

# PART 1

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## INTRODUCING PUBLIC SECTOR ACCOUNTING

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# 1 INTRODUCTION

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International Public Sector Accounting Standards (IPSAS) are gaining increasing acceptance globally (see Table 1.1 for a full listing of all IPSAS). Public administrators are today encountering important challenges in reducing the distance between accounting systems within countries as well as across borders. This entails a move towards harmonization<sup>1</sup> of accounting practices in the public sector and thus requires choosing an appropriate set of accounting and financial reporting standards (see also Caperchione, 2015).

The focus on creating one common set of standards at the global level is relatively new, in comparison to what we have witnessed for the private sector, with the global spread and institutionalization of International Financial Reporting Standards (IFRS) (see also for example Ball, 2012).

Many governments across the globe operate on a cash basis (or modified cash basis<sup>2</sup>) and do not account for many significant items, such as liabilities for public sector pensions and financial instruments. Accrual accounting is a fundamental tenet of strong accounting and reporting for public companies, and so it should be for governments as well. This is why the adoption of accrual accounting by public sector entities should result in a more comprehensive and accurate view of the financial position, and help to ensure that governments and other public sector entities are transparent and accountable. It should also be noted, however, that in some cases, governments do not have standardized practices for applying cash-basis accounting and, in such cases, applying cash-basis IPSAS could be a first step towards transparency and accountability.

The International Public Sector Accounting Standards Board (IPSASB) and the IPSAS that it establishes have increasingly become a point for international standardization and reference within the area of public sector accounting. The IPSASB is, today, an independent standard-setting board under the auspices of the International Federation of Accountants (IFAC). It has been said that the issuing of the complete Conceptual Framework in 2014 has served as a “landmark document that firmly

<sup>1</sup>Harmonization refers to a “process of increasing the compatibility of accounting practices by setting bounds to their degree of variation” (Nobes, 1991: 70).

<sup>2</sup>A *modified cash accounting* system recognizes transactions on a cash basis during the year, but it also incorporates the unpaid accounts and/or receivables at year’s end (Christiaens, Reyniers, and Rollé, 2010: 539).

places IPSASB alongside its private sector counterpart, the International Accounting Standards Board (IASB), as an international standard setter” (Cain, 2014).

### **AIM OF THE BOOK**

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The aim of this book is to provide the reader with an overview of IPSAS with a focus on their practical application and interpretation. With this in mind, the book includes numerous examples of their application by governments and public sector entities that are issuing IPSAS-compliant financial statements. By drawing on examples, practice highlights on specific accounting and reporting issues, and IPSAS, this book seeks to be a comprehensive guide on how to apply accrual-based IPSAS as well as cash basis. The book thus aims to serve as a practical implementation guide for IPSAS for practitioners, policy makers, academics, and students. Nevertheless, we would like to emphasize that this book is not a replacement for reading the standards themselves. We therefore recommend reading this book in conjunction with the full suite of IPSAS<sup>3</sup> in order to ensure that knowledge of all aspects of IPSAS is gained.

Readers will be able to find the answers to questions such as:

- What is the role and history of IPSASB?
- What is the scope of accrual-based IPSAS?
- What is prescribed in the suite of IPSAS for accrual basis accounting?
- What options do accrual-based IPSAS provide for measurement and recognition for each of the standards?
- What are some of the key practical implementation issues when preparing IPSAS-compliant financial statements?
- What options are provided within IPSAS when determining key accounting policy issues?
- What is prescribed in cash-basis IPSAS?
- How does one prepare a transition to cash-basis IPSAS or to accrual-based IPSAS?

### **IPSAS AND PUBLIC SECTOR ENTITIES**

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International Public Sector Accounting Standards (IPSAS) apply to public sector entities. Public sector entities can seem to be an obvious concept, but it is worth defining the key characteristics of public sector entities (see also Annex 2 at the end of this book).

As with applying any set of accounting standards, the first issue is to ensure that the scope is well defined and the preselected set of standards is really the one adapted to the current situation and entity.

<sup>3</sup>The standards are available in full at IFACs website ([www.ifac.org](http://www.ifac.org)): see under the section on IPSASB. It should be noted that the approved text of IPSAS is that published in the English language by the IPSASB. The IPSASB Handbook has been translated from English into a number of languages, including French, Spanish, German, Russian, and Chinese. The Arab Society of Certified Accountants (ASCA) of Jordan has issued an Arabic version of the IPSASB Handbook.

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The Conceptual Framework of IPSAS states that it applies to financial reporting by public sector entities, i.e.:

- National, state/provincial and local governments;
- Government ministries, departments, programs, boards, commissions, and agencies;
- Public sector social security funds, trusts, and statutory authorities; and
- International governmental organizations. (Conceptual Framework § 1.8).

The Conceptual Framework states: “The objectives of financial reporting by public sector entities are to provide information about the entity that is useful to users of GPFR (general purpose financial reporting) for accountability purposes and for decision-making purposes (hereafter referred to as “useful for accountability and decision-making purposes”)” (Conceptual Framework, § 2.1).

It also states that “the primary objective of governments and other public sector entities is to deliver services to constituents rather than to generate profits” (Conceptual Framework, BC 2.18), which constitutes a major difference with entities (usually companies) the purpose of which is to generate profits. In fact, governments around the world are entrusted by their populations with managing their financial resources in a sensible and cost-effective way. They collect revenues, largely through taxation, and in return are expected to deliver a wide range of public services such as education, health, infrastructure, and social transfers for the benefit of current and future generations. It is not a matter of profitability.

Another key characteristic is that: “[c]itizens and other eligible residents are dependent on governments and other public sector entities to provide a wide range of services on an ongoing basis over the long term. The activities of, and decisions made by, governments and other public sector entities in a particular reporting period can have significant consequences for future generations of service recipients and future generations of taxpayers and other involuntary resource providers” (Conceptual Framework, BC 2.18). In other words, the timescale of public sector entities is much longer than the timescale of companies preoccupied by their year-end result. In public sector entities, decisions can have impacts on the long run, even on future generations of taxpayers.

“Most governments and other public sector entities operate within spending mandates and financial constraints established through the budgetary process. Monitoring implementation of the approved budget is the primary method by which the legislature exercises oversight, and citizens and their elected representatives hold the government’s management financially accountable” (Conceptual Framework, BC 2.18). Budget is another characteristic of public sector entities.

All these specificities make public sector entities different from private sector entities.

At the same time, though, there are entities where it is not so easy to distinguish whether they are public or private sector entities. Following IPSAS, government business enterprises (GBEs) are not included within the scope of IPSAS. The scope section of each standard within IPSAS specifically excludes GBEs and includes a reference to the Preface to International Public Sector Accounting Standards (Preface),

which states that GBEs apply International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB).

Currently the term GBE is defined in IPSAS 1, Presentation of Financial Statements. A GBE is defined as an entity that has all of the following characteristics:

- (a) Is an entity with the power to contract in its own name;
- (b) Has been assigned the financial and operational authority to carry on a business;
- (c) Sells goods and services, in the normal course of its business, to other entities at a profit or full cost recovery;
- (d) Is not reliant on continuing government funding to be a going concern (other than purchases of outputs at arm's length); and
- (e) Is controlled by a public sector entity (IPSAS 1.7).

In substance GBEs are no different from entities carrying out similar activities in the private sector.<sup>4</sup> GBEs typically operate to make a profit. GBEs may however also have limited community service obligations under which they are required to provide some individuals and organizations in the community with goods and services either at no charge or at a significantly reduced charge (IPSAS 1.12).

There is a wide range of entities being described as GBEs. In some cases, entities clearly do not meet the IPSASB definition of a GBE. In other cases there are different interpretations of the components of the definition of a GBE. In order to clarify the definition of a GBE, the IPSASB issued the Consultation Paper "The Applicability of IPSASs to Government Business Enterprises and Other Public Sector Entities" in August 2014, in which they sought comments by 31 December 2014.

In this Consultation Paper, the IPSASB acknowledges the role of regulators and other relevant authorities in each jurisdiction in determining which entities should be required to prepare general purpose financial statements (GPFs) and the suite of accounting standards to be applied. In its role as the international standard setter for the public sector, the IPSASB considers that it has a responsibility to be transparent about the types of public sector entities for which it is developing IPSAS.

This ongoing debate shows how important it is to define the scope of the application of IPSAS in the public sector, and illustrates some of the complexities that can be identified in the debate on financial information within the public sector.

## **STRUCTURE OF THE BOOK**

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This book is divided into four key parts. The first part provides an introduction to global developments within public sector accounting more broadly as well as IPSAS. It introduces the IPSASB and its expanding role.

The second part provides an overview of cash-basis IPSAS. It addresses the key technical issues and provides practical examples of the application of cash-basis IPSAS.

<sup>4</sup>GBEs can comprise both trading enterprises, such as utilities, and financial enterprises, such as financial institutions.

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The third, and main, part of the book is devoted to a full review and explanation of accrual-based IPSAS as well as the conceptual framework underlying these standards. This is currently a suite of 38 standards<sup>5</sup> (however IPSAS 35–37 will replace the existing IPSAS 6–8). A number of IPSAS have been updated, and as a result we will see some changes in IPSAS over the coming few years. These changes are highlighted where each standard subject to change is covered. In addition a specific chapter is devoted to describing and discussing IPSASB work-in-progress.

**Table 1.1** Full listing of all IPSAS and IFRS “equivalent” as at 1 March 2015

IPSAS	IFRS “equivalent” (if applicable)
IPSAS 1—Presentation of Financial Statements	IAS 1
IPSAS 2—Cash Flow Statements	IAS 7
IPSAS 3—Accounting Policies, Changes in Accounting Estimates and Errors	IAS 8
IPSAS 4—The Effects of Changes in Foreign Exchange Rates	IAS 21
IPSAS 5—Borrowing Costs	IAS 23
IPSAS 6—Consolidated and Separate Financial Statements <sup>6</sup>	IAS 27 (replaced)
IPSAS 7—Investments in Associates <sup>7</sup>	IAS 28 (replaced)
IPSAS 8—Interests in Joint Ventures <sup>8</sup>	IAS 31 (replaced)
IPSAS 9—Revenue from Exchange Transactions	IAS 18
IPSAS 10—Financial Reporting in Hyperinflationary Economies	IAS 29
IPSAS 11—Construction Contracts	IAS 11
IPSAS 12—Inventories	IAS 2
IPSAS 13—Leases	IAS 17
IPSAS 14—Events after the Reporting Date	IAS 10
IPSAS 15— (withdrawn) <sup>9</sup>	
IPSAS 16—Investment Property	IAS 40
IPSAS 17—Property, Plant, and Equipment	IAS 16
IPSAS 18—Segment Reporting	IAS 14 (replaced)
IPSAS 19—Provisions, Contingent Liabilities and Contingent Assets	IAS 37
IPSAS 20—Related Party Disclosures	IAS 24
IPSAS 21—Impairment of Non-Cash-Generating Assets	N/A <sup>10</sup>
IPSAS 22—Disclosure of Information about the General Government Sector	N/A
IPSAS 23—Revenue from Non-Exchange Transactions (Taxes and Transfers)	N/A

*(continued)*

<sup>5</sup> Please note that IPSAS 33–38 are only required to be applied as of 1 January 2017. See also Table 1.1 at the end of this chapter, which provides a full listing of the accrual-based IPSAS and the corresponding IFRS (where applicable).

<sup>6</sup> To be replaced by IPSAS 34 and IPSAS 35.

<sup>7</sup> To be replaced by IPSAS 36.

<sup>8</sup> To be replaced by IPSAS 37.

<sup>9</sup> Replaced by IPSAS 28, IPSAS 29, and IPSAS 30 for accounting periods beginning on/after 1 January 2013.

<sup>10</sup> N/A: not applicable.

**Interpretation and Application of IPSAS****Table 1.1** (Continued)

IPSAS	IFRS “equivalent” (if applicable)
IPSAS 24—Presentation of Budget Information in Financial Statements	N/A
IPSAS 25—Employee Benefits	IAS 19
IPSAS 26—Impairment of Cash-Generating Assets	IAS 36
IPSAS 27—Agriculture	IAS 41
IPSAS 28—Financial Instruments: Presentation	IAS 32
IPSAS 29—Financial Instruments: Recognition and Measurement	IAS 39
IPSAS 30—Financial Instruments: Disclosures	IFRS 7
IPSAS 31—Intangible Assets	IAS 38
IPSAS 32—Service Concession Arrangements: grantor	N/A
IPSAS 33—First-Time Adoption of Accrual Basis IPSASs <i>An entity shall apply those amendments for annual financial statements covering periods beginning on or after 1 January 2017. Earlier application is permitted. If an entity applies IPSAS 33 for a period beginning before 1 January 2017, the amendments shall also be applied for that earlier period.</i>	IFRS 1
IPSAS 34—Separate Financial Statements <i>An entity shall apply this Standard for annual financial statements covering periods beginning on or after 1 January 2017. Earlier application is encouraged. If an entity applies this Standard for a period beginning before 1 January 2017, it shall disclose that fact and apply IPSAS 35, IPSAS 36, IPSAS 37, and IPSAS 38 at the same time.</i>	IAS 27 (2011)
IPSAS 35—Consolidated Financial Statements <i>An entity shall apply this Standard for annual financial statements covering periods beginning on or after 1 January 2017. Earlier application is encouraged. If an entity applies this Standard for a period beginning before 1 January 2017, it shall disclose that fact and apply IPSAS 34, Separate Financial Statements, IPSAS 36, IPSAS 37, and IPSAS 38 at the same time.</i>	IFRS 10
IPSAS 36—Investments in Associates and Joint Ventures <i>An entity shall apply this Standard for annual financial statements covering periods beginning on or after 1 January 2017. Earlier application is encouraged. If an entity applies this Standard for a period beginning before 1 January 2017, it shall disclose that fact and apply IPSAS 34, IPSAS 35, IPSAS 37, and IPSAS 38, Disclosure of Interests in Other Entities, at the same time.</i>	IAS 28 (2011)
IPSAS 37—Joint Arrangements <i>An entity shall apply this Standard for annual financial statements covering periods beginning on or after 1 January 2017. Earlier application is encouraged. If an entity applies this Standard for a period beginning before 1 January 2017, it shall disclose that fact and apply IPSAS 34, IPSAS 35, IPSAS 36 and IPSAS 38, Disclosure of Interests in Other Entities, at the same time.</i>	IFRS 11
IPSAS 38—Disclosure of Interests in Other Entities <i>An entity shall apply this Standard for annual financial statements covering periods beginning on or after 1 January 2017. Earlier application is encouraged.</i>	IFRS 12

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The fourth and final part of the book focuses on the practical aspects of transitioning to IPSAS. This section includes information on change management and governance of an accounting change project.

In addition, at the end of the book there is an annex that provides the readers with additional support information to the book as a whole.

All parts of the book are characterized by the inclusion of multiple examples and practice highlights borrowed from financial statements that are IPSAS-compliant. The inclusion of a number of real examples of how IPSAS is applied serve as a basis for enhancing our understanding of this.

