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Mr. Ross Smith
Program and Technical Director
International Public Sector Accounting Standards Board
International Federation of Accountants
277 Wellington Street West
Toronto, Ontario, Canada M5V 3H2

Comments on Consultation Paper "Presentation of Financial Statements"

Dear Mr. Smith,

The Japanese Institute of Certified Public Accountants (hereafter "JICPA") highly respects the International Public Sector Accounting Standards Board (hereafter "IPSASB") for its continuous effort to serve the public interest. We are also pleased to comment on Consultation Paper "*Presentation of Financial Statements*" (hereafter "CP"). Our comments to CP are as follows.

Preliminary View 2

The IPSASB's Preliminary View is to continue providing definitions on financial statement elements (aligned with the IPSASB Conceptual Framework and IFRS 18) in the new IPSAS Standard, and to provide other definitions that support the understanding and application of presentation requirements. Do you agree with the IPSASB's Preliminary View? If not, please provide your reasons, and clearly explain what you consider should be changed from a public-sector perspective.

Comment:

We agree.

However, while the alignment with IFRS 18 will require the use of "Operating," "Investing," and "Financing" categories in the statement of financial performance, to date, these categories have not necessarily been widely used in practices under IPSAS 1. Therefore, it is considered that a sufficient shared understanding of the meaning and boundaries of each category has not necessarily been built among preparers and users.

Particularly in the public sector, since there are many transactions that have characteristics different from those in the private sector, such as tax revenue, transfer revenue, grants, social security benefits, and capital transfer, in some cases, it may be difficult to determine which category among “Operating,” “Investing,” and “Financing” should be applied.

Accordingly, with regard to the definition and classification approach of “Operating,” “Investing,” and “Financing” categories, we propose enhancing illustrative examples and implementation guidance using transactions specific to the public sector. This is expected to promote consistent application by each entity, and improve understandability and comparability for financial statement users.

Preliminary View 8

The IPSASB’s Preliminary View is to present revenue and expense items recognized in surplus or deficit in categories on the Statement of Financial Performance. The categorization requirements are aligned with IFRS 18 requirements, with additional public sector guidance. Do you agree with the IPSASB’s Preliminary View? If not, please provide your reasons and clearly explain what you consider should be changed (for example, if you prefer a specific public-sector specific categorization, such as those considered in paragraph 4.30, please explain why it would meet the criteria in paragraph 4.29).

Comment:

We agree.

However, what is required of public sector financial performance information is to enable users to assess sources from which an entity obtains its funds, how much of its costs are recovered as consideration for service delivery, and how much is financed through tax revenue, transfer revenue, and other revenues. This information on the composition of funding sources is important information for assessing the extent to which service recipients bear costs, and sustainability of future service delivery.

Furthermore, in the public sector, tax revenue and transfer revenue are key revenue sources. Especially, tax revenue is based on the compulsory power to collect taxes, so it is different in nature from revenues from user charges, fees, and other exchange transactions. It is understandable that as tax and social security systems vary across countries, establishing uniform guidance for classifying tax revenue and other revenues as a separate presentation category is not easy. However, even taking into account such difficulties in the classification, it is important for public sector users to be able to distinguish tax revenue, transfer revenue, and other similar revenues, from revenues received from users and others in exchange for the provision of goods and services.

Therefore, we propose providing additional guidance to ensure that within the “Operating” category, tax revenue, transfer revenue, and other similar revenues are presented or disclosed separately from revenues received from users and others in exchange for the provision of goods and services. This approach is considered to be also consistent with the presentation of revenue by major category required by IPSAS 47.

Moreover, in the public sector, facility development grants, infrastructure development grants, and other capital transfer revenues may be significant revenue items. These are intended to maintain or enhance future service potential through acquisition or construction of non-current assets, so they are different in nature from revenues arising from current service delivery activities.

For example, operating surplus may increase significantly in a year when substantial capital transfer revenue is received. However, this increase does not necessarily reflect outcomes of service delivery activities or management efforts in that year, but indicates inflows of funds to build future service potential. Thus, if these items are included uniformly in the operating category, outcomes of current service delivery activities and effects of activities to build future service potential are presented without being distinguished from one another, making it difficult to understand outcomes of operating activities in the current period. This issue is important especially in entities receiving a large amount of facility development grants and other similar grants, such as local governments, universities, hospitals, and government-owned enterprises.

Therefore, with regard to capital transfer revenue, we propose considering additional presentation or disclosure methods that enable users to understand its nature, while the item is assumed to be presented in the operating category. In addition, with a view to more clearly distinguishing activities to build future service potential from current service delivery activities, we propose examining the appropriateness of presenting such revenue in the investing category as well. From the same perspective, it is also useful to further consider the classification of capital transfer expenses, gains or losses on disposal of non-current assets, and gains or losses on valuation of important service delivery assets between the operating and investing categories.

Preliminary View 9

The IPSASB’s Preliminary View is to present totals and subtotals, and to permit entities to present additional subtotals, on the Statement of Financial Performance, as listed in paragraph 4.35. The total and subtotal requirements are aligned with IFRS 18 requirements, adapted for the public sector.

Do you agree with the IPSASB’s Preliminary View?

If not, please provide your reasons and clearly explain what you consider should be changed.

Comment:

We agree.

However, we believe that for users, further explanations are necessary regarding what information the “operating surplus or deficit” subtotal provides, and for what purposes it is intended to be used.

For many public sector entities, tax revenue, intergovernmental transfers, grants, allotted charges, contributions, and other similar revenues constitute their principal sources of funding, and they do not necessarily have a concept equivalent to operating activities in private companies. In financial reporting of Japan’s national and local governments, tax revenue is positioned not as revenue as consideration for service delivery, but as a funding source for administrative costs, and presented in a financial statement separate from the financial statement corresponding to the statement of financial performance. We propose providing additional explanations of what information “operating surplus or deficit,” which is calculated by including tax revenue and transfer revenue, provides to public sector users and how it contributes to the assessment of accountability.

In addition, from the perspective of promoting users’ understanding of the purpose of use and information value of this subtotal, we propose enhancing illustrative examples based on specific transactions and the composition of funding sources in the public sector. Particularly, for entities in which tax revenue and transfer revenue constitute significant sources of funding, it is considered useful to show how “operating surplus or deficit” is calculated, and what information it is intended to provide, using illustrative examples.

Furthermore, as an example of application for the case where an entity presents additional subtotals, it would also be useful to show examples of additional subtotals that contribute to users’ understanding. For example, the understanding of the public sector structure of funding sources and financial performance could be enhanced by providing illustrative examples, and the like, that show a format in which “operating surplus or deficit” is presented, after showing a subtotal reflecting revenues received as consideration for service delivery.

Preliminary View 10

The IPSASB’s Preliminary View is to maintain the minimum requirements regarding the presentation of line items on the face of the Statement of Financial Performance, with additional guidance. The minimum line item presentation requirements are aligned with IFRS 18 requirements, with additional public sector guidance.

Do you agree with the IPSASB's Preliminary View?
If not, please provide your reasons and clearly explain what you consider should be changed.

Comment:

We agree.

However, while the IPSASB has proposed not to provide a subtotal corresponding to "profit or loss before financing and income taxes," we believe that further explanations on reasons for this are necessary. In the public sector, the impact of loans, bonds, and other financing activities on entities' financial management is also important, and users are considered to be interested in separately understanding outcomes of service delivery activities and the impact of financing activities.

In addition, this issue is also related to more fundamental issues: what concept the classification of "Operating," "Investing," and "Financing" categories in the public sector is based on; and what message each subtotal in the statement of financial performance is intended to convey to users.

Therefore, we propose providing additional explanations on reasons for not providing a subtotal corresponding to "profit or loss before financing and income taxes" and rationale for doing so, and clarifying what information existing subtotals are intended to provide to users, using illustrative examples, and the like.

Specific Matter for Comment 1

The IPSASB proposes to maintain the requirements to present expenses by the nature of the expenses or by their function to the entity on the face of the Statement of Financial Performance, in alignment with IFRS 18 requirements, with additional guidance.
In your view, should the new IPSAS Standard replacing IPSAS 1 permit mixed presentation, where some expense line items are presented by nature, while others are presented by function? Would mixed presentation result in a useful structured summary of those expenses for users of financial statements in your jurisdiction?
Please provide the reasoning behind your view.

Comment:

We agree.

However, we believe that which method of presentation is the most useful depends on the nature, operational structure, and user needs of public sector entities. Accordingly, we propose showing the approach to judging which of presentation by nature, by function, and on a mixed basis should be adopted from the viewpoints of entities' characteristics, diversity of operations, user needs, importance of expense items, and other factors, in the form of additional implementation guidance or illustrative examples. Furthermore, from the perspective of ensuring comparability and transparency, we also propose requiring entities to explain reasons for adopting mixed presentation, major allocation methods, and assumptions underlying them in notes.

Such additional guidance and examples are necessary because public sector entities have diverse operational structures and user needs. For example, as for the national government, government departments, local governments, international organization, and other bodies that implement many projects, policies, or programs, with presentation of expenses by nature alone, it is difficult to sufficiently understand resource allocation by project and relationships with performance, so mixed presentation including information by function is likely to be more useful to users. On the other hand, as for entities having a single or limited functions, presentation by nature alone may not impair users' understanding.

Also, in financial statements of Japan's national government, operating expenses are presented by nature in financial statements by government department, while cost information by policy and full cost information by project are disclosed. As users have already utilized both sets of information, it is considered that mixed presentation is likely to meet information needs of public sector users.

Preliminary View 11

The IPSASB's Preliminary View is to maintain (1) requirements to present revenue and expense items recognized outside surplus or deficit directly in net assets/equity, on the Statement of Changes in Net Assets/Equity, and (2) requirements related to reclassification adjustments. Do you agree with the IPSASB's Preliminary View, and are there additional enhancements to these IPSAS 1 requirements the IPSASB should consider (for example, whether to enhance disclosure requirements to help users better understand the nature and composition of material revenue and expense items recognized outside of surplus or deficit)? If you do not agree, please provide your reasons and clearly explain what you consider should be changed.

Comment:

We agree.

However, we believe that further explanations are necessary on the relationship between other comprehensive income under IFRS 18, and revenue and expense items recognized outside of surplus or deficit under IPSAS Standards.

If the two cover substantially the same content, it would be technically possible to adopt a presentation method similar to that of the statement of comprehensive income under IFRS. In such a situation, if IPSAS Standards maintain the approach of presenting the information in the statement of changes in net assets/equity, rather than providing a separate statement corresponding to the statement of comprehensive income, we believe that it is necessary to more clearly explain the reasons and benefits brought to users.

Yours sincerely,

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