IMPLEMENTING IPSAS: A GUIDE FOR TRAINERS

Introduction

2024 Edition

Contents

Advantages of Accrual Accounting

What is Accrual Accounting?

Accrual accounting is a system of accounting that has two key features:

a) Economic events are recognized at the time they occur, regardless of when the related cash receipts and payments take place. This contrasts with cash accounting systems, where economic events are only reported when the cash changes hands.

b) Assets and liabilities are recognized in the balance sheet. These include non-financial assets as well as financial assets, and all liabilities. By contrast, cash accounting only reports an entity's cash balances.

Accrual accounting concepts form the basis of government finance statistics. Frameworks such as the *System of National Accounts* and the *Government Finance Statistics Manual* are based on accrual accounting concepts.

The statistical frameworks report on the whole economy, or on subsectors of the economy, for example the general government sector.

However, accrual-based information is often needed to manage individual organizations. General-purpose financial statements are used to provide this information to a wide range of stakeholders, both in the private sector and, increasingly, in the public sector.

In the public sector, organizations such as government ministries, departments or agencies can produce financial statements. International Public Sector Accounting Standards® (IPSAS®) are designed to be used by public sector organizations (entities) that produce general purpose financial statements.

Advantages of Accrual Accounting

The advantages for public sector entities in using accrual accounting relate to the increased and improved financial information that is made available. The benefits of accrual accounting are achieved from using this better information to make better financial decisions, and better informing the development of policies.

The key improvements in information are as follows:

a) By capturing both cash and non-cash flows in financial statements, accrual-accounting provides a more comprehensive view of an entity's financial performance and the cost of its activities;

b) Reporting assets and liabilities can lead to greater consideration being given to the acquisition, disposal and management of these items;

c) The use of internationally recognized standards can increase the transparency, reliability, and comparability of financial reports; and

d) The use of consolidated financial statements can provide a more complete picture of an entity's financial position and financial performance. This is particularly valuable when the reporting entity is a government.

The following reports provide more details about the advantages of accrual accounting:

- *Pathways to Accrual* (IFAC)
- *Is Cash Still King?* (ACCA/IFAC)
- *Implementing Accrual Accounting in the Public Sector* (IMF)
- *Transition to Accrual Accounting* (IMF)
- *Getting Added Value out of Accruals Reforms* (OECD)

Introduction

Context of Development Material

The Handbook of International Public Sector Accounting Pronouncements is the primary authoritative source of international generally accepted accounting principles for public sector entities.

www.ipsasb.org

The International Federation of Accountants® (IFAC®) regularly publishes adoption and implementation support materials. This project is sponsored and funded by IFAC under this initiative.

The International Public Sector Accounting Standards Board® (IPSASB®) has not been involved in the development of the material nor has it formally approved the course material.

The material is intended to assist governments and government organizations wishing to report in accordance with the accrual based IPSAS. It is intended to build capacity and competencies within public sector entities currently on a cash basis (or a near-cash or modified-cash basis) of accounting and in the process of transitioning to accrual IPSAS.

The course may be helpful to public sector entities currently following accrual-based generally accepted accounting principles established by a national or similar authoritative standard setter (for example, ministries of finance) wishing to adopt IPSAS. However, since the primary audience are entities currently using the cash basis and transitioning to accrual IPSAS some of the content may have less relevance.

Course material is intended to assist with implementation. It covers the technical requirements of IPSAS and implementation issues arising from adoption of accrual IPSAS. The course material does not cover all issued IPSAS. Emphasis is placed on those areas considered to be the most significant issues faced by a public sector entity transitioning to IPSAS for the first time (for example, revenues, liabilities, reporting entity, presentation and asset impairment). For more complex issues, participants will have to refer directly to relevant IPSAS in the *IPSASB Handbook*.

The material covered in the course is not intended to be an accounting manual, nor does it establish authoritative accounting practices or standards. The *Handbook of International Public Sector Accounting Pronouncements* (IPSASB Handbook) is the primary authoritative source of international generally accepted accounting principles for public sector entities.

Accounting standards are constantly evolving. Participants should be aware that they must keep themselves up-to-date on the activities of IPSASB. This is best done by logging on to the *IPSASB website*. The website contains information on the status of projects and issues that may impact the contents of existing IPSAS or that may result in new IPSAS.

Material has been prepared based on some broad assumptions about participants.

Participants will be primarily technical accountants and professional auditors who are likely to be involved in the first-time implementation of accrual IPSAS. Participants from a public sector entity would be primarily from the finance/treasury function at all levels from the CFO to line finance staff.

It is assumed that participants, although not necessarily holding an accounting designation, will have a combination of background, experience and education in accounting, either in the public or private sector.

Modules are designed to progress from an overview of relevant IPSAS to technical components reflecting the specific knowledge and skills to be mastered.

Structure of Course

- Based on accrual IPSAS in the IPSASB Handbook
- Series of independent modules
- Illustrative examples and case studies
- Self assessment quiz

- Material uses illustrative examples and case studies to develop the participant's ability to apply the standards to transactions and events in accordance with the IPSAS
- Sessions close with self-assessment quiz designed to help participants test their knowledge acquired
- Material is organized into a set of independent modules

The course material is organized into a set of independent modules that could be taken over a period of between three and five full days (8 hours per day) or broken down into a series of sessions presented over consecutive days or weeks.

IPSASs Not Covered

The course material does not cover the following IPSASs.

- IPSAS 10 – *Financial Reporting in Hyperinflationary Economies*
- IPSAS 14 – *Events after the Reporting Date*
- IPSAS 22 – *Disclosure of Financial Information about the General Government Sector*

Who is the IPSASB?

- Independent standard-setting board
- 18 members; international composition; meetings and materials public
- Objective: Strengthening public financial management (PFM) globally through increasing adoption of accrual-based IPSAS

  Delivered through two main areas of activity, both of which have a public interest focus:

  - Developing and maintaining IPSAS and other high-quality financial reporting guidance for the public sector; and
  - Raising awareness of IPSAS and the benefits of their adoption.

The IPSASB is an independent standard setting board that develops IPSASs for public sector entities. The IPSASB is supported by IFAC through contributions of human resources, facilities management, communications support and funding. IFAC also facilitates the nominations and selection process for board members.

The IPSASB sets its own agendas and approves its publications without IFAC's involvement.

The IPSASB’s independence is safeguarded in a number of ways:

- Full transparency both in terms of due process for standard-setting, as well as public access to agenda materials, meetings, and a published basis for conclusions with each final standard;
- The involvement of observers in the standard- setting process;
- The requirement that IPSASB members, as well as nominating/employing organizations, commit to the board’s independence, integrity and public interest mission; and
- The Public Interest Committee (PIC) provides oversight of the IPSASB to ensure due process is followed and that it is acting in the public interest.

The IPSASB has *18 members* from a number of different countries (currently 17). Composition includes public sector preparers, ministry of finance officials, auditors, academics, and standard setters. Members can be nominated by governments, public sector entities, IFAC member bodies etc.

What are IPSAS?

- Authoritative standards for preparation of general-purpose financial statements
- Designed to apply to all public sector entities that:
  - are responsible for the delivery of services to benefit the public and/or to redistribute income and wealth;
  - mainly finance their activities, directly or indirectly, by means of taxes and/or transfers from other levels of government, social contributions, debt or fees; and
  - do not have a primary objective to make profits.

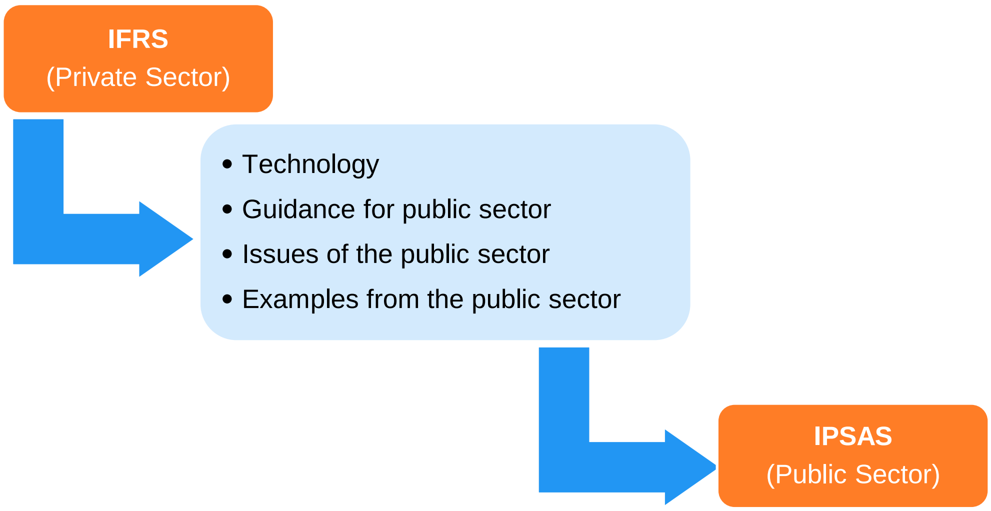
IPSAS stands for International Public Sector Accounting Standards®. IPSAS are developed by the International Public Sector Accounting Standards Board (IPSASB), an independent standard setting body established by the International Federation of Accountants (IFAC), specifically for public sector entities.

IPSAS are authoritative standards on accounting for and reporting economic transactions and events in general purpose financial statements of public sector entities.

IPSAS establish requirements on how particular economic transactions and events should be accounted for and reported in the general-purpose financial statements of public sector entities. General purpose financial statements are financial statements intended to meet the information needs of users who are unable to require the preparation of financial reports tailored to meet their specific information needs. They set the standards for recognition, measurement, presentation and disclosure of the elements that are presented on the face of the financial statements and the information that is disclosed in the notes to the financial statements.

Public sector entities include national, regional (for example, state, provincial, territorial) and local governments (for example, city, town) and their component entities (for example, departments, agencies, boards and commissions).

Aligned with IFRS® Accounting Standards where Appropriate



Many IPSAS are based on IFRS® Accounting Standards issued by the International Accounting Standards Board (IASB) for application by profit-oriented entities. If the underlying accounting transaction is the same in the private and public sectors the IPSASB may agree that the accounting treatment should be the same. Using the IFRS Accounting Standards to develop some IPSAS builds on the strong due process of the IASB using modifications appropriate to reflect public sector specific financial reporting issues. The IPSASB assesses the IFRS Accounting Standards and makes a determination as to whether public sector issues warrant a departure. Changes in terminology to reflect public sector language, guidance specific to the public sector, guidance to address public sector specific issues and public sector examples may be added.

IPSASB attempts, wherever possible, to maintain the accounting treatment and original text of the IFRS Accounting Standards unless there is a significant public sector issue which warrants a departure.

Examples of the different approaches can be seen in these IPSAS:

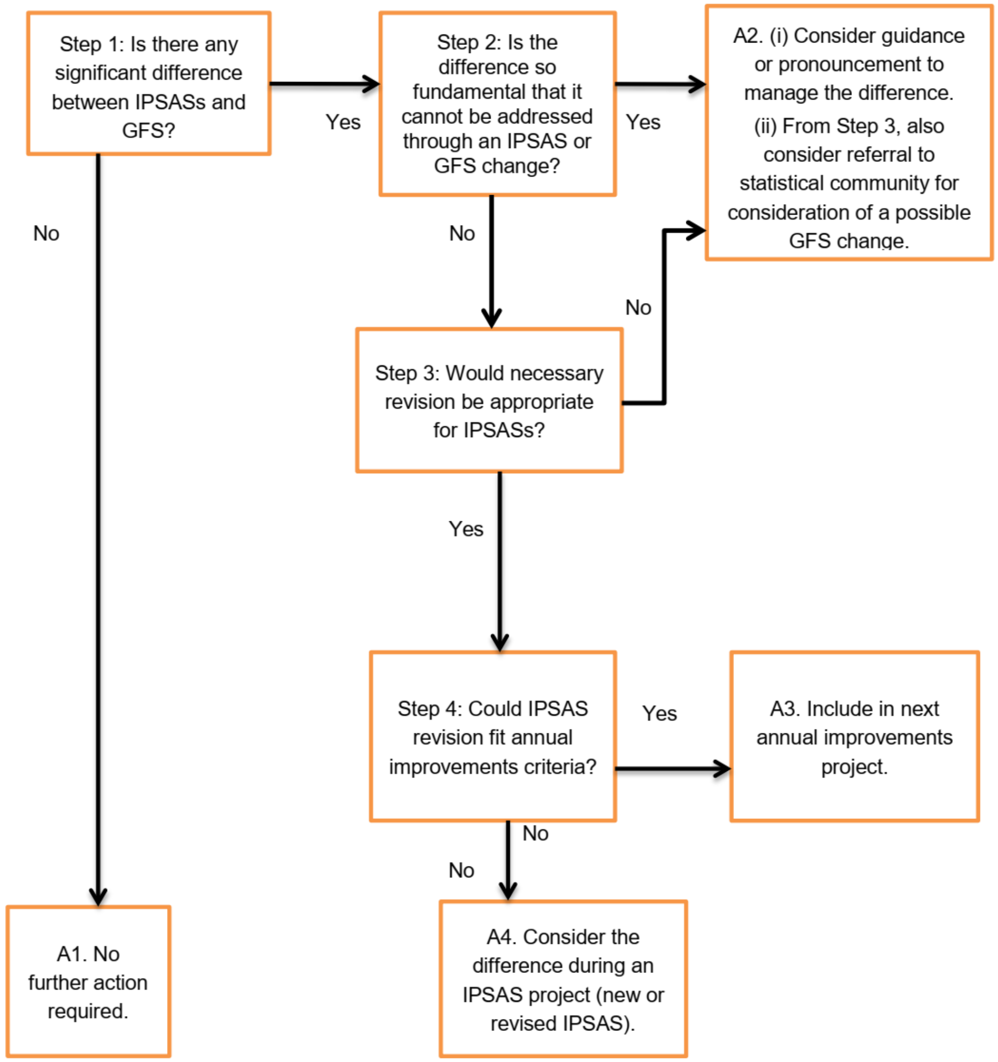
- IPSAS 39 *Employee Benefits* is based on IAS 19, with very minor differences.
- IPSAS 40 *Public Sector Combinations* is a public sector specific IPSAS. While it adopts the same approach to accounting for acquisitions as IFRS 3, it also includes accounting for amalgamations, and guidance on distinguishing between acquisitions and amalgamations. This is because, unlike the private sector, amalgamations are common in the public sector.

Relationship with GFS

The Government Finance Statistics (GFS) reporting guidelines are part of the wider macroeconomic statistical reporting framework.

GFS reporting is important for many governments. The IPSASB has a policy of seeking to reduce unnecessary differences between IPSAS and the GFS reporting guidelines in the development of IPSAS.

Where differences cannot be avoided, the IPSASB will consider guidance or pronouncements to manage the differences.



More on IPSAS

- In addition to authoritative standards (including application guidance) IPSASs include:
  - Basis for Conclusions
  - Implementation guidance
  - Illustrative Examples
  - Comparison with IFRS Accounting Standards where applicable
  - Comparison with Government Finance Statistics (GFS) where applicable (later IPSAS)

IPSAS have a general structure that includes an objective, scope, definitions, accounting and disclosure requirements, transitional provisions and effective date. The sections are generally self-explanatory. They may also include application guidance as part of the authoritative text.

All such guidance states whether it is an integral part of IPSAS. Guidance that is an integral part of IPSAS is mandatory. Guidance that is not an integral part of IPSAS does not contain requirements for financial statements.

IPSAS contain both bold and plain text paragraphs. Bold paragraphs generally state the main principles, while plain text paragraphs generally explain the principles or their application to a particular situation. In addition, plain text paragraphs may include guidance for practices that are encouraged or desirable, but not required. All paragraphs in IPSAS have equal authority.

An IPSAS will be accompanied by a Basis for Conclusions (other than older IPSAS which were developed prior to this policy).

The Basis for Conclusions is not part of the IPSAS, i.e., it is not authoritative. The Basis for Conclusions summarizes considerations that were deemed significant by members of the IPSASB in reaching its conclusions in developing the accounting standard for the public sector. The Basis for Conclusions will include a detailed description of the public sector issue, the rationale for departing from the related IASB document if applicable and the implications of the changes being made.

IPSAS may be accompanied by Implementation Guidance and by illustrative examples neither of which are authoritative. The implementation guidance is intended to assist entities in applying their requirements. The examples are intended to explain and illustrate the application of certain aspects of the standard to various common transactions and events encountered to which the IPSAS requirements are relevant. Changing one or two of the facts assumed in the examples can lead to substantially different conclusions concerning the appropriate application of the standard. In all cases, the provisions of the standard prevail.

When an IPSAS is based on an IFRS Accounting Standard, it will be accompanied by a comparison which highlights the changes in accounting treatment and original text of the relevant IFRS Accounting Standard when there is a significant public sector issue which warrants a departure.

More recent IPSAS are also accompanied by a comparison of the equivalent treatment adopted in GFS. This information will be helpful to entities that need to report on both bases, enabling differences to be identified and processes for addressing these differences to be put in place.

IPSAS Due Process

Required

- Research – relevant international and national standards and practices
- Develop and publish exposure draft – minimum 4-month comment period
- Consider responses and amend draft standard as appropriate
- Final IPSAS

Public consultation paper may be issued before ED at IPSASB's discretion

The IPSASB's due process is a public process with a number of required elements. All projects start with research of relevant international and national standards and practices and an analysis of various options and approaches. Where the project is based on an IFRS Accounting Standard, an assessment is done to identify any public sector issues and whether they warrant a departure from the IFRS Accounting Standard.

An exposure draft (ED) must be issued for public comment on all projects with a minimum 4-month comment period (except for minor amendments, where a shorter consultation period may be appropriate). Responses to the ED are analyzed and amendments to the draft standard may be made to address comments. A final IPSAS is issued only upon approval by two thirds vote of the board. If changes to the draft standard as a result of respondents' comment are determined to be substantive the draft standard may need to be re-exposed prior to finalization as an IPSAS.

The PIC is given the opportunity to comment on whether the IPSASB has followed due process before any IPSAS is issued.

The IPSASB may issue a public consultation paper prior to developing an ED, for example if a topic is particularly complex or the IPSASB is seeking views of stakeholders prior to finalizing its positions.

Different Bases of Accounting

IPSASB defines accounting basis to mean either the accrual or cash basis of accounting as defined in the accrual basis IPSASs or the Cash Basis IPSAS, respectively

Accounting Basis Continuum

Cash Basis	**Modified Cash Basis**	**Modified Accrual Basis**	**Accrual Basis**
Transactions recognized when cash received or paid — reports cash and changes to cash	Variations		Transactions recognized as they occur — reports all assets and liabilities

The *Handbook of International Public Sector Accounting Pronouncements* contains IPSAS that apply to the accrual basis of accounting and one IPSAS that applies to the cash basis of accounting. The IPSASB encourages governments to progress to the accrual basis of accounting, and to adopt accrual basis IPSAS. This course has been developed to assist with adoption of accrual IPSAS.

The cash basis of accounting recognizes transactions and other events only when cash is received or paid. Under the cash basis of accounting revenue is recorded when cash is received, and expenditures are recorded when cash is paid out. When the cash basis of accounting underlies the preparation of the financial statements, the primary financial statement is the statement of cash receipts and payments. Under the cash basis, long-term assets, accounts receivable, inventory, and prepaid assets are not recognized. Liabilities such as borrowings, accounts payable and accrued charges (e.g. payroll taxes, employee future benefits) are not recognized.

The measurement focus in the financial statements is balances of cash and changes therein. Notes to the financial statements may provide additional information about liabilities, such as payables and borrowings, and some non-cash assets, such as receivables, investments and property, plant and equipment.

Public sector entities are frequently required to track expenditures against the relevant budgetary authority. Budgets may be prepared on a cash basis.

The accrual basis of accounting recognizes the economic effects of transactions and other events when they occur regardless of whether there has been a receipt or payment of cash. Therefore, the transactions and events are recorded in the accounting records and recognized in the financial statements of the periods to which they relate. All assets and liabilities that meet the definitions and criteria for recognition are recognized in the financial statements. Assets and liabilities include items such as accounts receivable and payable and provisions for employee benefits.

For example, employee retirement benefits expense is recognized under accrual accounting as a liability and expense in the period when the benefits are earned by employees despite the fact that the obligations will not be paid for some time into the future.

When the accrual basis of accounting underlies the preparation of the financial statements, the financial statements will include the statement of financial position, the statement of financial performance, the cash flow statement and the statement of changes in net assets/equity. The elements recognized under accrual accounting are assets, liabilities, net assets/ equity, revenue, and expenses.

There are many different modifications that may be made to these bases of accounting. Although these modified bases are often referred to as modified cash and modified accrual, there is no standardized version of these bases.

Examples of modifications include the recognition of financial assets (cash, accounts receivable, etc.) and financial liabilities (accounts payable, bank loans, etc.). In other jurisdictions capital assets may be recognized.

Example of Difference Between Cash and Accrual

$100,000 10-year debenture with coupon rate of 6 % issued July 1, 20x0. Interest and principal payable annually. Fiscal period end is December 31.

	Cash Basis		Accrual	
July 1, 20X0	Dr. Cash	$100,000	Dr. Cash	$100,000
	Cr Cash Receipts	$100,000	Cr Liability	$100,000
Dec 31, 20X0			Dr Interest exp	$3,000
			Cr Accrued interest	$3,000
July 1, 20X1	Dr Debt repayment expense	$16,000	Dr Accrued interest	$3,000
			Dr Interest expense	$3,000
			Dr Liability	$10,000
	Cr Bank	$16,000	Cr Bank	$16,000

Scenario:

A Government issues a 10 year debenture of $100,000 with coupon rate of 6 % on July 1, 20x0. Interest and principal is payable annually on July 1. The Government's fiscal period end is December 31. What are the journal entries to record the transactions under a cash and accrual basis of accounting?

- Under cash basis of accounting
  - Proceeds from debt issue are reported as receipt when received
  - No interest expense is recognized for the period from July 1 to December 31, 20X0
  - Debt service payment is reported as expenditure when it is paid

- Under the accrual basis of accounting,
  - Proceeds from debt are recognized as a liability when received
  - Accrued interest and expense is recognized in the financial statements at December 31, 20X0 for period July 1 – December 31, 20X0
  - Annual installment of principal and interest reduces the liability by $10,000, accrued interest by $3,000 and an expense is recognized for $3,000 for period January 1 to July 1, 20X1

		Cash Basis		Accrual	
Journal Entry		**Debit**	**Credit**	**Debit**	**Credit**
July 1, 20X0	Bank	$100,000		$100,000	
	Financial resources		$100,000		
	Liability – Long term debt				$100,000
	To record receipt of proceeds				
Dec 31, 20X0	Interest expense			$3,000	
	Accrued interest				$3,000
	To record interest expense July 1 to Dec 31, 20X0				
July 1, 20X1	Liability – Long term debt			$10,000	
	Accrued interest			$3,000	
	Interest expense			$3,000	
	Debt service	$16,000			
	Bank		$16,000		$16,000

Why Adopt Accrual Basis IPSAS?

- Reports all
  - economic resources controlled by entity
  - claims against economic resources
  - full cost of goods and services
- Improves transparency and accountability
- Provides better information for decision making
- Improves consistency and comparability of reporting

The accrual basis of accounting provides information about the economic resources an organization controls; the claims against those resources and the full cost of services incurred in the provision of its goods and services.

It promotes more transparency, improves accountability and provides better information for decision-making purposes.

Financial statements prepared on the accrual basis inform users not only of past transactions involving the payment and receipt of cash but also of obligations to pay cash in the future and of resources that can be used to deliver services or generate cash to be received in the future. Hence, they provide the type of information about past transactions and other events that is most useful to users in making economic decisions.

The information provided under the accrual basis of accounting supports improved management and stewardship of resources which can improve operational efficiency and effectiveness. For example, the requirement to recognize employee benefit obligations such as retirement benefits supports better management of employee related costs.

The recognition of property, plant and equipment supports better management of these assets.

Adherence to independently established IPSAS improves credibility and comparability of financial statements produced by public sector entities.

Who has adopted IPSAS?

Over 90 countries have adopted IPSAS or are in the process of adopting IPSAS. Many international organizations, e.g. the OECD, EU, United Nations, NATO, and INTERPOL have also adopted IPSAS.

Examples of countries that have or are adopting accrual IPSAS: Tanzania, Chile, Indonesia, Estonia, Switzerland, Slovakia, Brazil, Spain, South Africa, Nigeria, Austria and New Zealand.

Transitioning to Accrual Accounting

- IPSAS 33 – Exceptions from other IPSAS during transition period
  - Recognition
  - Measurement
  - Presentation
  - Comparative information

Details of the accounting requirements that apply when an entity is transitioning to accrual accounting are provided in the First Time Adoption of Accrual Basis IPSAS module.

Features of Successful Transition

- A clear mandate;
- Political commitment;
- Commitment of central entities & key officials;
- Adequate resources (human & financial);
- An effective project management structure;
- Adequate technological capacity and IT systems; and
- Use of legislation.

A clear mandate - clear mandate from appropriate level of government stating what the reforms will encompass, expected timing and authority of various government bodies to initiate required changes.

Political commitment – from both governing body, or elected representatives who oversee governing body, and the opposing party is generally required to secure initial approval and provide continuing support when obstacles are encountered.

Commitment of central entities & key officials – changes to basis of accounting, together with financial management reforms such as devolution of authority for resources, involve changes to power structure; key people who are prepared to publicly stand by changes may also fulfill role officers.

Adequate resources (human & financial) – identification of types of skills required and planning to ensure availability of those skills is critical to success of transition.

An effective project management structure – need documented framework/philosophy, formal implementation plan, clear allocation of responsibility, project milestones and procedures for monitoring performance, approval process, formal communication and coordination mechanisms, know where to incorporate additional costs in budget process.

Adequate technological capacity and IT systems – assess existing systems that link to financial reporting systems; can be a key constraint.

Use of legislation – provides formal authority for changes and demonstrates governments' commitment to change.

Pathways to Accrual provides more guidance on the key features of a successful transition.

Implementation Plan Key Steps

- Phase 1: Outline strategy and plan
- Phase 2: Detailed planning
- Phase 3: Design
- Phase 4: Implementation
- Phase 5: Sustain

The transition to accrual accounting is a major project for most governments. Like any large-scale project, it requires careful planning and management. An entity needs to develop an implementation plan to enable it to achieve its goals.

See *Pathway to Accruals: Implementation Stategy* for a suggested implementation plan template.

Key steps

- Phase 1: Outline strategy and plan
- Phase 2: Detailed planning
- Phase 3: Design
- Phase 4: Implementation
- Phase 5: Sustain

Technical Steps to Implementation

- Determining the reporting entity
- Developing accounting policies
- Implementation
  - Inventory, existing assets, and liabilities
  - Recognition and measurement

Determining the reporting entity

The issue to be resolved is which individual entities and groups of entities should prepare general purpose financial statements as reporting entities. Similarly, in the case of an economic entity comprised of a group of entities under common control, the issue is deciding which entities should be included in the economic reporting entity for the purpose of preparing consolidated financial statements.

Develop accounting policies

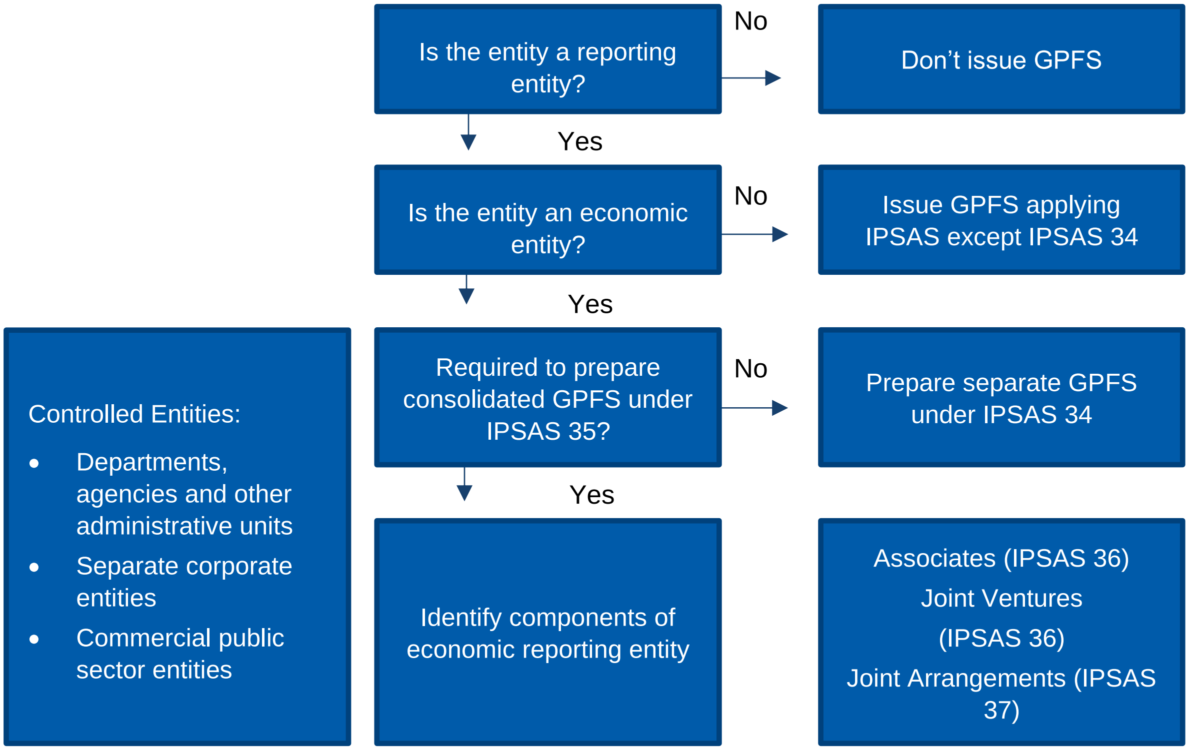
A critical step in transitioning to accrual accounting is establishing accounting policies. The module on Presentation of Financial Statements covers the choice of accounting policies for reporting under the accrual basis of accounting.

Implementation

Need to assess and create inventory of assets and liabilities and determine their measurement at the transition date – to be discussed later in the course.

The implementation tasks and issues associated with the initial identification, recognition, and measurement of existing assets and liabilities in compliance with IPSAS or other accounting standards can be onerous. For example, entities which have not previously used accrual accounting may have written off property, plant and equipment and intangible assets when the assets were acquired. In such cases, the entity will need to be concerned with establishing reliable cost figures for initial recognition of those assets in accordance with the relevant IPSAS. This may be difficult if there are no records of the initial purchase, construction or development, or receipt of the assets.

Identifying the Reporting Entity



See *Public Sector Conceptual Framework* – Chapter 4

An early focus on these issues is appropriate as it can affect the subsequent development of accounting policies as well as requirements for information systems, training strategies, and communication strategies. Entities which have not previously used accrual accounting, whether individual reporting entities or entities that are one of a group of entities included in a reporting entity are likely to be involved in the transition process.

The decision tree identifies the steps in the process to identify the reporting entity.

A public sector reporting entity is a government or other public sector organization, program or identifiable area of activity that prepares general purpose financial reports.

Key characteristics of the public sector reporting entity are (a) that it is an entity that raises resources from, or on behalf of, constituents and/or users resources to undertake activities for the benefit of, or on behalf of, those constituents; and (b) there are service recipients or resource providers dependent on general purpose financial reports of the entity for information for accountability or decision-making purposes.

For most entities, it will be readily apparent whether there are users who are dependent on financial reports for accountability and decision-making purposes. For other entities, it will be necessary to use judgment to make the determination. Consider whether it is reasonable to expect that there are external users dependent upon these financial statements for information for accountability or decision-making purposes.

Other factors to consider include whether there is a requirement to produce general purpose financial statements in legislation, government policy or historical practice.

A reporting entity is any entity that prepares general purpose financial reports. The determination will vary between jurisdictions and within jurisdictions. Reporting entities could be:

a) An individual entity such as a department, ministry, or other government entity; or

b) An economic entity which is a group of entities comprised of a controlling entity and any controlled entities such as the whole-of-government.

It is important to identify the boundaries of an economic entity that is a reporting entity early in the implementation because IPSAS 35, with few exceptions, requires that a controlling entity present consolidated financial statements in which it consolidates its controlled entities. Consolidated financial statements present financial information about the economic entity as that of a single entity.

Consolidated financial statements combine the financial statements of the controlling entity and its controlled entities after eliminating adjustments for balances, transactions, revenues, and expenses between entities within the economic entity.

Steps in the process of identifying the reporting entity include:

a) Identify and document the existing reporting entity/entities and the legislative requirements or decisions that have created the reporting entity/entities.

b) Determine that all entities currently preparing general purpose financial reports are required to do so.

c) Consider whether there are other entities that should produce and publish general purpose financial reports.

Accounting Policies

- Specific principles, bases, conventions, rules, and practices
  - Determined by IPSAS when applicable
  - Judgment used to select accounting policy when no IPSAS (IPSAS 3)
- GAAP hierarchy
  - IPSAS dealing with similar and related issues
  - Definitions, recognition and measurement criteria in the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*
  - Other standard setting bodies
  - Accepted practices

An early focus on accounting policies is appropriate, as they affect the subsequent requirements of information systems, training strategies, and communication strategies.

The choice of accounting policies will also have implications for the effort required to transition to accrual accounting. The choice will also have implications for the ongoing effort required to report on an accrual basis.

Accounting policies are specific principles, bases, conventions, rules, and practices applied in preparing and presenting financial statements:

a) Explain application of accounting standards to transactions and balances;

b) Explain choice among alternate accounting treatments selected; and

c) Policies for external reporting versus internal purposes.

An entity transitioning to accrual accounting is required to develop accounting policies. Initial accounting policies include:

a) Valuation methods used to obtain opening balances;

b) Transitional provisions in IPSAS applied; and

c) Policies for depreciation/amortization and impairment

The initial accounting policies developed by an entity should include an explanation of the valuation methods used to obtain opening balances for certain assets and liabilities, details of any transitional provisions applied, and the impact on those transitional provisions on the financial information. IPSAS 33 and IPSAS 46, *Measurement* provide more guidance on how items should be measured.

The accounting policies will determine the effort, project timelines and ultimately the cost of transition. Policies should be influenced by the costs to compile the information versus the value it has to users of financial statements and management.

IPSAS set out accounting policies that the IPSASB has concluded result in financial statements containing relevant and reliable information about the transactions, other events, and conditions to which they apply. IPSAS are accompanied by guidance to assist entities in applying their requirements.

Judgment is used to select an accounting policy.

There may be cases where an IPSAS does not specifically deal with the accounting treatment of transactions and events. In the absence of an IPSAS, an entity needs to develop policies based on other authoritative guidance that are consistent with the concepts in IPSAS and that results in information that is relevant to the accountability and decision-making needs of users; faithfully represents the financial position, financial performance, and cash flows of the entity; meets the qualitative characteristics of understandability, timeliness, comparability, and verifiability; and takes account of the constraints on information included in general purpose financial reports and the balance between the qualitative characteristics. The selection of an appropriate accounting policy requires the exercise of professional judgment. When an IPSAS does not specific ally apply to a transaction, other event, or condition, IPSAS 3 requires the development of accounting policies to ensure that the financial statements provide information that meets a number of qualitative characteristics of financial reporting. IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors* provides guidance on the hierarchy of sources of accounting principles in such cases.

In exercising judgment that will result in information that is relevant and reliable, management shall refer to, and consider the applicability of, the following sources in descending order:

a) The requirements in IPSAS dealing with similar and related issues; and

b) The definitions, recognition and measurement criteria for assets, liabilities, revenue and expenses described in the Conceptual Framework.

Management may also consider

a) The most recent pronouncements of other standard setting bodies (for example, various pronouncements of the IASB), and

b) Accepted public or private sector practices, but only to the extent that these do not conflict with definitions, recognition and measurement criteria for assets, liabilities, revenue and expenses described in other IPSAS.

Accounting policies chosen should result in information that is complete in all material respects. The information in financial statements should be complete within the bounds of materiality and cost.

Participants should refer to the *Public Sector Conceptual Framework* Chapter 3 for guidance on qualitative characteristics of financial information.

Application of Materiality

- IPSAS need not be applied when the effect of applying them is immaterial
- An item is material if omitting, misstating or obscuring it could reasonably be expected to 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
- The concept of materiality is considered in deciding
  - Whether items need to be recognized
  - The application of a particular accounting policy
  - What items should be disclosed in notes

See *Public Sector Conceptual Framework* Chapter 3 paragraphs 3.32-3.34.

IPSAS need not be applied when the effect of applying them is immaterial.

Judgment is required in deciding whether an item is material. Guidance on determining the materiality of items may be found in publications of individual jurisdictions. One must look to common definitions of materiality.

Information is material if omitting, misstating or obscuring it could reasonably be expected to 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.

The concept of materiality is used in a number of ways including deciding whether certain items need to be recognized, the amount of effort that should be directed towards measurement of certain items and whether certain items should be disclosed in the financial statements.

Examples of accounting policy decisions that may be affected by the concept of materiality

a) Is it necessary to inventory, value and track property plant and equipment items such as furniture and fixtures, computers and other portable electronic equipment?

For example, if a public sector entity has property, plant and equipment valued at cost CU 115 million; is it necessary to expend a lot of effort to initially identify, recognize and value office furniture estimated to be CU 2 million? Is it necessary to account for office equipment on an ongoing basis?

b) Is it necessary to account for certain inventories such as office supplies, printed materials, etc.?

For example, if a public sector entity has inventories of granular material valued at CU 10 million, is it necessary to track officesupplies and materials worth CU 50,000?

Questions and Discussion

Visit the IPSASB webpage

http://www.ipsasb.org

Review Questions

Question 1

The primary sources of international generally accepted accounting principles for public sector entities is/are:

a) The material covered in this course and the current Handbook of International Public Sector Accounting Pronouncements

b) The Handbook of International Public Sector Accounting Pronouncements, pronouncements of other authoritative standard setters and established practice within a particular sector

c) The current Handbook of International Public Sector Accounting Pronouncements

d) Implementation guidance, research reports, accounting textbooks, journals, studies and articles

Question 2

The IPSASB Handbook contains authoritative guidelines on which basis of accounting:

a) Cash

b) Modified cash

c) Modified accrual

d) Accrual

e) (a), (b) and (c) above

f) (a) and (d) above

Question 3

Which statement best describes the cash basis of accounting:

a) It recognizes transactions only when cash is received or paid.

b) The primary financial statement is the statement of cash receipts and payments

c) Accounts receivable, inventory, prepaid assets, accounts payable and accrued charges may be recorded.

d) All of the above

e) (a) and (b) above

Question 4

Which of the following best describe the accrual basis of accounting?

a) The receipt of the proceeds from long term debt and expenditures for the acquisition of property, plant and equipment are reported on the statement of financial performance.

b) The economic effects of transactions and other events are recognized and reported in the financial statements of the periods to which they relate.

c) The statement of financial position will include only financial assets and liabilities.

Question 5

The advantages of adopting accrual based accounting include:

a) It provides information about the economic resources an organization controls; the claims against those resources; and the full cost of services.

b) It promotes more transparency, improves accountability and provides better information for decision making purposes

c) It improves consistency in and comparability of financial statements produced by public sector entities

d) All of the above

Question 6

In the selection, development, and approval of accounting policies an entity is required to base them on the requirements of relevant IPSAS.

True or false? Why?

Question 7

All individual entities would need to develop a set of accounting policies.

True or false? Why?

Question 8

An entity must apply the requirements of IPSAS to all transactions and events.

True or false? Why?

Question 9

All existing entities or groups of entities currently preparing general purpose financial statements are required to report on a full accrual basis of accounting.

True or false? Why?

Answers to Review Questions

Question 1

The correct answer is (c). The IPSASB Handbook is the primary authoritative source of international generally accepted accounting standards for public sector entities.

The material covered in the course is not intended to be an accounting manual, nor does it establish authoritative accounting practices or standards. The IPSASB Handbook is the primary authoritative source of international generally accepted accounting standards for public sector entities.

IPSAS provide the financial statement accounting and reporting requirements as well as explanations and guidance for most transactions and events encountered by an entity. A public sector reporting entity should apply every IPSAS that deals with the accounting and reporting in financial statements of transactions or events encountered by the public sector reporting entity.

Matters may arise that are not specifically addressed in IPSAS. It is necessary to refer to other sources when an IPSAS does not deal with the accounting and reporting in financial statements of transactions or events that a public sector reporting entity encounters, or when additional guidance is needed to apply a primary source to specific circumstances. IPSAS 3, Accounting Policies, Changes in Accounting Estimates and Errors contains specific guidance on sources of GAAP in such cases.

Preparers and auditors of financial statements are required to be knowledgeable about IPSAS. As well preparers and auditors are required to be aware of changes to IPSAS because they may be changed and adapted to current reflect economic or social conditions.

Participants should be aware that they must keep themselves up-to-date on the activities of IPSASB. This is best done by logging on to the IPSASB website. The website contains the status of projects and issues that may impact the contents of existing IPSAS or that may result in new IPSAS.

Question 2

The correct answer is (f). The IPSASB Handbook states that accounting basis means the accrual or cash basis of accounting as defined in the accrual basis IPSAS and the Cash Basis IPSAS.

The IPSASB encourages governments to progress to the accrual basis of accounting and to harmonize national requirements with the IPSAS prepared for application by entities adopting the accrual basis of accounting.

Question 3

The correct answer is (e). Financial statements prepared under the cash basis provide readers with information about the sources of cash raised during the period, the purposes for which cash was used and the cash balances at the reporting date. Cash basis of accounting recognizes transactions and other events only when cash is received or paid. When the cash basis of accounting underlies the preparation of the financial statements, the primary financial statement is the statement of cash receipts and payments.

Under the cash basis, physical assets are not capitalized, and, hence, no depreciation or amortization is recorded. Also, no accruals are made for accounts payable and accrued charges (e.g. payroll taxes, employee future benefits) and accounts receivable, inventory, and prepaid assets are not recorded.

Notes to the financial statements may provide additional information about liabilities, such as payables and borrowings, and some non-cash assets, such as receivables, investments and property, plant and equipment.

Question 4

The correct answer is (b). The accrual basis of accounting is an accounting method under which transactions and other events are recognized when they occur (and not only when cash or its equivalent is received or paid). Therefore, the transactions and events are recorded in the accounting records and recognized in the financial statements of the periods to which they relate.

When the accrual basis of accounting underlies the preparation of the financial statements, the financial statements will include the statement of financial position, the statement of financial performance, the cash flow statement and the statement of changes in net assets/equity. The elements recognized under accrual accounting are assets, liabilities, net assets/equity, revenue, and expenses.

Under the modified cash basis of accounting transactions involving the receipt or use of financial resources are reported on the statement of financial performance, including the issuance of long- term debt and expenditures for the construction or acquisition of property, plant and equipment.

Question 5

The correct answer is (d). Financial statements prepared on the accrual basis inform users not only of past transactions involving the payment and receipt of cash but also of obligations to pay cash in the future and of resources that represent cash to be received in the future. Hence, they provide the type of information about past transactions and other events that is most useful to users in making economic decisions.

Adherence to independently established IPSAS improves credibility and comparability of financial statements produced by public sector entities.

The information provided under the accrual basis of accounting supports improved management and stewardship of resources which can improve operational efficiency and effectiveness. For example, the requirement to recognize employee benefit obligations such as retirement benefits supports better management of employee related costs. The recognition of property, plant and equipment supports better management of these assets.

Question 6

The statement is partially true. To ensure that an entity's financial statements are in full compliance with the requirements of all applicable accrual basis IPSAS, in developing accounting policies an entity looks first to the requirements of relevant IPSAS. Where there is no IPSAS on a topic, an entity will need to develop policies based on other authoritative guidance.

Where no IPSAS has yet been developed management may need to use judgment in developing an accounting policy. In the absence of an IPSAS on a particular issue an entity may refer to and apply:

a) the definitions, recognition and measurement criteria for elements described in the Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities;

b) pronouncements of other standard-setting bodies (for example IASB); and

c) accepted public or private sector accounting and reporting practices to the extent they do not conflict with the definitions, recognition and measurement in IPSAS.

Question 7

The statement is partially true. All entities that prepare and present financial statements on a full accrual accounting basis will have to adopt accounting policies that comply with the requirements of an authoritative standard setter. Public sector entities, shoud base their accounting policies on the requirements of relevant IPSAS.

An entity may be required to prepare consolidated financial statements in which it combines the financial position and performance of all controlled entities. Consolidated financial statements are intended to present financial information about the economic entity as that of a single entity. Consolidated financial statements shall be prepared using uniform accounting policies for like transactions and other events.

In developing accounting policies a decision should be made as to which entities the policies are intended to apply. This is not intended to preclude individual entities from developing accounting policies that are specific to their requirements. However, early specification of certain accounting policies by central entities may limit the number of adjustments required when preparing consolidated financial statements. This is due to the fact that if an entity that is a member of the economic entity uses accounting policies other than those adopted for the preparation of consolidated financial statements, adjustments are required to conform accounting policies.

Question 8

The answer is false. The application of the requirements of all IPSAS is subject to the concept of materiality. An item(s) is material if omitting, misstating or obscuring it could reasonably be expected to 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.

Judgment is required in deciding whether an item is material.

The concept of materiality can be used to reduce the amount of effort required to transition from the cash basis to the accrual basis of accounting as well as in the ongoing accrual accounting. For example, it could be used in deciding whether certain items need to be recognized, the amount of effort that should be directed towards measurement of certain items and whether certain items should be disclosed in the financial statements.

Question 9

The answer is false. Entities that currently prepare financial statements may not be required to do so under IPSAS. One of the first steps in transitioning to the accrual basis of accounting is the identification of existing reporting entities and the legislative requirements or decisions that have required that they prepare financial statements. The next step is determining whether the entity is a reporting entity. Reporting entities are required to prepare general purpose financial statements.

An entity or group of entities may be required to prepare and present general purpose financial statements if it is reasonable to expect that there are external users dependent upon these financial statements for information for accountability or decision-making purposes. The determination will vary between jurisdictions and within jurisdictions. In many jurisdictions this will include each individual department or government entity and the whole-of-government entity.