand why the entity exists, what it intends to achieve, and how it goes about achieving its objectives.

This information should draw together any or all of the dimensions (or elements) of performance necessary to explain to the user how the entity operates and which aspects of its performance are of greatest importance to the entity and its stakeholders. It may include, but should not be restricted to, information on outputs and outcomes/impacts.

The information provided should be as flexible (broad or narrow, comprehensive or succinct) as needed to provide context for the performance indicators. It should allow the reporting entity to describe its business and express a performance framework that it considers most appropriate to its business model.

At the very least, we would expect entities to describe or explain what they provide and why.

(b) Performance indicators for assessment

The standard should require the performance report to provide performance indicators to enable the user to assess what the entity has achieved and whether it achieved what it intended. Performance "indicators" need to meet the qualitative characteristics.

The standard needs to recognise the increasing flexibility in the way entities report. For example entities may report their performance using case studies as well as with more traditional performance measures.

To be understandable, the Standard should avoid technical language

We appreciate the difficulty in arriving at language that is suitable to all readers. For example, the terms input, output, and outcome are long-standing conventional terms used in economic and accounting settings and are understood by some people.

However, even within the public sector, different sub-sectors use different terminology, partly because of differing language within legislation.

More importantly, the constituency for this reporting standard is wide and varied and includes not only public sector entities but also not-for-profit entities in the private sector.

Therefore we think the Standard would be more “user-friendly” if it were to adopt common language as much as possible, with only passing reference to the corresponding technical terms, rather than the other way around. For example, the Standard could refer to:

- Goods and services (also known as products or outputs)
- The “effects” of providing goods or services (also known as outcomes or impacts)
- Resources (also known as capitals or inputs)
- Business activities (also known as production processes, which are to be distinguished from administrative process).

2 Do you agree that application of the qualitative characteristics and appropriate balancing of the pervasive constraints on information will result in appropriate and meaningful service performance information? If not, please explain why not and identify any alternative proposals. (paragraphs 14–15)

Yes, we agree. These characteristics and constraints are recognised concepts in the public sector, which we believe have provided a useful framework for appropriate performance information.

However, in terms of applying the qualitative characteristics in the exposure draft, we thought it would be useful to highlight to the New Zealand Accounting Standards Board that some public sector entities choose to report on more than 100 performance measures in their annual reports. Where a public entity chooses to report on a large number of measures we think it will be challenging to meet the requirements of paragraph 28(f) ‘verifiability’ for each measure.

We think it would be helpful if the standard was clear about expectations where such a large number of performance measures are included, particularly for paragraph 28(f).

3 Do you agree with the use of the term “appropriate and meaningful”? If not, please explain why not and identify any alternative proposals. (paragraphs 14–15)

Yes, we think the term “appropriate and meaningful” is helpful to preparers of performance information. The term has a common meaning that is likely to be well understood, without the need for much explanation. We envisage the term being a helpful touchstone for preparers. As performance information is being prepared, preparers can ask the question: Is this information both appropriate and meaningful for all of the users?

4 **Do you agree with the proposed information to be reported? If not, please explain why not and identify any alternative proposals. (paragraphs 16–17)**

Please refer to our response to question 1 above. Although the standard is intended to be focused on principles, we consider that its use of the outputs, outcomes, and impacts framework makes it too prescriptive, such that it doesn't work with some of the legislative requirements related to PBEs in the public sector, or with other performance frameworks.

5 **Do you agree that cross referencing to information outside of the service performance section of the general purpose financial reports should be permitted? If not, why not? (paragraph 18)**

Yes, we agree with permitting the cross referencing of performance information outside of a general purpose financial report. This would be consistent with the increased flexibility for government departments and Crown entities.

6 **Do you agree with the proposed scope in relation to:**

(a) public sector public benefit entities with existing legislative requirements to report service performance information;

(b) public sector public benefit entities currently without existing legislative requirements to report service performance information; and

(c) not-for-profit public benefit entities?

The NZASB would welcome information on the costs and benefits of the proposals in relation to specific types of entities. If you do not agree with the proposed scope, please explain why not and your views on what the scope should be. (paragraphs 19–22)

We broadly agree with the proposed scope of the standard, including limiting its application for Tier 1 and Tier 2 public sector PBEs to those which are required by legislation to provide a statement of service performance (by whatever name called). We consider it appropriate that the standard does not apply to those public sector PBEs without such a legislative requirement, such as schools.

However, there are three matters related to scope that require further consideration.

Firstly, we note that the standard only applies to PBEs (Tiers 1 and 2), even though there are some public sector for-profit entities that have to prepare performance information. As it stands, those for-profit entities will presumably still need to apply FRS-44. There are differences in the requirements proposed in the exposure draft to those in FRS-44, which in our view would be a problem in the public sector.

In some sectors, similar types of entities will have different reporting requirements. For example, in the Council-Controlled Organisation (CCO) sector, Council-Controlled Trading Organisations (CCTOs) are typically for-profit entities and apply NZ IFRS. Other CCOs are typically PBEs and apply PBE IPSAS, which in time will include a standard based on the exposure draft. The application of different standards as currently proposed could lead to inconsistent reporting.

Secondly, we note that there are groups of public sector PBEs, such as tertiary education institutions and CCOs, that have a legislative requirement to provide a statement of service

performance (by whatever name called) but do not have a legislative requirement to prepare that information in accordance with GAAP. It would be helpful if the exposure draft clarified whether these entities would be required to comply with this standard.

Thirdly, we note paragraph 31 of the exposure draft appears to require entities to report performance information at the group level. Not all of the entities in the public sector which are required by legislation to report performance information have to do so at the group level¹. In our view, the proposed standard needs to acknowledge that on occasion, there may be conflict between legislative requirements and the standard. The standard should set out the approach preparers should take when a conflict is identified.

7 Do you agree that a two year implementation period would be appropriate? (paragraph 23)

Yes, we agree with a two year implementation period. Many public sector PBEs have been required to report on their performance, and have it audited, for a number of years. Those entities should be well placed to meet the requirements of the proposed standard.

8 Do you agree with the proposal to change the title of PBE IPSAS 1 *Presentation of Financial Statements* to *Presentation of Financial Reports* and the proposed amendments to that Standard? If not, please explain why not and indicate your preferred alternative approach. (paragraphs 24–26)

Yes, we agree. The proposed changed title and other amendments to refer to both financial information and, where appropriate, service performance information seem sensible.

9 What type of guidance should the NZASB develop to support entities preparing service performance information in accordance with the proposed standard? (paragraph 32)

As mentioned above, the exposure draft should be less prescriptive about what is required to be reported, and focus on the principles underpinning service performance reporting.

We suggest that you initially develop guidance for the not-for-profit sector, given service performance reporting is something new for that sector. In our view, example-based guidance would be practical.

We also think it desirable to have guidance for different types of public sector PBEs. Guidance for these entities is something that the NZASB may be able to facilitate. In our view, such guidance needs to involve people that work in and have a good understanding about how the different types of public sector PBEs operate.

Preparing a set of targeted guidance documents is likely to result in different types of performance frameworks being demonstrated through those documents.

10 Do you have any other comments on ED NZASB 2016-6?

Yes, as outlined below.

¹ For example, the Local Government Act 2002 requires local authorities to report performance information at a “group of activity” level. The Act also requires local authorities to report performance information for Council-controlled organisations. The Act does not require groups of activity to comprise the operations of the local authority and its subsidiaries, or for the performance information of Council-controlled organisations to be integrated with other reported performance information as implied by paragraph 31 of the exposure draft.

Additional comments

Ex ante reporting

We are comfortable with the exposure draft's focus on ex post service performance reporting, given that the standard applies to not-for-profit PBEs as well as public sector PBEs. However, ex ante performance reports are an important part of public sector PBE accountability requirements, establishing the base at the start of the year against which performance can be measured and reported at the end of the year. We suggest that NZASB consider how and where to include requirements for ex ante performance reporting.

Output cost disclosure (paragraphs 36-38)

It is important that performance information is integrated with financial information. Therefore, we consider that the standard should require cost disclosures related to services or activities, unless it is impractical to provide that information. We do not expect many situations where it is not practicable for entities to disclose costs.

Performance indicators (paragraphs 45-51)

The increased flexibility from the 2013 legislative changes to the Public Finance Act 1989 and Crown Entities Act 2004 enables entities to use other means of measuring and reporting performance, such as case studies, as well as traditional performance indicators. We suggest that the standard recognise that performance measurement may include other forms.

Although we agree that in general performance indicators should not **focus** on internal activities, processes, plans or policies (paragraph 50 of the exposure draft), Government departments and Crown entities can include measures/indicators of other aspects of their performance, such as objectives or internal processes, if they consider these material performance information. For example, a District Health Board may wish to measure and report on progress with major projects such as building a new hospital.

Prior year comparatives (paragraph 57)

We support the requirement for prior year comparatives, as these help users by providing some context to current year performance.

Principles approach to service performance reporting

This submission has advocated that the exposure draft be amended to take a principles approach to reporting performance information. If the External Reporting Board decided not to take this approach and we were limited to commenting on the framework (which considers outputs, outcomes, and impacts) rather than the principles underpinning performance reporting we may have provided other feedback to the External Reporting Board.

As an example, paragraph 44 of the exposure draft says:

"Information on impacts should be reported only where the entity has evidence between the links between outputs and outcomes, and the information can be measured in a way that meets the qualitative characteristics and constraints".

We think that the word "only" creates a benchmark which is too high and will result in entities deciding not to report information which they consider helpful to users. We would prefer to see entities report information that they consider helpful to users and accompany that information with a brief discussion about any significant weaknesses in the link between outputs and outcomes.