

A CONSTRAINING PRINCIPLE FOR SERVICE PERFORMANCE REPORTING

Background and the purpose of this paper

1. At its September 2009 meeting, the AASB considered a number of threshold issues relating to service performance reporting. Emerging from the discussion was the question of whether there should be a constraining principle for the type of information the Board might prescribe to be included in service performance reports and, if so, what that principle should be. In that regard, minute item 7, second (e), notes that the Board tentatively decided:

consideration should be given to identifying a constraining principle for the information the AASB might decide should be included in service performance reports. The Board directed staff to develop a draft paper on this issue for discussion at a future Board meeting. The paper should include consideration of at least the following constraints:

- (i) information that explains amounts recognised in the financial statements; and
- (ii) information that is directly related to the principal, not-for-profit, objective of the entity.

This issue is closely related to the distinction between financial and non-financial information, because one possible constraining principle would be to limit the information the AASB might decide should be included in service performance reports to financial information. In that regard, minute item 7, second (b), notes that the Board tentatively decided:

service performance information might comprise both financial and non-financial information of a quantitative or qualitative nature, including disaggregated/program financial information, which is pertinent to the entity's principal objective and assessment of service performance. What constitutes non-financial information within a general purpose financial statements framework is to be considered.

The purpose of this paper is to fulfil the Board's directions as recorded in the above extracts from the September 2009 minutes, after considering the relationship of those directions to the Board's Conceptual Framework project.

Perspectives from New Zealand

2. In relation to the issues of identifying a constraining principle and distinguishing between financial and non-financial information, as reported in agenda paper 9.1 of the AASB/FRSB joint October 2009 meeting, the FRSB's Public Benefit Entities (PBE) Working Group has formed the tentative view (noted under issue 2 of the appendix in that agenda paper) that service performance reporting links financial and non-financial information. Therefore, the Working Group concludes, the distinction between financial and non-financial information is not critical in determining the scope and/or applicability of the project. The Working Group does not identify what non-financial information is. Issue 3 of the appendix goes on to note the Working Group's tentative view that non-financial reporting is just as important, if not more important, than financial reporting for PBEs. The Working Group notes that some non-financial information is already provided in the notes to the financial statements of profit-oriented entities and there may be some financial information included in service performance reports. Furthermore, issue 6 of the appendix notes the Working Group's tentative view that it is not necessary to develop a constraining principle on the information to be included in service performance reports. The Working Group comments that the fact a number of public sector service performance reports are audited has the potential to act as a natural constraint on the type of information included in such reports but should not be permitted to limit the provision of relevant and reliable information.

The relationship of this paper to the Conceptual Framework project

3. The project outline posted on the AASB website, which is based on the project proposal considered by the Board at its July 2009 meeting, identifies the Conceptual Framework project as a cross-cutting issue. There is a risk that consideration of the issues identified in paragraph 1 above will impinge on issues more pertinent to the Conceptual Framework project, such as issues relating to the scope of general purpose financial statements or financial reporting. If this project were to address such fundamental issues, progress on developing pronouncements specifically for service performance reporting could be severely delayed. To help avoid that consequence, this paper focuses on identifying a constraining principle for the scope of information that the AASB might prescribe to be included in service performance reports rather than the scope of general purpose financial statements or the scope of financial reporting. Whether the information that the Board decides should be included in service performance reports falls within the scope of general purpose financial statements or financial reporting is a matter for the Conceptual Framework project.
4. A risk of proceeding on this basis is the Board could specify requirements for service performance reports that the Conceptual Framework project might subsequently conclude are not within the scope of general purpose financial reports or even financial reporting.¹ This kind of risk is not unique to this project – any project being progressed prior to resolution of pertinent aspects of the Conceptual Framework faces a similar risk. There is precedent for standard-setting Boards, including the AASB, progressing standards-level projects in advance of developments in the Conceptual Framework. However, it is relevant to note that the International Public Sector Accounting Standards Board (IPSASB) has decided to not progress its Reporting of Service Performance Information project until it has reviewed responses to the IPSASB Conceptual Framework Consultation Paper, which includes the proposal that service performance reporting falls within the scope of general purpose financial reports. In particular, IPSASB’s preliminary view 5 (following paragraph 3.18) states:

The scope of financial reporting encompasses the provision of financial and non-financial information about:

...

 - the reporting entity’s achievement of its service delivery objectives; and
 - prospective financial and other information about the reporting entity’s future service delivery activities and objectives, and the resources necessary to support those activities.

It also encompasses explanatory material about: (a) ... the achievement of its service delivery and other objectives and the factors which are likely to influence its performance in the future; ...
5. Another consequence of proceeding to consider the scope of service performance reports ahead of the Conceptual Framework work is that it arguably implicitly accepts that the term ‘financial’ in the phrases ‘general purpose *financial* statements’ or ‘*financial* reporting’ does not necessarily preclude the Board from deciding that non-

1 Minute item 7, second (d), of the Board’s September 2009 meeting records that the Board tentatively decided “in noting the concern of some that a significant amount of service performance information is too subjective/qualitative to go into general purpose financial statements, consideration on whether service performance information falls within or outside the general purpose financial statements should be revisited when the project has been developed further.”

financial information should be included in service performance reports. If this is accepted, defining the distinction between financial and non-financial information might be of limited use to the Board's work on service performance reporting. Despite this, paragraphs 12 to 18 below consider issues pertinent to distinguishing between financial and non-financial information. Pragmatically, it would be useful for the Board to develop some kind of principle for constraining the type of information that it would consider prescribing to be included in service performance reports, even if it is not based on the distinction between financial and non-financial information, to provide a focus for the Board's ongoing deliberations.

6. *Tentative staff view:* For the purpose of this paper (and this project), it is not necessary for the Board to determine whether service performance reports are within the scope of general purpose financial statements or even financial reporting. However, as the project progresses, regard should be had to developments in the Conceptual Framework project. This is arguably consistent with the Board's tentative decision, as noted in minute item 7, second (a), of the September 2009 AASB meeting minutes, that the Board:
- ... has an interest in the form and content of service performance reports, irrespective of whether service performance information falls within the scope of general purpose financial statements. In that regard, the Board would be reluctant to take on a project that would not include a mandatory element falling within general purpose financial statements

Question 1 for the Board:

Do you agree that the question of the scope of service performance reports and the Board's role in specifying requirements within that scope can and should be addressed even though the Conceptual Framework project has not yet addressed the broader questions of the scope of general purpose financial statements and financial reporting?

7. The remainder of this paper presumes that the response to *Question 1 for the Board* is 'yes'.

Identifying a constraining principle

8. Arguably, the phrase/descriptor 'service performance reporting' (the working title for this part of the project) provides its own constraint – for example, with its focus on service, it would appear to exclude performance on environmental matters or employee relations. Furthermore, it would appear to explicitly relate to an entity's outputs, and only implicitly relate to inputs (and perhaps outcomes). It is notable that the descriptor adopted could be broader. For example, the US Governmental Accounting Standards Board (GASB) adopts the descriptor 'service efforts and accomplishments' (SEA), which would appear to relate more explicitly to both inputs and outputs, and perhaps outcomes. Therefore, although the descriptor provides some indication as to what it means, it is useful to consider what constraining principle might underlie it. Depending on the decisions the AASB makes in relation to this paper, consideration of the specific nature of the information to be specified for inclusion in service performance reports (whether at the level of inputs, outputs and/or outcomes) will be the subject of a future paper.

9. This section of the paper considers a range of ‘possible constraining principles’. It presumes that it is appropriate for private sector not-for-profit entities to disclose information relevant to assessing service performance, and for the Board to specify at least some aspects of the disclosures. In particular, it considers the appropriateness of the AASB limiting its deliberations on the content of service performance reports to:
- (A) financial information about service performance not included elsewhere in the general purpose financial statements, after considering alternative ways of defining financial information [which may include (B)-(E) immediately below, although for the purpose of this paper, as noted in paragraph 18, to avoid repetition, (B)-(E) are discussed separately from the definition of financial information];
 - (B) service performance information that relates to an entity’s principal financial objective;
 - (C) service performance information that relates to an entity’s principal objective (irrespective of whether it is financial or non-financial);
 - (D) service performance information that can be used by a user as input for making financial (economic resource allocation) decisions; and
 - (E) information that, after following a rigorous due process, the Board concludes should be included in service performance reports.
10. Some have suggested that a further possible constraining principle would be the qualitative characteristics (understandability, relevance [including materiality], reliability and comparability) specified in the Conceptual Framework. However, for the purpose of this paper, it is assumed that the Conceptual Framework underpins any constraining principle that might be developed and therefore is not itself a constraining principle.
11. Others suggest that more specific constraining principles could be identified. For example, in Canada, paragraph 34 of CICA Statement of Recommended Practice SORP-2 *Public Performance Reporting* states that a public performance report should focus on “the few critical aspects of performance”; and in the US, the paragraph between paragraphs 9 and 10 of GASB’s *Proposed Suggested Guidelines for Voluntary Reporting SEA Performance Information* states that Service Efforts and Accomplishments reports include “the major goals and objectives of the programs and services being reported or what those programs or services are intended to accomplish”. Whilst there might be merit in adopting such constraints at a standards level, they are not regarded as suitable candidates for possible constraining principles for the purpose of this paper. This is because they would pre-empt a decision about the content of a service performance report from the perspective of what the AASB should prescribe without regard to the broader issues addressed in this paper relating to:
- the relationship of service performance information to conventional financial statements;
 - the principal objective of private sector not-for-profit entities;
 - user needs; and
 - the process for determining the information that should be included in service performance reports.

Possible constraining principle (A): Financial information, as defined, about service performance

12. The distinction between financial and non-financial information might be useful in defining the scope of general purpose financial statements and/or financial reporting to the extent, as alluded to in paragraph 5 above, the term ‘financial’ is used in both those phrases to effectively define their scopes. However, as noted in paragraph 3 above, this is a Conceptual Framework issue that is beyond the scope of this paper. Despite this, it is relevant to note that the IASB will consider the boundaries of financial reporting in a later phase of its Conceptual Framework project. Paragraph 13 of the current IASB *Framework for the Preparation and Presentation of Financial Statements* states that “... financial statements ... do not necessarily provide non-financial information”, which suggests that non-financial information is not precluded. What the IASB will say on this in its revised Framework will not be known for some time.
13. The distinction between financial and non-financial information might also be necessary in defining the scope of service performance reports, if the Board decides that its focus should be on financial information about service performance. This subsection of the paper first considers possible ways of defining financial information (and thereby defining its obverse – non-financial information) and then considers whether the definition would be suitable as a constraining principle for the information the Board might prescribe to be included in service performance reports.
14. Before developing a principle-based definition of financial information, it is useful to consider whether all the information currently prescribed by the Board to be included in general purpose financial statements is financial information. This can be facilitated by listing the types of information that could be characterised as financial along a spectrum, as depicted in the following table using the example of information required to be disclosed about financial assets under current Australian Accounting Standards. From narrowest to broadest, financial information might be variously restricted to:
- | | |
|-----|---|
| (a) | \$115m (ie a dollar amount) |
| (b) | Financial assets \$115m (ie a dollar amount and its line-item description) |
| (c) | Financial assets \$115m + notes providing disaggregated information |
| (d) | Financial assets \$115m + notes providing disaggregated information + accounting policies (eg basis of measurement) |
| (e) | Financial assets \$115m + notes providing disaggregated information + accounting policies (eg basis of measurement) + other information about the financial assets (eg nature and extent of risks arising from financial instruments that is currently required to be disclosed by AASB 7 <i>Financial Instruments: Disclosures</i>) |
15. Those who believe that the term ‘financial’ in the phrase ‘general purpose financial statements’ limits the scope of those statements might argue that (e) provides an appropriate definition of financial information. However, because any of the possible definitions in (a) to (e) might effectively codify the status quo, it would be a static definition that lacks a general principle. Also, arguably, such a definition would take too narrow a view of information, focusing on packets of information, rather than taking a top-down, entity-wide perspective.

16. To overcome these criticisms, the definition of financial information could be expressed more generally as ‘financial information is any information that is related to information intended to be conveyed in conventional financial statements’.
17. If that definition were to be applied to service performance reports, the Board would only focus on information that is related to the dollar amounts recognised in the conventional financial statements. For example, it might be limited to segment type information, providing a description of a not-for-profit entity’s charitable programs and the costs of each program. It might be difficult to justify prescribing disclosure of even financial information about the non-financial outputs or outcomes of the entity under such a definition, even though the term ‘service performance report’ suggests a report that provides information that goes beyond such a constraint. However, it is interesting to note that this concern could be, at least to some extent, overcome if an entity were to elect to disclose its expenses by output (as is explicitly allowed under paragraph NZ 103 of NZ IAS 1 *Presentation of Financial Statements*), because further disclosures about outputs in a service performance report are clearly related to those financial disclosures.
18. Although financial information could be defined more broadly than the definition suggested in paragraph 16 above, for example as (B), (C), (D) or (E) in paragraph 9, the following discusses each of (B) to (E) in paragraph 9 as a ‘possible constraining principle’ rather than their suitability as a definition of financial information. This avoids duplication of the discussion that would occur if (B) to (E) in paragraph 9 were to be discussed in terms of both possible definitions of financial information and as possible constraining principles. Once the substantive technical issue of a constraining principle is resolved, it is then a semantic question of whether it is appropriate to refer to it in terms of the dichotomy between financial and non-financial information.

Possible constraining principle (B): Service performance information that relates to an entity’s principal financial objective

19. Arguments in favour of this constraint include that it:
 - (a) is consistent with the financial nature of the Board’s traditional role;
 - (b) is more likely to result in a range of information that would satisfy a greater range of user needs than possible constraining principle (A);
 - (c) is consistent with transaction neutral principles, because it is equivalent to the for-profit entity focus on profit, which is a financial objective that is the focus of general purpose financial statements of for-profit entities;
 - (d) enhances comparability among not-for-profit entities, to the extent the principal financial objective of diverse not-for-profit entities is common (for example, among charities, a common financial objective might be the maximisation of net fund-raising revenue, to enable entities to maximise their charitable work); and
 - (e) is consistent with the view that information about the financial aspects of a not-for-profit entity is of key interest to users, and of greater interest than information about non-financial aspects. As noted in paper 3 of this project ‘Threshold issues pertinent to service performance reporting by private sector not-for-profit entities’ (considered by the Board at its September 2009 meeting), unless the financial aspects of a not-for-profit entity are managed properly, the entity is unlikely to be able to continue to operate.

20. Arguments against this constraint include that it:
- (a) is too narrow, because it is reasonable to presume that users would also want information about the non-financial objectives of a not-for-profit entity. The essential difference between a for-profit entity and a not-for-profit entity is that a not-for-profit entity has a principal objective other than profit. Although its objectives will include financial objectives, it is likely that the principal objective is non-financial;
 - (b) is not consistent with the substance implied by the phrase ‘service performance’, which includes non-financial aspects; and
 - (c) information about financial objectives can be better conveyed through the presentation of conventional financial statements rather than through service performance reports. The presentation of the conventional financial statements needs to be considered in addition to issues relating to service performance reports, to help ensure the conventional financial statements convey information in a way that facilitates better communication of information about financial objectives other than profit.

Possible constraining principle (C): Service performance information that relates to an entity’s principal objective (irrespective of whether it is financial or non-financial)

21. Arguments in favour of this constraint include that it:
- (a) is more likely to satisfy a wider range of user needs than possible constraining principles (A) and (B);
 - (b) adds rigour to the application of the definition of not-for-profit entity, because an entity would be required to identify its principal objective, rather than merely state that it is not the generation of profit;
 - (c) is more consistent with the underlying notion of service performance, as implied by the descriptor ‘service performance report’;
 - (d) can be implemented in a way that would not require the AASB to prescribe requirements that are beyond its expertise. For example, the Board could specify the principles upon which an entity determines what non-financial service delivery (outputs) it should disclose in a service performance report, without specifying what those outputs should be for a particular entity (eg whether the output is expressed in quantitative or qualitative terms, or a combination of the two, such as the number of nutritious meals served to the homeless). The Board could then prescribe the financial information to be disclosed about that non-financial information entities choose to disclose within the principles specified by the Board;
 - (e) is consistent with the view that non-financial objectives have financial consequences, and reporting only on the financial consequences does not provide sufficient information upon which to assess the performance of an entity. A user could use the information about the entity’s pursuit/achievement of its principal non-financial objective to help decide their relationship with the entity. In contrast, in a for-profit context, it is reasonable to conclude that the principle objective is for-profit, which readily lends itself to financial information conveyed in the conventional financial statements supplemented by disclosures; and

- (f) it provides a rationale for dealing with service performance reporting by not-for-profit entities separately from such reporting by for-profit entities.²
22. Arguments against this constraint include that it:
- (a) goes beyond the financial nature of the Board's traditional role;
 - (b) is dependent on a clear identification of an entity's principal objective. In applying the definition of not-for-profit entity, it is not currently necessary to specifically identify that objective – it is sufficient to merely determine that the principal objective is not the generation of profit. It might be difficult for a not-for-profit entity to identify a single principal objective, except at a very high level at which point it is so general that it is not meaningful;
 - (c) might not provide comparable information across entities, given the potentially diverse non-financial objectives of not-for-profit entities; and
 - (d) results in the inclusion of information in a service performance report that is likely to be already reflected in the budget or strategic plan of an entity, and therefore it is unnecessary for it to be repeated in the service performance report. (Arguably, this criticism is related to the question of the level of detail that should be included in service performance reports. The criticism could be addressed by allowing the service performance report to incorporate by cross-reference information that is located elsewhere, to avoid duplication.)

Possible constraining principle (D): Service performance information that can be used by a user as input for making financial (economic resource allocation) decisions

23. Arguments in favour of this constraint include that it:
- (a) is focused on user needs rather than the entity's objectives (although the two would be expected to be interrelated). Consistent with paragraph 21(e) above, this possible constraining principle would lead to a user being provided with information about the entity's pursuit/achievement of its principal non-financial objective to help the user decide their relationship with the entity;
 - (b) is related to the financial nature of the Board's traditional role (from a user perspective rather than from an entity perspective);
 - (c) enhances comparability among entities, to the extent users of the information that would be included within such a constraint have similar needs;
 - (d) is similar to possible constraining principle (C), but expressed as a higher level principle;
 - (e) like constraint (C), can be implemented in a way that would not require the AASB to prescribe requirements beyond its expertise. Within the constraint, the Board could specify the principles upon which an entity determines what non-financial service delivery (outputs) it should disclose in a service performance report, without specifying what those outputs should be for a particular entity. The Board could then prescribe the financial information to be disclosed about that non-financial information entities choose to disclose within the principles specified by the Board; and

2 The minutes of the Board's September 2009 meeting record that "The Board also considered the range of entities that might be affected by this project and decided to: (a) formally consider the project in the light of its *Process for Modifying IFRSs for PBE/NFP*, before determining whether the project should have implications for for-profit entities. In the meantime, the focus will continue to be not-for-profit entities ..." (see minute item 7, fourth (a)).

- (f) is consistent with the view that information on what an entity has achieved in terms of service performance could influence users' decisions on the financial information.
24. Arguments against this constraint include that it:
- (a) is akin to the objective of financial reports, which is the subject of the Conceptual Framework project, and therefore is not sufficiently focused as a standards-level constraining principle;
 - (b) does not provide an effective constraint, because conceivably any information (for example, information that is not service performance information) about an entity could influence a user's financial decisions;
 - (c) would require the Board to address issues that are beyond its traditional financially-focused role, unless the argument in paragraph 23(e) is accepted; and
 - (d) does not enable a distinction to be drawn between for-profit and not-for-profit service performance reports, which would be inconsistent with our understanding of the Board's intention that this project only address service performance reporting issues from a not-for-profit perspective (see agenda paper 12.3 "Applying the AASB/FRSB 'Process for Modifying IFRSs for PBE/NFP to Service Performance Reporting by Private Sector Not-for-profit Entities"). There are users in a for-profit environment who would presumably want non-financial information about service performance (eg 'ethical investors').

Possible constraining principle (E): Information that, after following a rigorous due process, the Board concludes should be included in service performance reports

25. Arguments in favour of this constraint include that it:
- (a) is consistent with allowing the scope of service performance reports to evolve in response to user needs having regard to cost/benefit considerations and the competencies of preparers and standard setters – effectively the rigours of the due process provide a self-checking mechanism to provide the constraint; and
 - (b) effectively avoids the need to explicitly define the scope of service performance reports and the Board's role in relation to that scope.
26. Arguments against this constraint include that it:
- (a) does not provide the Board with a practical constraint that can be used without going through the costly exercise of the due process;
 - (b) puts pressure on the Board's agenda setting process to ensure vested interests do not skew the type of information included in service performance reports;
 - (c) might make it difficult to rationalise why not-for-profit entities should be subject to service performance reporting requirements while for-profit entities are not;
 - (d) differs in nature from all the other possible constraining principles because it is focused on a process for determining the content of service performance reports rather than providing the Board with an objective test for assessing the content of such reports.

Conclusion

- 27 *Tentative staff view:* Constraints (A) and (E) are not sufficiently principles-based to satisfy the Board's need for a constraining principle. Aspects of the various other constraints (B) to (D) are not mutually exclusive. For example, constraint (C) might

be indistinguishable from (D), except for a lack of explicit user focus. Even constraint (B) could be seen as a re-expression of (D) – for example the principle financial objective of a not-for-profit entity might be to produce the greatest quantity of low cost housing with the available financial resources, which is not very different from the way the non-financial objective might be expressed: to produce the greatest quantity of low cost housing.

28. Constraint (B) is too focused on the financial aspects of an entity, potentially at the expense of meeting user needs. In concept, there are merits in possible constraint (D). However, it does not provide a practical way for the Board to focus on not-for-profit entities, because it could equally apply to for-profit entities. Therefore, on balance, project staff favour possible constraining principle (C) – it provides a practical basis for the Board, having regard to the Board's expertise, to consider candidates for inclusion in service performance reports by private sector not-for-profit entities and is consistent with user needs.
29. In applying constraint (C), an entity should not be constrained from disclosing information about its service performance. Therefore, non-financial information, however defined, should not be precluded from service performance reports. Indeed, it is not necessary to define a distinction between financial and non-financial information for the purpose of agreeing the Board's role in specifying service performance reporting requirements. Consistent with this view, the AASB could prescribe:
- (a) the principle that should be followed by an entity in identifying the non-financial service performance information to be disclose; and
 - (b) financial information about the entity's non-financial service performance.

To illustrate, an entity might articulate its principal non-financial objective as: to provide low cost housing to the poor. It would therefore be relevant to include in a service performance report information to enable users to assess the entity's performance against that objective. The outputs achieved might be that 450 families (or whatever non-financial metric best reflects the entity's non-financial performance) were housed during a given year, at a cost of \$xxx (being the related financial information) enabling an assessment of the cost per family.

Question 2 for the Board:

Do you think it is necessary for the Board to identify a constraining principle for service performance reporting?

If so, which of the following possible constraining principles do you think has the greatest potential to assist the Board in progressing this project:

- (A) Financial information, defined as any information that is related to information intended to be conveyed in the conventional financial statements, related to service performance;*
- (B) Service performance information that relates to an entity's principal financial objective;*
- (C) Service performance information that relates to an entity's principal objective;*
- (D) Information that can be used by users as input for making financial decisions; or*

(E) Information that, after following a rigorous due process, the Board concludes should be included in service performance reports.

Is there another constraining principle that you think would be better than any of the above?

Question 3 for the Board:

If constraint (C) or (D) is adopted, should the Board prescribe the type of non-financial information to be disclosed?

If yes, should the Board prescribe principles (eg identify the type of non-financial information to be disclosed using a 'through the eyes of management' approach) or detail (eg specify the type of non-financial information to be disclosed, whether it be in terms of quantity, quality or a mix of quantity and quality)?