# IMPLEMENTING IPSAS: A GUIDE FOR TRAINERS

Presentation

2024 Edition

# Contents

# Financial Statements

# Statements of Financial Position, Financial Performance and Changes in Net Assets/Equity

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

This module covers the requirements in IPSAS 1, *Presentation of Financial Statements*.

**IPSAS 1, Presentation of Financial Statements**

The objective of this Standard is to prescribe the manner in which general purpose financial statements should be presented to ensure comparability both with the entity's financial statements of previous periods and with the financial statements of other entities. To achieve this objective, this Standard sets out overall considerations for the presentation of financial statements, guidance for their structure, and minimum requirements for the content of financial statements prepared under the accrual basis of accounting.

IPSAS 1 does not deal with the recognition, measurement and disclosure requirements for specific transactions and events. Participants should refer to the current IPSASB handbook to reference the appropriate IPSASs that set out the requirements related to these specific transactions or events. Also, participants may refer to other modules which cover these requirements.

At the end of this session, participants should:

- Understand the requirements for presentation, structure and content of general purpose financial statements prepared and presented under the accrual basis of accounting.
- Know the minimum requirements for disclosure of financial information on the face of the statements of financial position, financial performance, changes in net assets/equity and statement of cash flows.
- Understand the distinction between information to be provided in financial statements, supplementary schedules and notes.

# Objectives of Financial Statements

- To meet information needs of service recipients and resource providers for accountability and decision making
- Users need information about:
    - The performance of the entity e.g. meeting service delivery and other operating and financial objectives;
    - Managing resources it is responsible for
    - Complying with legislative & other authority
    - Liquidity and solvency
    - Sustainability of service delivery and other operations
    - Capacity to adapt to changing circumstances

**Background**:

General-purpose financial statements are developed primarily to respond to information needs of service recipients and resource providers who do not possess the authority to require a public sector entity to disclose the information they need for accountability and decision-making

Financial statements present summarized information about the financial position, financial performance and cash flows of an entity. The objective of general-purpose financial statements is to provide financial information to a wide range of users who are not in a position to demand reports tailored to meet their particular information needs. Users of general-purpose financial statements include taxpayers and ratepayers, members of the legislature, creditors, suppliers, the media, and employees.

General-purpose financial statements cannot be expected to fulfill all of the users' needs. Some information, such as related performance information and narrative can only be provided by financial reports other than financial statements. General purpose financial statements may include summarized information from other reports and/or may include references to these other reports.

The Conceptual Framework discusses the information needs of service recipients and resource providers.

## Required Financial Statements

- A complete set of financial statements includes:
    - Statement of financial position
    - Statement of financial performance
    - Statement of changes in net assets/equity
    - Cash flow statement
    - Comparison of budget and actual amounts
    - Notes
    - Comparative information in respect of the preceeding period

Provided the information provided in the statements is consistent with the requirements of IPSAS, the naming convention is not critical. For example, the statement of financial position may be referred to as a balance sheet or statement of assets and liabilities. The statement of performance may also be referred to as a statement of revenues and expenses, an income statement, an operating statement or a profit and loss statement. The notes may include items referred to as schedules.

## Comparative Information

- Required for previous period for all amounts reported
- Included for narrative and descriptive information when relevant to understanding

Comparability of information over reporting periods assists users in making and evaluating decisions, especially by allowing the assessment of trends in financial information. Except when an IPSAS permits or requires otherwise, comparative information shall be disclosed in respect of the previous period for all amounts reported in the financial statements.

Comparative information is included for narrative and descriptive information when it is relevant to understanding the financial statements.

In some cases, narrative information provided in the financial statements for the previous period(s) continues to be relevant in the current period. For example, details of a legal dispute, the outcome of which was uncertain at the last reporting date and is yet to be resolved, are disclosed in the current period. Users benefit from information (a) that the uncertainty existed at the last reporting date, and (b) about the steps that have been taken during the period to resolve the uncertainty.

## Presentation and Disclosure

- Consistency of presentation and classification in financial statements is retained unless
  - Another is more appropriate
  - An IPSAS requires a change
- If changed, comparative amounts reclassified
- Disclosure for reclassified items or class of item
- Disclosure on face of statements or in notes

**Background**:

The presentation and classification of items in the financial statements is retained from one period to the next.

The presentation and classification is changed if:

- It is apparent that another presentation or classification would be more appropriate; or
- An IPSAS requires a change in presentation.

If the presentation or classification of items is amended, comparative amounts are reclassified unless that is impracticable. In some circumstances, it is impracticable to reclassify comparative information for a particular prior period to achieve comparability with the current period.

For example, data may not have been collected in the prior period(s) in a way that allows reclassification, and it may not be practicable to recreate the information.

Disclosure is made of the nature, reason and amount of each item or class of item reclassified.

When it is impracticable to reclassify comparative amounts, an entity discloses the reason for not reclassifying the amounts and the nature of the adjustments that would have been made if the amounts had been reclassified.

Disclosure may be on the face of financial statements or in notes - certain items that must be disclosed on the face of each of the financial statements.

## Materiality and Aggregation

- Each material class of similar items shall be presented separately
- Items of a dissimilar nature or function shall be presented separately unless immaterial
- Specific requirements in IPSASs need not be satisfied if information immaterial

Financial statements result from processing large numbers of transactions or other events that are aggregated into classes according to their nature or function. Financial statements should use terminology to describe any classification of items so that significant information is presented clearly and is readily understandable. Excessive detail can result in confusion and misinterpretation. Items not significant in themselves would be grouped with other items as most closely approximate their nature.

The process of aggregation and classification is the presentation of condensed and classified data for presentation as line items on the face of the statement of financial position, statement of financial performance, statement of changes in net assets/equity, and cash flow statement, or in the notes. If a line item is not individually material, it is aggregated with other items either on the face of those statements or in the notes. An item that is not sufficiently material to warrant separate presentation on the face of those statements may nevertheless be sufficiently material for it to be presented separately in the notes.

Applying the concept of materiality means that specific recognition, measurement, or disclosure requirements in an IPSAS need not be satisfied if the information is not material.

## Offsetting

- Assets and liabilities, and revenue and expenses shall not be offset
    - Measuring assets net of valuation allowances is not offsetting
    - Netting of revenue and expenses may be appropriate if it reflects the substance of the transaction

Assets and liabilities, and revenue and expenses, are not offset unless required or permitted by an IPSAS.

It is important that assets and liabilities, and revenue and expenses, are reported separately. Offsetting in the statement of financial performance or the statement of financial position, except when offsetting reflects the substance of the transaction or other event, detracts from the ability of users both (a) to understand the transactions, other events and conditions that have occurred, and (b) to assess the entity's future cash flows.

Measuring assets net of valuation allowances – for example, obsolescence allowances on inventories and doubtful debts allowances on receivables – is not offsetting.

Netting of revenue with related expenses arising on the same transaction is appropriate when this presentation reflects the substance of the transaction.

## Minimum Disclosures on Statement of Financial Position

| ASSETS | | LIABILITIES |
|---|---|---|
| 1. Property, plant and equipment<br>2. Investment property<br>3. Intangible assets<br>4. Financial assets<br>5. Investments (equity method)<br>6. Inventories<br>7. Receivables<br>8. Cash and cash equivalents<br>9. Total of assets classified as held for sale and assets in disposal groups classified as held for sale | | 1. Taxes and transfers payable<br>2. Social benefit liabilities<br>3. Payables<br>4. Provisions<br>5. Financial liabilities<br>6. Total of assets classified as held for sale and assets in disposal groups classified as held for sale<br>7. Non-controlling interests<br><br>NET ASSETS/ EQUITY |
| Additional items relevant to understanding statements | | |

Additional line items, headings, and sub-totals are presented on the face of the statement of financial position when such presentation is relevant to an understanding of the entity's financial position.

IPSAS 1 does not prescribe the order or format in which items are to be presented. IPSAS 1 simply provides a list of items that are sufficiently different in nature or function to warrant separate presentation on the face of the statement of financial position.

The judgment on whether additional items are presented separately is based on an assessment of:

a) The nature and liquidity of assets;

b) The function of assets within the entity; and

c) The amounts, nature and timing of liabilities.

## Current/Non-current Distinction

- Statement of financial position presents current and non-current assets and liabilities separately
- Current asset is cash or cash equivalents or item expected to be realized within twelve months after the reporting date
- Current liability is expected to be settled within 12 months after the reporting date

An entity shall present current and non-current assets, and current and non-current liabilities, as separate classifications on the face of its statement of financial position.

A current asset is:

a) expected to be realized in, or is held for sale or consumption in the normal operating cycle;

b) held primarily for the purpose of being traded;

c) It is expected to be realized within twelve months after the reporting date; or

d) It is cash or a cash equivalent

All other assets (e.g., tangible, intangible, and financial assets of a long-term nature) are classified as non-current.

A current liability is:

a) expected to be settled in the normal operating cycle;

b) held primarily for the purpose of being traded;

c) due to be settled within twelve months after the reporting date; or

d) entity does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting date.

All other liabilities shall be classified as non-current.

## Public Sector Entity Consolidated Statement of Financial Position

**As at December 31, 20X2 (in thousands of currency units)**

| | 20X2 | 20X1 |
|---|---|---|
| ASSETS | | |
| Current assets | x,xxx,xxx | x,xxx,xxx |
| Non-current assets | x,xxx,xxx | x,xxx,xxx |
| Total assets | x,xxx,xxx | x,xxx,xxx |
| LIABILITES | | |
| Current Liabilities | x,xxx,xxx | x,xxx,xxx |
| Non-current liabilities | x,xxx,xxx | x,xxx,xxx |
| Total liabilities | x,xxx,xxx | x,xxx,xxx |
| NET ASSETS/EQUITY | x,xxx,xxx | x,xxx,xxx |
| Total liabilities and net assets/equity | x,xxx,xxx | x,xxx,xxx |

Note the requirements that are illustrated.

- Statement of Financial Position is clearly identified.

The following information is prominently displayed:

- The name of the reporting entity;
- The financial statements cover the economic entity;
- The reporting date (appropriate for this component of the financial statements);
- The presentation currency; and
- The level of rounding used.

Key messages displayed include:

- Distinction between current and noncurrent assets and liabilities; and
- Net assets/equity.

IPSAS 1 requires presentation of specific sub-classifications of assets, liabilities and net assets/equity be shown on the face of the statement. This has not been illustrated due to space limitations.

## Statement of Financial Performance

- As a minimum, the face of the statement includes:
  - Revenue, presenting separately:
    - Interest revenue calculated using the effective interest method
    - Gains and losses arising from the derecognition of financial assets measured at amortized cost
  - Finance costs
  - Impairment losses
  - Share of the surplus or deficit of associates and joint ventures
  - Gains or losses on reclassification of financial assets
  - Surplus or deficit
  - A single amount for the total of discontinued operations
- Additional items are presented if relevant to users understanding of financial performance

The reclassification of financial assets is dealt with in IPSAS 41, *Financial Instruments* (see Module 6) Gains and losses on reclassification arise from two types of reclassification that are presented separately:

- If a financial asset is reclassified out of the amortized cost measurement category so that it is measured at fair value through surplus or deficit, any gain or loss arising from a difference between the previous amortized cost of the financial asset and its fair value at the reclassification date
- If a financial asset is reclassified out of the fair value through net asset/equity measurement category so that it is measured at fair value through surplus or deficit, any cumulative gain or loss previously recognized in net assets/equity that is reclassified to surplus or deficit

Normally, all items of revenue and expense recognized in a period are included in surplus or deficit. This includes the effects of changes in accounting estimates. However, circumstances may exist when particular items may be excluded from surplus or deficit for the current period. IPSAS 3, Accounting Policies, Changes in Accounting Estimates and Errors, deals with two such circumstances: the correction of errors and the effect of changes in accounting policies.

Other IPSASs deal with items that may meet definitions of revenue or expense, but are usually excluded from surplus or deficit. For example, revaluation surpluses resulting from adoption of the revaluation model. (see IPSAS 45, *Property, Plant and Equipment*).

Additional line items, headings, and subtotals are included on the face of the statement of financial performance, and the descriptions used and the ordering of items are amended when this is necessary to explain the elements of performance. Factors to be considered include materiality and the nature and function of the components of revenue and expenses

## Items Presented on Face or in Notes

- Revenue by operations
  - Analysis of expenses classified by nature or function
- Material revenues and expenses such as
  - Revenue by operations
  - Write-downs and reversals
  - Restructuring costs
  - Gains or losses on disposals
  - Reversals of provisions
  - Other unusual or material items

When items of revenue and expense are material, their nature and amount shall be disclosed separately.

Examples:

a) Write-downs of inventories to net realizable value or of property, plant, and equipment to recoverable amount or recoverable service amount as appropriate, as well as reversals of such write-downs;

b) Restructurings of the activities of an entity and reversals of any provisions for the costs of restructuring;

c) Disposals of items of property, plant, and equipment;

d) Privatizations or other disposals of investments;

e) Discontinued operations;

f) Litigation settlements; and

g) Other reversals of provisions.

An entity shall present, either on the face of the statement of financial performance or in the notes, a sub-classification of total revenue, classified in a manner appropriate to the entity's operations.

Expenses are sub-classified to highlight the costs and cost recoveries of particular programs, activities, or other relevant segments of the reporting entity. This analysis is provided in one of two ways.

The first form of analysis is the nature of expense method where expenses are aggregated according to their nature (for example, depreciation, purchases of materials, transport costs, employee benefits, and advertising costs), and are not reallocated among various functions within the entity. This method may be simple because no allocations of expenses to functional classifications are necessary.

The second option is the function of expense method and classifies expenses according to the program or purpose for which they were made. This method can provide more relevant information to users than the classification of expenses by nature, but allocating costs to functions may require arbitrary allocations and involves considerable judgment. The expenses associated with the main functions undertaken by the entity are shown separately. In the example in the slides, the entity has functions relating to the provision of health and education services.

The choice between the function of expense method and the nature of expense method depends on historical and regulatory factors and the nature of the entity. Management should select the most relevant and reliable presentation.

## Expenses Classified by Nature

| | |
|---|---|
| **Revenues** | x,xxx,xxx |
| **Expenses** | |
| Employee benefits | (x,xxx,xxx) |
| Grants & other transfers payments | (x,xxx,xxx) |
| Depreciation & amortization | (x,xxx,xxx) |
| Other expenses | (x,xxx,xxx) |
| **Total expenses** | (x,xxx,xxx) |
| **Surplus/(deficit) for continuing operations** | x,xxx,xxx |

## Expenses by Functional Classification

| | |
|---|---|
| **Revenues** | x,xxx,xxx |
| **Expenses** | |
| Health | (x,xxx,xxx) |
| Education | (x,xxx,xxx) |
| Social protection | (x,xxx,xxx) |
| Other expenses | (x,xxx,xxx) |
| **Total expenses** | (x,xxx,xxx) |
| **Surplus/(deficit) for continuing operations** | x,xxx,xxx |

## Public Sector Entity Consolidated Statement of Financial Performance

For the year ended December 31, 20X2(in thousands of currency units)

| | 20X2 | 20X1 |
|---|---|---|
| Revenues | | |
| Taxes | x,xxx,xxx | x,xxx,xxx |
| Fees, fines, penalties and licenses | x,xxx,xxx | x,xxx,xxx |
| Transfers from other governments | x,xxx,xxx | x,xxx,xxx |
| Other revenue | x,xxx,xxx | x,xxx,xxx |
| Total revenue | x,xxx,xxx | x,xxx,xxx |
| Expenses | | |
| General government | x,xxx,xxx | x,xxx,xxx |
| Public order and safety | x,xxx,xxx | x,xxx,xxx |
| Social protection | x,xxx,xxx | x,xxx,xxx |
| Total expenses | x,xxx,xxx | x,xxx,xxx |
| Surplus/Deficit for the period from continuing operations | x,xxx,xxx | x,xxx,xxx |
| Gain/Loss from discontinued operations | x,xxx,xxx | x,xxx,xxx |
| Surplus/Deficit for the period | x,xxx,xxx | x,xxx,xxx |

Note the IPSAS 1 requirements illustrated. For example,

a) Statement of Financial Performance clearly identified.

b) The following information prominently displayed:

   (i) The name of the reporting entity;

   (ii) The financial statements cover the economic entity (consolidated statements);

   (iii) The reporting date (appropriate for this component of the financial statements);

   (iv) The presentation currency; and

   (v) The level of rounding used.

c) Key messages shown

   (i) the revenues recognized in the period

   (ii) the cost of government services provided in the period

   (iii) surplus or deficit from continuing operations

   (iv) gain or loss on discontinued operations

The statement of financial performance reports the surplus or deficit from operations in the accounting period. It measures, in monetary terms, the extent to which an entity has maintained its net assets in the period. The entity discloses the revenues by source recognized in the period, the cost of services provided in the period by function and the difference between them. Since the entity is disclosing expenses by function, the nature of expense is disclosed in notes or supplementary schedules to the financial statements.

## Statement of Changes in Net Assets/Equity

Statement of changes in net assets/equity required showing on the face

1. Surplus or deficit for the period
2. Revenue and expense recognized directly in net assets/equity
3. Total revenue and expense for the period (the sum of above) – attributable to owners & to minority interest
4. Effect of changes in accounting policies

Because it is important to consider all items of revenue and expense in assessing changes in an entity's financial position between two reporting dates a statement of changes in net assets/equity that highlights an entity's total revenue and expenses, including those that are recognized directly in net assets/equity is required.

Changes in an entity's net assets/equity between two reporting dates reflect the increase or decrease in its net assets during the period. Other IPSASs may require some items (such as revaluation increases and decreases) to be recognized directly as changes in net assets/equity.

An entity shall present a statement of changes in net assets/equity showing on the face of the statement:

a) Surplus or deficit for the period;
b) Each item of revenue and expense for the period that, as required by other standards, is recognized directly in net assets/equity, and the total of these items;
c) Total revenue and expense for the period (calculated as the sum of (a) and (b)), showing separately the total amounts attributable to owners of the controlling entity and to minority interest; and
d) For each component of net assets/equity separately disclosed, the effects of changes in accounting policies and corrections of errors recognized in accordance with IPSAS 3.

## Statement of Changes in Net Assets/Equity (continued)

On the face or in notes

1. Transactions with owners, showing distributions separately
2. Balance of accumulated surpluses or deficits at beginning and end of period and changes during the period
3. Reconciliation for each component of net assets/equity beginning and end

Present on the face or in the notes:

a) Amounts of transactions with owners acting in their capacity as owners, showing distributions to owners separately;
b) Balance of accumulated surpluses or deficits at the beginning of the period and at the reporting date, and the changes during the period; and

c) To the extent that components of net assets/ equity are separately disclosed, reconciliation between the carrying amount of each component of net assets/equity at the beginning and the end of the period, separately disclosing each change.

## Public Sector Entity Consolidated Statement of Changes in Net Assets/Equity

**For the Year Ended December 31, 20X2 (in thousands of currency units)**

| | Reserve | Acc Surplus Deficit | Total |
|---|---|---|---|
| Balance at December 31, 20X0 | x,xxx | x,xxx | x,xxx |
| Changes in accounting policy | | xxx | xxx |
| Restated balance, December 31, 20X0 | x,xxx | x,xxx | x,xxx |
| Change in net assets/equity for period | | | |
| Surplus/Deficit for the period | | x,xxx | x,xxx |
| Balance at December 31, 20X1 | x,xxx | x,xxx | x,xxx |
| Change in net assets/equity for period | | | |
| Surplus/Deficit for the period | | x,xxx | x,xxx |
| Balance at December 31, 20X2 | x,xxx | x,xxx | x,xxx |

Note the requirements illustrated:

a) Statement of Changes in net assets/equity is clearly identified.

b) The following information prominently displayed:

(i) The name of the reporting entity;

(ii) The financial statements cover the economic entity;

(iii) The reporting date (appropriate for this component of the financial statements);

(iv) The presentation currency; and

(v) The level of rounding used.

c) Key messages shown:

(i) The changes in an entity's net assets/ equity between two reporting dates; and.

(ii) Whether the net asset/equity position was maintained during the period.

This illustration assumes an adjustment of the previous reported balance due to an accounting policy change in accordance with IPSAS 3.

The change in net assets/equity for each period presented results only from a surplus or deficit. There are no items of revenue and expense for the periods presented that, as required by other standards, is recognized directly in net assets/equity. Therefore the total revenue and expense for the period is the surplus for the period. In this illustration there are no amounts attributable to owners of the controlling entity and to minority interests.

## Notes to Financial Statements

- Present information about the basis of preparation of the financial statements and the specific accounting policies
- Disclose required information not presented on the face of statements and
- Provide additional information
- Significant judgments made
- Information about estimation uncertainty

Notes and schedules that are integral to the financial statements report information that is necessary for a fair presentation of an entity's financial position, results of operations, change in net assets/equity and cash flow.

They are useful for clarifying and explaining items in the financial statements and are cross-referenced to the specific financial statement items to which they relate. They have the same significance as if the information or explanations were set forth in the body of the statements themselves.

The notes should present information about the basis of preparation of the financial statements and the specific accounting policies used.

Notes are normally presented in the following order, which assists users in understanding the financial statements and comparing them with financial statements of other entities:

a) A statement of compliance with IPSASs;

b) A summary of significant accounting policies applied;

c) Supporting information for items presented on the face of the statement of financial position, statement of financial performance, statement of changes in net assets/equity, or cash flow statement, in the order in which each statement and each line item is presented; and

d) Other disclosures, including:

   i. Contingent liabilities (see IPSAS 19), and unrecognized contractual commitments; and

   ii. Non-financial disclosures, e.g., the entity's financial risk management objectives and policies (see IPSAS 30).

In the process of applying the entity's accounting policies, management makes various judgments, apart from those involving estimations, that can significantly affect the amounts recognized in the financial statements. For example, management makes judgments in determining for example, whether the substance of the relationship between the reporting entity and other entities indicates that these other entities are controlled by the reporting entity.

## Questions and Discussion

Visit the IPSASB webpage

http://www.ipsasb.org

That concludes our module on the presentation of financial statements. Participants should refer to the review questions to test themselves on their knowledge.

# Review Questions

## Question 1

An entity has decided that a change to functional classification of expenses from the classification based on their nature would be more relevant to users of its financial statements.

**What are the requirements of IPSAS 1 for making such a change?**

## Question 2

IPSAS allows the offsetting of assets and liabilities and revenue and expenses..

**True or false? Why?**

## Question 3

An entity has set up a valuation allowance for uncollectible taxes.

**Can the entity net the valuation allowance against the taxes receivable asset for presentation purposes in its statement of financial position? Why?**

## Question 4

Under IPSAS 1 and other IPSAS, required disclosures may be made either on the face of the financial statements or in notes.

**True or false? Why?**

# Answers to Review Questions

## Question 1

When presentation or classification of items in the financial statements is amended, comparative amounts shall be reclassified. When comparative amounts are reclassified, an entity shall disclose:

a) **The nature of the reclassification;**

b) **The amount of each item or class of items that is reclassified; and**

c) **The reason for the reclassification. (IPSAS 1, paragraph 55)**

## Question 2

**The answer is false (although there are limited exceptions).**

It is important that assets and liabilities, and revenue and expenses, are reported separately, although there are exceptions. Offsetting in the statement of financial performance or the statement of financial position, except when offsetting reflects the substance of the transaction or other event, detracts from the ability of users both (a) to understand the transactions, other events and conditions that have occurred, and (b) to assess the entity's future cash flows.

Some transactions an entity undertakes do not generate revenue but are incidental to the main revenue-generating activities. The results of such transactions are presented, when this presentation reflects the substance of the transaction or other event, by netting any revenue with related expenses arising on the same transaction. For example, it may be appropriate to net expenses reimbursed under a contractual arrangement with a third party such as supplier's warranty agreement.

## Question 3

**The answer is yes.** Measuring assets net of valuation allowances – for example, obsolescence allowances on inventories and doubtful debts allowances on receivables – is not offsetting.

## Question 4

**The answer is false.**

IPSAS 1 requires particular disclosures to appear on the face of the statement of financial position, statement of financial performance, and statement of changes in net assets/equity. Other disclosures may be made either on the face of those statements or in the notes. (IPSAS 1, paragraph 59) Preparers of financial statements should check the disclosure requirements of other IPSASs to determine the appropriate presentation of required disclosures.

# Cash Flow Statement

# Cash Flow Statement

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

This module covers the requirements in IPSAS 2, Cash Flow Statements.

# Objective of Cash Flow Statement

- Mandatory
- Provides users with basis to assess how entity generates and uses cash
- Users can assess effect activities had on financial position
- Information has predictive value
  - Amounts, timing and certainty of future cash flows
  - Future cash requirements
  - Sustainability of activities

Users of an entity's financial statements are generally interested in how the entity generates and uses cash and cash equivalents.

The cash flow statement identifies

a) the sources of cash inflows,

b) the items on which cash was expended during the reporting period, and

c) the cash balance as at the reporting date.

The cash flow statement reports the opening and closing cash and cash equivalent balances and shows the changes during the period.

Users are interested in the affect activities had on financial position of the entity.

Information on cash flows has predictive value. Although providing historical information about changes in cash and cash equivalents of an entity, the statement of cash flow can be used to predict:

a) the amounts and timing of future cash flows;

b) future cash requirements;

c) ability to fund changes in the scope and nature of its activities; and

d) the sustainability of the entity's activities.

## Cash and Cash Equivalents

| Cash | Cash Equivalents |
| --- | --- |
| • Cash<br>• Demand deposits | • Short- term liquid investments (3 months or less)<br>• Readily convertible<br>• Insignificant risk |
| Components must be disclosed | |

Cash comprises cash on hand and demand deposits. Cash equivalents are:

- short-term, highly liquid investments that are readily convertible to known amounts of cash;
- subject to an insignificant risk of changes in value; and
- held for the purpose of meeting short term cash commitments rather than for investment or other purposes.

For an investment to qualify as a cash equivalent:

a) it must be readily convertible to a known amount of cash;

b) have a maturity date of less than 3 months; and

c) be subject to an insignificant risk of changes in value. (*IPSAS 2*, paragraph 9)

## Illustrative Examples Cash and Cash Equivalents

*Scenario 1*

An entity acquires a three year fixed rate government bond in an active market two months before its maturity.

- Is the bond cash and cash equivalent? Explain.

**Answer**:

The investment is a cash equivalent. It is short term (maturity date within two months of purchase date), highly liquid (traded in active market), readily converted to a known amount of cash (capital plus interest at maturity or at market value if sold before maturity) and subject to an insignificant risk of changes in value (government bond with fixed interest rate close to maturity unlikely to fluctuate significantly in value).

## Illustrative Examples Cash and Cash Equivalents

*Scenario 2*

An entity's general bank fluctuates between having a balance and overdraft in accordance with the entity's cash receipts and payments cycle. The overdraft is repayable on demand.

- Is overdraft part of cash and cash equivalents? Explain.

**Answer**:

The bank overdraft is a cash equivalent. It is repayable on demand and forms an integral part of the entity's cash management.

## Cash Flow Statement

Report cash flows classified by:

- Operating activities - derived from main cash- generating activities e.g. revenue from taxes, payments to suppliers
- Investing activities - purchase/sale of assets and other long-term investments for resources contributing to future service delivery
- Financing activities - changes in the size and composition of contributed capital and borrowings of entity (e.g., payment of interest; issuance of debt)

Cash flow arising from operating activities is a key indicator of the extent to which operations are funded from revenues of the period. The amount of the net cash flows from operations assists in showing:

a) the ability of the entity to maintain its operating capability, repay obligations and make new investments, without recourse to external sources of financing; and

b) an indication of the extent to which an entity has financed its current activities through current period revenues (e.g., taxation, fees and service charges, investment income, etc.)

Information about the specific components of historical operating cash flows is useful, in conjunction with other information, in forecasting future operating cash flows.

Cash flows from operating activities are primarily derived from the principal cash-generating activities of the entity. Examples of cash flows from operating activities are:

a) Cash receipts from taxes, levies, and fines;

b) Cash receipts from charges for goods and services provided by the entity;

c) Cash receipts from grants, transfers and other appropriations[1] or other budget authority made by central government or other public sector entities;

d) Cash receipts from royalties, fees, commissions, and other revenue;

e) Cash payments to other public sector entities to finance their operations (not including loans);

f) Cash payments to suppliers for goods and services;

g) Cash payments to and on behalf of employees.

[1] In some jurisdictions, there may not be a clear distinction between appropriations or budgetary authorizations for current activities, capital works, and contributed capital. In these cases, the appropriation or budget authorization should be classified as cash flows from operations, and this fact should be disclosed in the notes to the financial statements. (IPSAS 2, paragraph 24).

Investing activities are the acquisition and disposal of long-term assets and other investments not included in cash equivalents.

The separate disclosure of cash flows arising from investing activities is important because the cash flows represent the extent to which cash outflows have been made for resources that are intended to contribute to the entity's future service delivery.

Only cash outflows that result in a recognized asset in the statement of financial position are eligible for classification as investing activities.

The more common examples of cash flows arising from investing activities are:

a) Cash payments to acquire and cash receipts from the sale of property, plant and equipment, intangibles, and other long-term assets;

b) Cash payments to acquire and cash receipts for the sales of long term investments (excluding those classified as cash equivalents or those held for dealing or trading purposes);

c) Cash advances and loans made to and cash receipts from the repayment of advances and loans made to other parties. (IPSAS 2, paragraph 25)

Financing activities - Cash flows that result in changes in the size and composition of contributed capital and borrowings of the entity.

Examples of cash flows arising from financing activities are:

a) Cash proceeds from issuing debentures, loans, notes, bonds, mortgages, and other short or long-term borrowings;

b) Cash repayments of amounts borrowed; and

c) Cash payments by a lessee for the reduction of the outstanding liability relating to a lease. (IPSAS 2, paragraph 26)

The disclosure of cash flows arising from financing activities is useful in predicting claims on future cash flows by providers of capital to the entity. For example, inflows from issuing of debentures, loans, notes, bonds, mortgages, and other short or long-term borrowings will result in future outflows for principal repayment and debt service.

## Reporting Operating Activities

| ***Direct Method*** | ***Indirect Method*** |
|---|---|
| *Discloses*<br>• major classes of gross cash receipts<br>• gross cash payments | *Surplus/deficit adjusted for*<br>• noncash transactions<br>• deferrals<br>• accruals |
| Use of direct method preferred | |

Under the direct method, information is reported about major classes of operating revenues, operating expenses and other items in the statement of financial performance except items of revenue or expense associated with investing or financing cash flows.

Under the indirect method, the net cash flow from operating activities is determined by adjusting net surplus or deficit from ordinary activities for the effects of:

a) Changes during the period in inventories and operating receivables and payables;

b) Non-cash items such as depreciation, provisions, deferred taxes, unrealized foreign currency gains and losses, undistributed surpluses of associates, and minority interests; and

c) All other items for which the cash effects are investing or financing cash flows. (IPSAS 2, paragraph 30)

Entities are encouraged to report cash flows from operating activities using the direct method. The direct method provides information that (a) may be useful in estimating future cash flows, and (b) not available under the indirect method.

## Public Sector Entity Consolidated Statement of Cash Flows (Direct Method)

**For the year ended December 31, 20X2 (in thousands of currency units)**

| | 20X2 | 20X1 |
|---|---|---|
| **Cash Flows from Operating Activities** | | |
| Receipts | | |
| Taxation | x,xxx,xxx | x,xxx,xxx |
| Sales of goods and services | x,xxx,xxx | x,xxx,xxx |
| Other revenue | x,xxx,xxx | x,xxx,xxx |
| Payments | | |
| Employee costs | (x,xxx,xxx) | (x,xxx,xxx) |
| Other expenses | (x,xxx,xxx) | (x,xxx,xxx) |
| Net cash from operating activities | x,xxx,xxx | x,xxx,xxx |
| **Cash Flows From Investing Activities** | | |
| Purchase of plant and equipment | (x,xxx,xxx) | (x,xxx,xxx) |
| **Cash Flows from Financing Activities** | | |
| Proceeds from borrowing | x,xxx,xxx | x,xxx,xxx |
| **Net increase (decrease) in cash** | x,xxx,xxx | x,xxx,xxx |
| **Cash beginning of period** | x,xxx,xxx | x,xxx,xxx |
| **Cash, end of period** | x,xxx,xxx | x,xxx,xxx |

The illustrative example is based on the IPSASB preferred approach of the direct method of reporting cash flows from operating activities.

Note the disclosure requirements illustrated.

The following disclosure requirements are illustrated.

a) Statement of cash flows clearly identified.

b) The following information prominently displayed:

   (i) The name of the reporting entity;

   (ii) The financial statements cover the economic entity (consolidated statements);

   (iii) The reporting date (appropriate for this component of the financial statements);

   (iv) The presentation currency; and

   (v) The level of rounding used.

c) Key messages shown

   (i) information about major classes of operating revenues, operating expenses and other items' cash flows

   (ii) cash flows from operating, investing and financing activities

   (iii) the opening and closing balance of cash and cash equivalents

Implementation guidance in IPSAS 2, *Cash Flow Statements* gives a more robust example of a cash flow statement for both the direct method and the indirect method.

## Public Sector Entity Consolidated Statement of Cash Flows (Indirect Method)

**For the year ended December 31, 20X2 (in thousands of currency units)**

| | 20X2 | 20X1 |
|---|---|---|
| **Cash Flows from Operating Activities** | | |
| Surplus deficit for period | x,xxx,xxx | x,xxx,xxx |
| Adjustments for non-cash items | | |
| Depreciation Expense | x,xxx,xxx | x,xxx,xxx |
| Increase in receivables | (x,xxx,xxx) | (x,xxx,xxx) |
| Increase in payables | x,xxx,xxx | x,xxx,xxx |
| Net cash flows from operating activities | x,xxx,xxx | x,xxx,xxx |
| **Cash Flows From Investing Activities** | | |
| Purchase of plant and equipment | (x,xxx,xxx) | (x,xxx,xxx) |
| **Cash Flows from Financing Activities** | | |
| Proceeds from borrowing | x,xxx,xxx | x,xxx,xxx |
| **Net increase (decrease) in cash** | x,xxx,xxx | x,xxx,xxx |
| **Cash beginning of period** | x,xxx,xxx | x,xxx,xxx |
| **Cash, end of period** | x,xxx,xxx | x,xxx,xxx |

The illustrative example is based on the IPSASB alternative approach of the indirect method of reporting cash flows from operating activities.

The following disclosure requirements are illustrated.

a) Statement of cash flows clearly identified.

b) The following information prominently displayed:

   (i) The name of the reporting entity;

   (ii) The financial statements cover the economic entity (consolidated statements);

   (iii) The reporting date (appropriate for this component of the financial statements);

   (iv) The presentation currency; and

   (v) The level of rounding used.

c) Key messages shown

   (i) cash flows from operating, investing and financing activities

   (ii) the opening and closing balance of cash and cash equivalents

Implementation guidance in IPSAS 2, *Cash Flow Statements* gives a more robust example of a cash flow statement for both the direct method and the indirect method.

## Netting

Cash flows may be reported on a net basis when:

- Cash receipts collected and payments made on behalf of others (e.g. collection of taxes by one level of government for another level of government)
- Cash receipts and payments when
  - Turnover is quick
  - Amounts are large
  - Maturities are short

  (e.g. purchase and sale of investments)

Cash flows may be reported on a net basis when:

a) Cash receipts collected and payments made on behalf of others are reflective of the activities of the other party; and

b) Cash receipts and payments for items in which the turnover is quick, the amounts are large, and the maturities are short (e.g. purchase and sale of investments).

Item (a) refers only to transactions where the resulting cash balances are controlled by the reporting entity. Examples of such cash receipts and payments include:

a) The collection of taxes by one level of government for another level of government, not including taxes collected by a government for its own use as part of a tax-sharing arrangement;

b) The acceptance and repayment of demand deposits of a public financial institution;

c) Funds held for customers by an investment or trust entity; and

d) Rents collected on behalf of, and paid over to, the owners of properties.

Examples of cash receipts and payments referred to item (b) are advances made for, and the repayment of:

a) The purchase and sale of investments; and

b) Other short-term borrowings, for example, those that have a maturity period of three months or less.

## Disclosures

- Changes in liabilities arising from financing activities
- Components of cash and cash equivalents
- Additional information relevant to users in understanding the financial position and liquidity of entity
  - Amount of undrawn borrowing facilities and restrictions
  - Amount and nature of restricted cash balances
- Reconciliation of the surplus/deficit with net cash flow from operating activities when direct method used

Entities should disclose information to enable users of financial statements to evaluate changes in liabilities arising from financing activities. This should include both changes arising from cash flows and non-cash changes.

An entity should disclose the components of cash and cash equivalents.

Additional information may be relevant to users in understanding the financial position and liquidity of an entity. Disclosure of this information, together with a description in the notes to the financial statements, is encouraged, and may include:

a) The amount of undrawn borrowing facilities that may be available for future operating activities and to settle capital commitments, indicating any restrictions on the use of these facilities; and

b) The amount and nature of restricted cash balances.

Entities reporting cash flows from operating activities using the direct method are also encouraged to provide a reconciliation, either as part of the cash flow statement or in the notes, of the surplus/deficit from ordinary activities with the net cash flow from operating activities. The reconciliation is prepared in the same way as the indirect method of presenting a cash flow statement.

## Questions and Discussion

Visit the IPSASB webpage http://www.ipsasb.org

That concludes our module on the cash flow statement. Participants should refer to the review questions to test themselves on their knowledge.

# Review Questions

## Question 1

Entities are encouraged to report cash flows from operating activities using the direct method.

**Which statement best describes this method of reporting?**

a) A reconciliation of the surplus/deficit with the net cash flow from operating activities

b) Surplus or deficit for the period is adjusted for effects of noncash transactions, deferrals

c) Major cash flows from operating revenues, expenses and other items in the statement of financial performance are reported.

## Question 2

Which of the following are cash flows from operating activities?

a) Cash receipts from taxes, levies, fines, fees

b) Cash transfers (excluding capital) made to other public sector entities

c) Cash payments for salaries, wages and benefits

d) Cash payments of interest and principal

e) Cash receipts from sale of property plant and equipment

f) Items a, b and c

g) All of the above

## Question 3

Which of the following are cash flows from investing activities?

a) Cash payments to acquire property, plant and equipment;

b) Gain or loss on sale of property, plant and equipment;

c) Cash proceeds from issuing debentures for the acquisition of property, plant and equipment;

d) Cash payments that reduce the outstanding liability under a lease;

e) Items a and b above;

f) All of the above.

# Answers to Review Questions

## Question 1

### The answer is (c).

Under the direct method, the net cash flow from operating activities includes information about major classes of operating revenues, operating expenses and other items in the statement of financial performance except items of revenue or expense associated with investing or financing cash flows.

Under the direct method, information about major classes of gross cash receipts and gross cash payments may be obtained either:

a) From the accounting records of the entity; or

b) By adjusting operating revenues, operating expenses (interest and similar revenue, and interest expense and similar charges for a public financial institution), and other items in the statement of financial performance for:

   (i) Changes during the period in inventories and operating receivables and payables;

   (ii) Other noncash items; and

   (iii) Other items for which the cash effects are investing or financing cash flows.

Under the indirect method, the net cash flow from operating activities is determined by adjusting net surplus or deficit from ordinary activities for the effects of:

a) Changes during the period in inventories and operating receivables and payables;

b) Non-cash items such as depreciation, provisions, deferred taxes, unrealized foreign currency gains and losses, undistributed surpluses of associates, and minority interests;

c) All other items for which the cash effects are investing or financing cash flows; and

d) The impact of any extraordinary items that are classified as operating cash flows.

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## Question 2

### The answer is (f).

Cash flows from operating activities are primarily derived from the principal cash-generating activities of the entity. For other examples of cash flows from operating activities, refer to IPSAS 2, paragraph 22.

Cash repayments of amounts borrowed are financing activities. Cash receipts from the sale of property, plant and equipment are investing activities.

## Question 3

### The answer is (a).

Cash payments to acquire property, plant and equipment, intangibles, and other long-term assets

The gain or loss on disposal of property, plant and equipment is a non-cash transaction. The actual cash receipts from the disposal of property plant and equipment is a cash flow from an investing activity.

Cash proceeds from issuing debentures for the acquisition of property, plant and equipment and cash payments that reduce the outstanding liability under a lease are both financing activities.

# Related Party Disclosures

# Related Party Transactions IPSAS 20

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

IPSAS 20, *Related Party Disclosures*, contains requirements on the disclosure of related party relationships and certain transactions with related parties.

Applying IPSAS 20 involves identifying related parties (the reporting entity's controlled and controlling entities, associates, and key management personnel and their close family members) and making the required disclosures about them.

To comply with the standard, a reporting entity will need to have in place:

- Mechanisms to identify related party transactions that are not conducted within the parameters of the normal operating procedures/mandate of the reporting entity; and
- Records of the remuneration and benefits received by the key management personnel and their close family members, from the reporting entity.

# Objective

- Disclose existence of related parties where control exists – identifying parties that control or significantly influence
- Disclose information about related party transactions – determining what to disclose
- Substance over form

Related party relationships exist throughout the public sector. Ministers and other elected/appointed members of the government and senior management can exert significant influence on the operations of government departments and other entities.

Government departments and entities frequently conduct activities necessary for the discharge of their responsibilities and achievement of their objectives through separate controlled entities, and through entities over which they have significant influence.

IPSAS 20 requires the disclosure of the existence of related party relationships where control exists, and the disclosure of information about transactions between the entity and its related parties in certain circumstances. The information is required for accountability purposes and to facilitate a better understanding of the financial position and performance of the reporting entity.

Disclosure of transactions with key management personnel and their close family members is intended to reduce the risk of these related parties entering into transactions that expose the entity to risks or are on more favorable terms than usual.

## Defining Related Parties

Parties considered related if one party has the ability to:

- Control the other party or
- Exercise significant influence

Or if the related party entity and another entity are subject to common control

Significant influence is the power to participate in the financial and operating policy decisions of an entity, but not control those policies.

Significant influence may be exercised in several ways, usually by representation on the board of directors or equivalent governing body but also by, for example, participation in (a) the policy making process, (b) material transactions between entities within an economic entity, (c) interchange of managerial personnel, or (d) dependence on technical information. Significant influence may be gained by an ownership interest, statute, or agreement. With regard to an ownership interest, significant influence is presumed in accordance with the definition contained in IPSAS 36.

## Examples of Related Parties

a) Entities that directly, or indirectly through one or more intermediaries, control, or are controlled by, the reporting entity;

b) Associates (see IPSAS 36, *Investments in Associates and Joint ventures*);

c) Individuals owning, directly or indirectly, an interest in the reporting entity that gives them significant influence over the entity, and close members of the family of any such individual;

d) Key management personnel, and close members of the family of key management personnel; and

e) Entities in which a substantial ownership interest is held, directly or indirectly, by any person described in (c) or (d), or over which such a person is able to exercise significant influence

The reporting entity must create a process to identify and review its related parties. The process will include:

a) Identifying the reporting entity's controlled and controlling entities. IPSAS 35, *Consolidated Financial Statements*, provides guidance on the concept of "control" of another entity for financial reporting purposes;

b) Identifying the reporting entity's associates. IPSAS 36, *Investments in Associates and Joint Ventures*, provides guidance on associates;

c) Identifying individuals and entities which have joint control over the reporting entity. IPSAS 37, *Joint Arrangements*, provides guidance on joint arrangements. Although the definition of related parties in IPSAS 20 does not specifically refer to individuals or entities that have joint control over the reporting entity, for the purposes of IPSAS 20, significant influence is defined to encompass entities subject to joint control;

d) Maintaining a record of the reporting entity's key management personnel and their close family members. This record will include information on:

- The amount of remuneration and benefits received from the reporting entity; and
- Entities in which a substantial ownership interest is held (directly or indirectly) by the key management personnel and their family.

## Related Party Transactions

- Transfer of resources or obligations between related parties
- Price may or may not be charged
- Economic dependence excluded

Related party transactions include all transfers of resources or obligations between related parties, regardless of whether a price is charged. However, only certain related party transactions must be disclosed in the financial statements. IPSAS 20 does not require disclosure of transactions between related parties if they are on normal terms and conditions.

To identify these types of transactions, the reporting entity will need to:

a) Review its relationship with its related parties; and

b) Identify what constitutes the normal operating procedures/mandate with its related parties and develop new policies to deal with any uncertainties.

If an entity is required to maintain a register of interests for elected or high-ranking officials, this would be a useful starting point for identifying information relating to key management personnel.

## Disclosure

- Accountability
- Transparency
- Related party relationships disclosed
- Transactions disclosed – types, elements to clarify significance
- Key management personnel details

To comply with the disclosure requirements of IPSASs regarding related party disclosures, an entity will need to:

a) Identify all of its related parties.

b) Identify and maintain records of the relevant related party transactions. These records should outline:

   (i) The nature of the related party relationships;

   (ii) Types of transaction that have occurred; and

   (iii) Other elements of the transactions necessary to clarify the significance of the transactions to its operations such as the terms and conditions of these transactions.

c) Identify and disclose aggregate remuneration of key management personnel (see also IPSAS 39, *Employee Benefits*) and all other remuneration and compensation provided to key management personnel and their close family members.

d) Identify loans provided to key management personnel and their close family members, the availability of which is not widely available to persons who are outside the key management group or which are not widely known by the public. Management should establish policies and criteria on when and how such loans can be approved. An entity providing these types of loans should have systems that are able to generate:

   (i) The amount advanced and the terms and conditions thereof;

   (ii) The amount repaid during the period and the closing balance of all loans and receivables; and

   (iii) Where the recipient is not a member of the governing body nor part of the senior management group of the entity, the relationship of the individual to the governing body or senior management group.

## Questions and Discussion

Visit the IPSASB webpage

http://www.ipsasb.org

That concludes our module on related party disclosures. Participants should refer to the review questions to test themselves on their knowledge.

# Review Questions

## Question 1

A government agency discloses its relationships and transactions with related parties.

**Which of the following are related parties?**

a) A company owned by the husband of the chief executive of a government Agency

b) A controlled entity of a government agency

c) An associate of a government agency?

d) A junior employee.

## Question 2

Entities are required to collect information about transaction with key management personnel and their close family members?

**What types of transaction should be disclosed?**

# Answers to Review Questions

## Question 1

**The answer is (a), (b) and (c).**

The following are examples of related parties:

a) Entities that directly, or indirectly through one or more intermediaries, control, or are controlled by, the reporting entity;

b) Associates (see IPSAS 36, *Investments in Associates and Joint Ventures*);

c) Individuals owning, directly or indirectly, an interest in the reporting entity that gives them significant influence over the entity, and close members of the family of any such individual;

d) Key management personnel, and close members of the family of key management personnel; and

e) Entities in which a substantial ownership interest is held, directly or indirectly, by any person described in (c) or (d), or over which such a person is able to exercise significant influence.

## Question 2

**The items of information that entities will need to collect in respect of key management personnel and their close family members are:**

a) Remuneration and compensation provided; and

b) Loans that are not widely available to persons who are not key management personnel and loans whose availability is not widely known by members of the public.

# Budget Information

## Introduction

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

## Presentation of Budget Information

- Applies to public sector entities that make their approved budget publicly available
- Does not require that entities make their budgets available
- Does not establish requirements about the basis of accounting in a budget or the presentation of information in a budget
- Enhances the transparency of financial statement and demonstrates accountability

The budget is an important document for many governments. Reporting comparisons of budgets and the results of budget execution enhances the transparency of financial statements and is an important element in demonstrating accountability, particularly for those entities that make their budgets publicly available.

Budgets are not static. They are often updated throughout the reporting period and differing versions of a budget may be made available to the public at different points in the reporting period. Because there can be more than one budget IPSAS 24 establishes the following definitions:

a) Original budget is the initial approved budget for the budget period.

b) Approved budget means the expenditure authority derived from laws, appropriation bills, government ordinances, and other decisions related to the anticipated revenue or receipts for the budgetary period.

c) Final budget is the original budget adjusted for all reserves, carry over amounts, transfers, allocations, supplemental appropriations, and other authorized legislative, or similar authority changes applicable to the budget period.

Budgets can also be for more than one year.

IPSAS 24 therefore distinguishes between annual and multiyear budgets.

## Presentation

- Comparison of budgeted amounts and actual amounts
- If financial statements and budget prepared on comparable basis (e.g., accrual f/s & accrual budget)
    - Additional budget columns in the financial statements
    - Separate additional financial statement
- If financial statements and budget not prepared on comparable basis (e.g. accrual f/s & cash budget) separate additional financial statement required
- Comparable basis to the budget

IPSAS 24 requires the presentation of a comparison of budgeted amounts (original and final budget) and actual amounts in the financial statements. The comparison must be provided for each level of legislative oversight. The way in which this comparison is presented depends on whether the financial statements and the budget are prepared on a comparable basis.

If the financial statements and the budget are prepared on a comparable basis (for example, accrual financial statements and an accrual budget) the comparison may be presented by way of additional columns in the primary financial statements or in a separate statement. If the financial statements and the budget are prepared on a different basis (for example, accrual financial statements and cash basis budget) the comparison must be presented in a separate statement.

The comparison between budget and actual amounts must be presented on a comparable basis to the budget (for example, if the budget is presented on a cash basis then the comparison of budgeted and actual amounts must also be presented on the cash basis).

Comparable basis means the actual amounts are presented on the same accounting basis, the same classification basis, for the same entities, and for the same period as the approved budget. On a comparable basis means that:

a) the same accounting basis is used (i.e., cash or accrual),

b) the amounts are for the same economic entity (i.e. the same entities),

c) the same classifications are used and

d) the budget and financial statements are for the same fiscal period.

The figures in the comparison statement must be reconciled to key figures in the financial statements.

The following examples illustrate different formats that may be used.

The first example illustrates the additional column approach. This approach is only permitted where the financial statements and the budget are prepared on a comparable basis. In this example, additional columns are included in the primary financial statements to show the budget information. The example shows the statement of financial performance; a similar approach would be taken with the other financial statements.

The second example illustrates the separate financial statement approach. This approach is required when the budget is prepared on a different basis to the financial statements, and may be adopted where the budget and the financial statements are prepared on a comparable basis. Line items in this format are those used in the budget, not the financial statements.

## Example – Additional Column Approach

| Actual 20XX-1 | (in currency units) | Actual 20XX | Final Budget 20XX | Original Budget 20XX | *Difference: Original Budget and Actual |
|---|---|---|---|---|---|
| | Revenue | | | | |
| X | Taxes | X | X | X | X |
| X | Other compulsory contributions and levies | X | X | X | X |
| X | Transfers without a binding arrangement | X | X | X | X |
| X | Revenue from compliance obligations in a binding arrangement | X | X | X | X |
| **X** | **Total revenue** | **X** | **X** | **X** | **X** |
| | **Expenses** | | | | |
| (X) | Grants and other transfer payments | (X) | (X) | (X) | (X) |
| (X) | Supplies and consumables used | (X) | (X) | (X) | (X) |
| (X) | Depreciation/amortization expense | (X) | (X) | (X) | (X) |
| (X) | Other expenses | (X) | (X) | (X) | (X) |
| (X) | Finance costs | (X) | (X) | (X) | (X) |
| **(X)** | **Total expenses** | **(X)** | **(X)** | **(X)** | **(X)** |

# Example – Separate Financial Statement

| (in currency units) | Original | Final | Comparable Basis | Final Budget and Actual |
|---|---|---|---|---|
| **RECEIPTS** | | | | |
| **Taxation** | X | X | X | X |
| **Aid Agreements** | X | X | X | X |
| **International agencies** | X | X | X | X |
| **Other Grants and Aid** | X | X | X | X |
| **Proceeds: Borrowing** | X | X | X | X |
| **Proceeds: Disposal of plant and equipment** | X | X | X | X |
| **Trading Activities** | X | X | X | X |
| **Other receipts** | X | X | X | X |
| **Total receipts** | X | X | X | X |
| **PAYMENTS** | | | | |
| **Health** | (X) | (X) | (X) | (X) |
| **Education** | (X) | (X) | (X) | (X) |
| **Public Order** | (X) | (X) | (X) | (X) |
| **Social Benefits** | (X) | (X) | (X) | (X) |
| **Defense** | (X) | (X) | (X) | (X) |
| **Housing and Amenities** | (X) | (X) | (X) | (X) |
| **Recreational and Cultural** | (X) | (X) | (X) | (X) |
| **Economic Affairs** | (X) | (X) | (X) | (X) |
| **Total payments** | (X) | (X) | (X) | (X) |
| **Net Receipts / (Payments)** | X | X | X | X |

## Note Disclosures

- Material differences between the budget and actual amounts
- Explanation of whether changes between the original and final budget are from reallocations within the budget, or of other factors
- Explanation of the budgetary basis and classification basis adopted in the approved budget;
- Period of the approved budget; and
- Entities included in the approved budget

IPSAS 24 also specifies note disclosures to help the reader understand the comparison.

These include:

a) An explanation of material differences between the budget and actual amounts.

There is an exception to this requirement if this information is provided in another public document issued in conjunction with the financial statements and the financial statements include a cross reference to that other document;

b) An explanation of whether changes between the original and final budget are a consequence of reallocations within the budget, or of other factors. Again, this explanation may be in the notes to the financial statements or in another document

c) An explanation of the budgetary basis and classification basis adopted in the approved budget;

d) The period of the approved budget; and

e) The entities included in the approved budget.

## Questions and Discussion

Visit the IPSASB webpage http://www.ipsasb.org

That concludes our module on the presentation of budget information. Participants should refer to the review questions to test themselves on their knowledge.

# Review Questions

## Question 1

**Which of the following describe the purpose of IPSAS 24?.**

a) To require entities to make approved budgets publicly available

b) To provide information to users of general purpose financial reports that demonstrates compliance with the legally adopted budget for accountability.

c) Provide information that users need to assess an entity's performance against plans for the period.

d) Provide guidance on the preparation of budgets on a comparable basis as the financial statements.

# Answers to Review Questions

## Question 1

**Items (b) and (c) best describe the purpose of IPSAS 24.**

The reporting of a comparison of budget amounts with actual amounts on a comparable basis in the financial statements provides users with information about an entity's compliance with the legally adopted budget.

Provision of a comparison of budget amounts with actual amounts on a comparable basis in the financial statements provides users with information needed to assess an entity's performance against plans for the period.

This standard does not require approved budgets to be made publicly available, nor does it require that the financial statements disclose information about, or make comparisons with, approved budgets that are not made publicly available.

IPSASs do not establish standards or specify requirements for the formulation or presentation of approved budgets that are made publicly available.

# Foreign Exchange

# Foreign Exchange IPSAS 4

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

IPSAS 4, *The Effects of Changes in Foreign Exchange Rates*, contains guidance on accounting for foreign currency transactions and foreign operations.

In order to apply IPSAS 4, entities will need to ensure they have systems for identifying the transactions and balances referred to in IPSAS 4 and have classified foreign operations as either foreign operations that are integral to the operations of the reporting entity or as foreign entities.

The adoption of accrual accounting is often associated with an increased emphasis on the management of foreign exchange risk. This may involve the development of policies regarding exposures to individual currencies and financial institutions, and the types of instruments to be used to manage those exposures.

# Scope

- Transactions in foreign currencies
- Foreign operations
- Presentation currency

IPSAS 4:

a) Deals with accounting for foreign currency transactions and foreign operations;

b) Sets out the requirements for determining which exchange rate to use for the recognition of certain transactions and balances; and

c) Explains how to recognize the financial effect of changes in exchange rates in the financial statements.

A foreign exchange gain or loss occurs when there are transactions payable or receivable in foreign currency and exchange rates change between the time of recognition of the transaction and the time of payment. Such gains or losses may be realized or unrealized at the end of the reporting period. Gains or losses may also occur due to changes in the rates used to translate the balances associated with foreign operations.

As noted in the International Monetary Fund (IMF) and World Bank's *Revised Guidelines for Public Debt Management* (IMF and World Bank, 2014), excessive unhedged foreign exchange exposures are a common pitfall in public debt management. Excessive amounts of foreign currency denominated debt and foreign exchange indexed debt can leave governments vulnerable to volatile and possibly increasing debt service costs if their exchange rates depreciate, and the risk of default if they cannot roll over their debts.

Many governments will also have significant foreign exchange risk exposures arising from government entities' purchases and sales. The adoption of accrual accounting provides a government with a timely opportunity to review its management of foreign exchange exposures, both in relation to debt and the operations of its entities. Options include the establishment of specific thresholds beyond which cover will be taken, or remaining uninsured at the whole-of-government level (sometimes referred to as self-insuring). Foreign currency management of risks associated with the operations of individual entities can occur at an entity level or as a centralized function.

## Functional Currency

- Currency of the primary economic environment in which the entity operates
- Generally straightforward
- Revenue raised; costs settled
- Foreign currency items generally translated to functional currency.

IPSAS 4 requires that an entity initially record its foreign currency transactions in the entity's functional currency.

At each reporting date an entity must translate all foreign currency items into the functional currency. The rate which must be used depends on the type of item (for example, foreign currency monetary items are translated using the closing rate).

## Recognition

Initially:

- Apply spot exchange rate to foreign currency amount at transaction date

Subsequent

- Foreign currency monetary items at closing rate
- Nonmonetary items measured at historical cost translated at transaction date
- Nonmonetary items at fair value or current operational vlaue translated at date when fair value or current operational value measured.

A foreign currency transaction is recorded, on initial recognition in the functional currency, by applying to the foreign currency amount the spot exchange rate between the functional currency and the foreign currency at the date of the transaction.

The date of a transaction is the date on which the transaction first qualifies for recognition in accordance with IPSASs. For practical reasons, a rate that approximates the actual rate at the date of the transaction is often used, for example, an average rate for a week or a month might be used for all transactions in each foreign currency occurring during that period. However, if exchange rates fluctuate significantly, the use of the average rate for a period is inappropriate.

## Exchange Differences

- Monetary items – recognize differences in surplus/deficit
- Nonmonetary item – recognize where related gain/loss recognized – net assets/ equity or surplus/deficit
- Monetary item part of foreign operations – surplus/deficit of separate financial statements.

Exchange differences arising on settlement of monetary items and on translation of monetary items at a rate different from when initially recognized are generally recognized in surplus or deficit. However, exchange differences arising from monetary items that form part of the reporting entity's net investment in a foreign operation are recognized in a separate component of net assets/equity in the consolidated financial statements (and subsequently recognized in surplus or deficit on disposal of that net investment).

## Disclosure

- Exchange differences recognized in surplus/deficit
- Net exchange differences on net assets/equity
- Change in functional currency

## Questions and Discussion

Visit the IPSASB webpage

http://www.ipsasb.org

That concludes our module on foreign exchange. Participants should refer to the review questions to test themselves on their knowledge.

# Review Questions

## Question 1

**Which of the following describes the rate to be used when initially recognizing a foreign exchange transaction?**

a) The average exchange rate for the year

b) The spot rate at the transaction date

c) The spot rate at the end of the reporting period.

## Question 2

**Which items are subsequently measured at the closing rate?**

**a)** Foreign currency monetary items

**b)** Nonmonetary items measured at historical cost

**c)** Nonmonetary items measured at fair value or current operational value

# Answers to Review Questions

## Question 1

### The answer is (b), the spot rate at the transaction date

Foreign exchange transactions are recognized using the spot rate at the transaction date, not the reporting date. While an average rate may be used where rate that approximates the actual rate at the date of the transaction, the use of an annual average is not appropriate.

## Question 2

### The answer is (a), foreign currency monetary items.

Nonmonetary items measured at historical cost are translated at transaction date. Nonmonetary items measured at fair value or current operational value are translated at the date at which the fair value or current operational value was measured.

# Non-Current Assets Held for Sale and Discontinued Operations

# Non-Current Assets Held for Sale and Discontinued Operations IPSAS 44

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

IPSAS 44, *Non-Current Assets Held for Sale and Discontinued Operations*, provides guidance on the classification, presentation, and measurement of non-current assets held for sale and discontinued operations.

## Scope

- Classification and presentation requirements apply to all non-current assets and disposal groups
- Measurement requirements apply to all non-current assets and disposal groups except:
  - Assets arising from employee benefits (IPSAS 39, *Employee Benefits*)
  - Financial assets within the scope of IPSAS 41, *Financial Instruments*
  - Investment property measured at fair value (IPSAS 16, *Investment Property*)
  - Agriculture assets measured at fair value less costs to sell (IPSAS 27, *Agriculture*)
  - Deferred tax assets or groups of insurance contracts (relevant international or national standards)

The measurement requirements in IPSAS 44 apply to all non-current assets and disposal groups except those listed above. Those assets to which the measurement requirements of IPSAS 44 do not apply are measured in accordance with the relevant Standard, which are detailed above. For example, financial assets are measured in accordance with IPSAS 41 rather than IPSAS 44. For deferred tax assets and assets from insurance contracts, where there is no IPSAS that covers these transactions, the relevant international standards (that is, IFRS) or national standards are applied in measuring the assets.

## Definitions: Non-Current Assets

- An entity shall classify an asset as a current asset when:
  - It expects to realize the asset, or intends to sell or consume it, in its normal operating cycle;
  - It holds the asset primarily for the purpose of trading;
  - It expects to realize the asset within twelve months after the reporting period; or
  - The asset is cash or a cash equivalent (as defined in IPSAS 2, Cash Flow Statements) unless the asset is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting period.
- A non-current asset is an asset that does not meet the definition of a current asset.

IPSAS 44 provides definitions of current and non-current assets. Assets that are classified as non-current assets in accordance with IPSAS 1, *Presentation of Financial Statements* should not be reclassified as current assets until they meet the criteria to be classified as held for sale in accordance with IPSAS 44. Assets of a class that an entity would normally regard as non-current but that are acquired exclusively with a view to resale shall not be classified as current unless they meet the criteria to be classified as held for sale in accordance with IPSAS 44. The distinction between current and non-current items is covered earlier in this module.

## Definition: Disposal Groups

- A disposal group is a group of assets to be disposed of, by sale or otherwise, together as a group in a single transaction, and liabilities directly associated with those assets that will be transferred in the transaction.
- The group includes goodwill acquired in a public sector combination if the group is a cash generating unit to which goodwill has been allocated in accordance with the requirements of IPSAS 26, *Impairment of Cash-Generating Assets* or if it is an operation within such a cash generating unit.

Sometimes an entity disposes of a group of assets, possibly with some directly associated liabilities, together in a single transaction. These groups of assets and liabilities are referred to as disposal groups.

A disposal group may be a group of cash-generating units, a single cash-generating unit, or part of a cash-generating unit. The group may include any assets and any liabilities of the entity, including current assets, current liabilities and assets to which the measurement requirements of IPSAS 44 do not apply (see Scope above).

## Classification of Non-current Assets (or Disposal Groups) as Held for Sale

- **An entity shall classify a non-current asset (or disposal group) as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use.**
- Criteria to be classified as held for sale:
    - Carrying amount will be recovered principally through sale rather than continuing use
    - Asset must be available for immediate sale
    - Sale is highly probable

The key principle in determining whether an asset (or disposal group) meets the criteria to be classified as held for sale is that the carrying amount of the asset will be recovered principally through as commercial sale rather than through the continuing use of the asset.

For this to be the case, the asset (or disposal group) must be available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets (or disposal groups) and its sale must be highly probable.

## Sale is Highly Probable:

- For the sale to be highly probable:
  - Appropriate level of management must be committed to a plan to sell the asset (or disposal group)
  - Active program to locate a buyer and complete the plan must have been initiated
  - Asset (or disposal group) must be actively marketed for sale ata price that is reasonable in relation to its current fair value
  - Sale should be expected to qualify for recognition as a completed sale within one year from the date of classification

For the sale to be highly probable (which IPSAS 44 defines as "significantly more likely than probable"), management must be committed to a plan to sell the asset, and an active program to locate a buyer and complete the plan must have been initiated.

The asset must be actively marketed for sale at a price that is reasonable in relation to its current fair value. In addition, the sale should be expected to qualify for recognition as a completed sale within one year from the date of classification, and actions required to complete the plan should indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn.

The probability of owners' approval (if required in the jurisdiction) should be considered as part of the assessment of whether the sale is highly probable.

Events or circumstances may sometimes extend the period to complete the sale beyond one year. Such an extension does not preclude an asset from being classified as held for sale if the delay is caused by events or circumstances beyond the entity's control and there is sufficient evidence that the entity remains committed to its plan to sell the asset.

Appendix A of IPSAS 44 provides further detailed guidance on the circumstances that could give rise to an extension of the period required to complete a sale without affecting the classification as held for sale.

## Examples of Assets Not Classified as Held for Sale

- Idle or surplus assets
- Abandoned assets
- Transferred assets
- Service concession assets

The examples listed above are not classified as held for sale because the assets do not meet the criteria to be so classified. This is because:

- Idle or surplus assets: Public sector entities often have assets that are idle or surplus to its needs, but which the entity does not plan to sell. Such assets are not classified as held for sale, as the carrying amount will not be primarily recovered from a sale. In addition, such assets may not be immediately available for sale, and a sale will not be highly probable.
- Abandoned assets: IPSAS 44 specifically excludes abandoned assets from being classified as held for sale because the carrying amount of such assets will, again, not be recovered through a sale.

- Transferred assets: Non-current assets transferred between different public sector entities are not classified as held for sale because the carrying amount of the assets in not recovered through a sale. However, where a public sector entity has made an asset available for sale on commercial terms, and the prospective purchaser is another public sector entity, the asset would be classified as held for sale.
- Service concession assets: An operator may use the grantor's assets to deliver public services in accordance with the terms of a service concession arrangement (see Module 2). The carrying amount of these assets is recovered through their continuing use not through a sale, and the assets are therefore not classified as held for sale.

In some cases, a non-current asset (or disposal group) may be classified as held for distribution to owners, for example from a controlled entity to a controlling entity. A non-current asset is classified as held for distribution to owners when the entity is committed to distribute the asset to the owners. For this to be the case, the assets must be available for immediate distribution in their present condition and the distribution must be highly probable.

## Measurement of Non-Current Assets Classified as Held for Sale

- Immediately prior to classification as held for sale, measured in accordance with applicable IPSAS:
    - Historical cost model – update for depreciation and impairment to date
    - Current value model – revalue assets at date of classification
- After classification as held for sale
    - Measured at lower of carrying amount and fair value less costs to sell – impairment losses recognized for any write-down to fair value less costs to sell
    - Asset is no longer depreciated or amortized

Immediately before the initial classification of the asset (or disposal group) as held for sale, the carrying amounts of the asset (or all the assets and liabilities in the group) shall be measured in accordance with applicable IPSAS.

This means that, for assets measured at historical cost, depreciation or amortization up to this date should be charged, along with any impairment.

For assets held using a current value model, the asset should be revalued immediately before the classification of the asset as held for sale. Individual IPSAS set out the revaluation requirements and the measurement basis to be used.

After the asset is classified as held for sale, it is measured at the lower of its carrying amount and fair value less costs to sell. If an asset needs to be written down to its fair value less costs to sell, the entity will need to recognize an impairment loss as an expense at the date that the asset is classified as held for sale. Assets classified as held for distribution to owners are measured on the same basis

Once an asset has been classified as held for sale (or for distribution to owners), no further depreciation or amortization is charged. If the value of the asset has decreased at the reporting date, this will be reflected in its fair value less costs to sell.

Specific measurement requirements apply to newly acquired assets that meet the criteria to be classified as held for sale. This may occur where assets that are surplus to requirements are acquired in a public sector combination (see IPSAS 40, *Public Sector Combinations* and Module 7), whether the combination is an acquisition or an amalgamation.

If a newly acquired asset (or disposal group) meets the criteria to be classified as held for sale, the asset (or disposal group) is measured on initial recognition at the lower of what its carrying amount would have been had not been classified as held for sale (for example, cost) and fair value less costs to sell. Hence, if an asset is acquired as part of a public sector acquisition, it is measured at fair value less costs to sell. If an asset is acquired as part of a public sector amalgamation, it is measured at the lower of its carrying amount and fair value less costs to sell.

## Presentation and Disclosure of Non-Current Assets Classified as Held for Sale

- Non-current assets (or a disposal group) held for sale are presented separately from other assets in the statement of financial position
- If there are liabilities, these are also presented separately from other liabilities
- These assets and liabilities are not offset
- Where assets held for sale are measured at their carrying amount, the fair value of such assets is disclosed where this is materially different from the carrying amount

An entity should present a non-current asset classified as held for sale (and the assets of a disposal group classified as held for sale) separately from other assets in the statement of financial position. The liabilities of a disposal group classified as held for sale should be presented separately from other liabilities in the statement of financial position. Those assets and liabilities must not be offset and presented as a single amount. The major classes of assets and liabilities classified as held for sale should be separately disclosed either in the statement of financial position or in the notes.

If the disposal group is a newly acquired controlled entity that meets the criteria to be classified as held for sale on acquisition, disclosure of the major classes of assets and liabilities is not required.

An entity should not reclassify or re-present amounts presented for non-current assets or for the assets and liabilities of disposal groups classified as held for sale in the statements of financial position for prior periods.

IPSAS 44 requires information about the fair value of assets (and any liabilities) held for sale. The following disclosures are required whether the assets and liabilities are measured at fair value, or where the assets and liabilities are measured on a different basis, but the fair value is required to be disclosed.

a) The fair value measurement at the end of the reporting period, and the reasons for the measurement (assets and liabilities measured at fair value only).

b) The level of the fair value hierarchy within which the fair value measurements are categorized in their entirety (Level 1, 2 or 3). See IPSAS 46, Measurement and Module x for details of the fair value hierarchy.

c) For fair value measurements categorized within Level 2 and Level 3 of the fair value hierarchy, a description of the measurement technique(s) and the inputs used in the fair value measurement. For fair value measurements categorized within Level 3 of the fair value hierarchy, an entity shall provide quantitative information about the significant unobservable inputs used in the fair value measurement (quantitative information is not required for assets and liabilities not measured at fair value).

d) For fair value measurements categorized within Level 3 of the fair value hierarchy, a description of the valuation processes used by the entity (assets and liabilities measured at fair value only).

e) For fair value measurements, if the highest and best use of a non-financial asset differs from its current use, an entity shall disclose that fact and why the non-financial asset is being used in a manner that differs from its highest and best use.

## Definitions: Discontinued Operations

- A **discontinued operation** is a component of an entity that either has been disposed of or is classified as held for sale and:
  - Represents a separate major operation or geographical area of operations;
  - Is part of a single coordinated plan to dispose of a separate operation or geographical area of operations; or
  - Is a controlled entity acquired exclusively with a view to resale
- A **component of an entity** comprises operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity.

Where non-current assets have been disposed of or are classified as held for sale, this may impact the financial performance of the entity in future periods. This is likely to be the case where the assets are part of a disposal group and are associated with operations that being disposed of as part of the same transaction. Information about the likely effect in future periods is useful information for users of the financial statements. Consequently, IPSAS 44 requires the entity to distinguish between continuing operations and discontinued operations. The definitions above describe this distinction.

## Presenting Discontinued Operations

- An entity shall disclose:
  - A single amount for all discontinued operations in the statement of financial performance
  - An analysis of this amount in either the statement of financial performance or in the notes
  - The net cash flows attributable to the operating, investing and financing activities of discontinued operations in either the cash flow statement or the notes
  - The amount of revenue from continuing operations and from discontinued operations attributable to owners of the controlling entity in either the statement of financial performance or in the notes

An entity that has discontinued operations should disclose:

a) A single amount in the statement of financial performance comprising the total of:

   (i) The post-tax surplus or deficit of discontinued operations; and

   (ii) The post-tax gain or loss recognized on the measurement to fair value less costs to sell or on the disposal of the assets or disposal group(s) constituting the discontinued operation.

b) An analysis of that single amount into:

   (i) The revenue, expenses and pre-tax surplus or deficit of discontinued operations;

   (ii) The related income tax expense as required by the relevant international or national accounting standard dealing with income taxes;

   (iii) The gain or loss recognized on the measurement to fair value less costs to sell or on the disposal of the assets or disposal group(s) constituting the discontinued operation; and

(iv) The related income tax expense as required by the relevant international or national accounting standard dealing with income taxes.

c) The net cash flows attributable to the operating, investing and financing activities of discontinued operations. These disclosures may be presented either in the notes or in the financial statements. These disclosures are not required for disposal groups that are newly acquired controlled entities that meet the criteria to be classified as held for sale on acquisition.

d) The amount of revenue from continuing operations and from discontinued operations attributable to owners of the controlling entity. These disclosures may be presented either in the notes or in the statement of financial performance.

These disclosures should be represented for prior periods presented in the financial statements so that the disclosures relate to all operations that have been discontinued by the end of the reporting period for the latest period presented.

## Extract from Statement of Financial Position

| | 20X2 | 20X1 |
|---|---|---|
| Surplus/(deficit) for the period from continuing operations | X | X |
| Discontinued operations | | |
| Surplus for the period from discontinued operations | X | X |
| Surplus for the period | X | X |
| Attributable to: | | |
| Owners of the controlling entity | | |
| Surplus for the period from continuing operations | X | X |
| Surplus for the period from discontinued operations | X | X |
| Surplus for the period attributable to owners of the controlling entity | X | X |
| Non-controlling interests | | |
| Surplus for the period from continuing operations | X | X |
| Surplus for the period from discontinued operations | X | X |
| Surplus for the period attributable to non-controlling interests | X | X |
| | X | X |

This extract from the statement of financial position illustrates some of the additional line items that are required when presenting discontinued operations.

## Questions and Discussion

Visit the IPSASB webpage

http://www.ipsasb.org

That concludes our module on non-current assets held for sale and discontinued operations. Participants should refer to the review questions to test themselves on their knowledge.

# Review Questions

## Question 1

A property owner is unable to pay the taxes it owes to a government, and agrees to transfer a property (land and buildings) to the government in lieu of the taxes owed. The government intends to sell the property once it has completed renovations to increase the property's sale value.

**Should the government classify the property as held for sale?**

## Question 2

A municipality determines that a property is surplus to requirements and puts in place a plan to sell the property. The property satisfies the criteria to be classified as held for sale.

Immediately prior to being classified as held for sale, the carrying amount of the property was CU135,000. The fair value of the property was CU140,000, with estimated costs to sell being CU10,000.

**At what value should the municipality measure the property at the point that it is classified as held for sale?**

# Answers to Review Questions

## Question 1

### The property should *not* be classified as held for sale.

There is a delay in the timing of the sale of the property imposed by the government (the period during which renovations will be carried out. This demonstrates that the property is not available for immediate sale, and that the criteria for being classifed as held for sale are not met.

It is likely that the property will meet the criteria to be classified as held for sale once the renovations are complete.

## Question 2

### At the point that it is classified as held for sale, the property should be measured at CU130,000

After being classified as held for sale, assets are measured at the lower of carrying amount and fair value less costs to sell. The carrying amount of the property (CU135,000) is greater than the fair value less costs to sell (CU140,000 less CU10,000 = CU130,000), and the property is therefore measured at fair value less costs to sell, that is at CU130,000.

Impairment losses are recognized for any write-down to fair value less costs to sell. The municipality will therefore recognize an impairment expense of CU5,000 when it remeasures the property following its classification as held for sale.

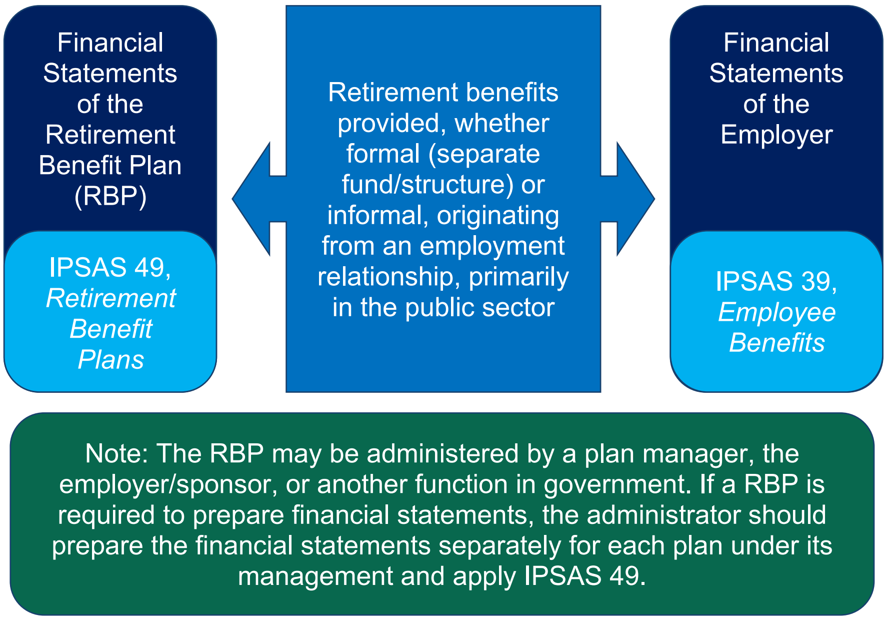
# Retirement Benefit Plans

# Retirement Benefit Plans IPSAS 49

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

*IPSAS 49, Retirement Benefit Plans*, provides guidance on the presentation of financial statements of retirement benefit plans as separate reporting entities..

## IPSAS 49 and IPSAS 39




IPSAS 49 applies to the financial statements of retirement benefit plans as separate reporting entities, unlike IPSAS 39, *Employee Benefits*, that applies to the financial statements of employers. This difference affects the recognition, measurement and presentation requirements. For example, an employer's obligations under a defined contribution plan usually end with the payment of the contribution to the plan, whereas the plan will have an obligation to pay contributions and investment income to plan participants at a later date, and will therefore report a liability in respect of the contributions received.

Some entities will administer a number of retirement benefit plans. Because IPSAS 49 considers each plan to be a separate reporting entity, these administrators will need to prepare the financial statements for each retirement benefit plan.

## Objective

- The objective of IPSAS 49 is to prescribe the accounting and reporting requirements for public sector retirement benefit plans, which provide retirement benefits to public sector employees and other eligible participants
- Some public sector retirement benefit plans may also be open to participants working in the same field in the private sector (e.g., teachers in private sector schools)

IPSAS 49 deals with retirement benefits for public sector employees and other participants who are eligible to join the plan.

Public sector retirement benefit plans provide retirement benefits to public sector employees and other eligible participants. It is important for accountability and transparency that these plans provide information about their activities, their obligations to the plan participants, and the resources that are available to them to meet these obligations. This information is useful to plan participants and, in the case of defined benefit schemes, the employers/sponsors who would have to make good any difference between the obligations and the resources available to meet those obligations.

## Objective of Different Types of Plan

- Retirement benefit plans are normally described as either defined benefit plans or defined contribution plans
  - Plans that contain characteristics of both (hybrid plans) are treated as defined benefit plans by IPSAS 49
- The objective of reporting by a defined contribution plan is to provide information about the plan and the performance of its investments
- The objective of reporting by a defined benefit plan is to provide information about the financial resources and activities of the plan that is useful in assessing the relationship between the accumulation of resources (where the defined benefit plan is funded) and plan benefits over time and, in particular, the extent of any deficits

Retirement benefit plans usually come in one of two forms.

**Defined contribution plans** are, for the purposes of IPSAS 49, defined as "*retirement benefit plans under which amounts to be paid as retirement benefits are determined by contributions to a fund together with investment earnings thereon.*"

Under a defined contribution plan, the amount of a participant's future benefits is determined by the contributions paid by the employer/sponsor, the participant, or both, and the operating efficiency and investment earnings of the fund. An employer's/sponsor's obligation is usually discharged by contributions to the fund. Therefore, any investment risk typically falls on the participant.

The objective of reporting by a defined contribution plan is to provide information about the plan and the performance of its investments. That objective is usually achieved by providing financial statements that include the following:

- The recognition of the defined contribution obligation;
- A description of significant activities for the period and the effect of any changes relating to the plan, and its membership and terms and conditions;
- Statements reporting on the transactions and investment performance for the period and the financial position of the plan at the end of the period; and
- A description of the investment policies.

**Defined benefit plans** are, for the purposes of IPSAS 49, defined as "*retirement benefit plans other than defined contribution plans.*" This includes hybrid plans, which are retirement benefit plans that contain characteristics of both defined benefit plans and defined contribution plans.

A defined benefit plan is a retirement benefit plan under which amounts to be paid as retirement benefits are typically determined by reference to a formula usually based on participants' earnings and/or years of service. The extent of the obligation for future retirement benefits is determined by the measurement of the promised retirement benefits and not by the level of contributions.

Defined benefit plans may be funded or unfunded. For funded plans, benefits are paid from plan investments, and where a shortfall arises, the employer/sponsor has a legal or constructive obligation to provide for the additional promised benefits.

For unfunded plans, such as those established on a pay-as-you-go basis, all benefits payable will be financed from, for example, general taxation.

Because the employer/sponsor is required to make good any shortfall, any investment risk typically falls on the employer/sponsor.

The objective of reporting by a defined benefit plan is to provide information that is useful in assessing the relationship between the accumulation of resources (where the defined benefit plan is funded) and plan benefits over time and, in particular, the extent of any deficits. This objective is usually achieved by providing financial statements that include the following:

- The recognition of the actuarial present value of promised retirement benefits (and for hybrid plans, the defined contribution obligation);
- Actuarial information about the retirement benefit obligations, including the measurementbasis;
- A description of significant activities for the period and the effect of any changes relating to the plan, and its membership and terms and conditions;
- Statements reporting on the transactions and investment performance for the period and the financial position of the plan at the end of the period;
- A description of the investment policies; and
- How a pay-as-you-go retirement benefit plan obligation is funded.

## Scope

- Applies to the financial statements of retirement benefit plans
  - Also known as 'pension schemes', 'superannuation schemes' or 'retirement benefit schemes'
  - Does not deal with other forms of employment benefits
- Retirement benefit plan is regarded as a reporting entity separate from the employers of the participants in the plan.
- IPSAS 49 deals with accounting and reporting requirements for the plan for all participants as a group (i.e., general purpose reporting)
  - Does not deal with reports to individual participants about their retirement benefit rights

IPSAS 49 does not deal with other forms of employment benefits, such as employment termination payments, deferred compensation arrangements, long-service leave benefits, special early retirement or redundancy plans, health and welfare plans or bonus plans.

Government social security arrangements are also excluded from the scope of IPSAS 49. Social security arrangements that involve the payment of cash transfers will usually meet the definition of a social benefit, which is covered by IPSAS 42, *Social Benefits*. Social security arrangements that involve the transfer of goods or services will usually meet the definition of individual services, which are covered in IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*. Social benefits and individual services are both covered in Module 5, *Expenses*.

IPSAS 49 covers the information to be provided in a retirement benefit plan's financial statement, that is in general purpose financial reporting. It does not, therefore, deal with reports to individual participants.

IPSAS 49 applies to all retirement benefit plans, whether or not they require the creation of separate funds, (which may or may not have separate legal identity and may or may not have trustees) to which contributions are made and from which retirement benefits are paid.

Retirement benefit plans with assets invested with insurance companies are within the scope of IPSAS 49 unless the contract with the insurance company is in the name of a specified participant or a group of participants and the retirement benefit obligation is solely the responsibility of the insurance company (in which case, the insurance company would, in substance, be administering a retirement benefit plan for each participant or groups of participants).

## Recognition

- **Defined benefit plans:**
  - Retirement benefit obligations owed to participants are recognized in the statement of financial position as a provision for the actuarial present value of the promised retirement benefits
- **Defined contribution plans:**
  - Retirement benefit obligations owed to participants are recognized in the statement of financial position as defined contribution obligations.

**Actuarial present value of promised retirement benefits** is "*the present value of the expected payments by a retirement benefit plan to participants attributable to service, as employees, already rendered.*"

**Defined contribution obligations** are "*the amounts owed to participants under the terms of a defined contribution plan.*"

Hybrid plans will need to recognize both defined benefit retirement benefit obligations and defined contribution obligations.

Retirement benefit plans will also need to recognize the asset that they hold. IPSAS 49 does not specify the recognition requirements for assets; retirement benefit plans will apply other IPSAS in recognizing these assets. A retirement benefit plan should apply all other IPSAS in preparing its financial statements, except where these other IPSAS are superseded by the requirements of IPSAS 49.

## Measurement

- **Valuation of Plan Investments**
  - Retirement benefit plan investments are measured at fair value
- **Actuarial Present Value of Promised Retirement Benefits**
  - The actuarial present value of promised retirement benefits for defined benefit plans should be based on the benefits promised under the terms of the plan on service rendered to date using projected salary levels
  - If an actuarial valuation has not been prepared at the date of the financial statements, the most recent actuarial valuation, updated for any material transactions and material changes in circumstances, should be used

The term 'plan assets' is an overarching term for all assets of the retirement benefit plan. Plan investments are a subset of plan assets and are those assets that are required specifically for their investment potential to fund payment of retirement benefit obligations.

IPSAS 49 requires all plan investments to be measured at fair value. Any plan investments that are financial instruments shall be measured at fair value in accordance with IPSAS 41, *Financial Instruments*. Other plan investments shall be measured at fair value in accordance with the applicable IPSAS (e.g., IPSAS 16, *Investment Property*). The requirement to measure plan investments at fair value removes the option permitted under some other IPSAS to measure these assets on a different basis. For example, the option in IPSAS 16 to measure investment property at historical cost is not permitted for plan investments. Where actuarial valuations are not prepared each year, and the most recent actuarial valuation needs to be updated for any material transactions and material changes in circumstances, the changes are likely to include changes in market prices, interest rates, and expected inflation rate of projected salaries

Because a retirement benefit plan may have different risks and assumptions when compared to the employer/sponsor, an actuarial valuation may result in different valuations of the same defined benefit obligations for the retirement benefit plan and for the employer/sponsor.

For example, the discount rate applied by the employer/sponsor may differ from that of the retirement benefit plan as a result of different risks related to the employer/sponsor compared to the plan.

As a result, when the actuarial valuation performed for the employer/sponsor is used as a base for determining the obligation of the retirement benefit plan, it is likely that it will be necessary to make adjustments to reflect the retirement benefit plan's risks and assumptions.

## Presentation

- A retirement benefit plan, whether defined benefit or defined contribution, is required to present the following:
  - A statement of financial position
  - A statement of changes in net assets available for benefits
  - A cash flow statement
  - Notes to the financial statements
- A retirement benefit plan is also required to explain the changes in retirement benefit obligations to participants either by:
  - Presenting a statement of changes in retirement benefit obligations; or
  - Disclosing in the notes to the financial statements a reconciliation between the opening and closing retirement benefit obligation balances

IPSAS specifies the financial statements to be presented by a retirement benefit plan. These are different from the financial statements required by IPSAS 1, *Presentation of Financial Statements*, and the requirements of IPSAS 49 override the requirements of IPSAS 1 for retirement benefit plans.

The minimum required content of the financial statements is set out below. Additional lines should be presented where required to ensure the financial statements are understandable:

**Statement of Financial Position**

- Plan investments (suitably classified)
- Contributions receivable
- Other assets
- Benefits due and payable
- Any other liabilities excluding retirement benefit obligations to participants

- Net assets available for benefits
- Provision for actuarial present value of promised retirement benefits in a defined benefit plan
- Defined contribution obligation to participants
- Excess or deficit

This statements distinguishes between benefits due and payable and obligations for retirement benefits (both the provision for the defined benefit obligations and the defined contribution obligation). Benefits due and payable only include those amounts that are immediately payable. For example, it may represent a monthly defined benefit pension payment yet to be paid or a withdrawal from a defined contribution plan requested by the participant that is yet to be paid.

The statement of financial position presents the actuarial present value of promised retirement benefits and defined contribution obligation to plan participants below net assets available for benefits. This is intended to increase the transparency and accountability about retirement benefit plan obligations of public sector entities to participants by clearly showing the resources available to pay promised retirement benefits as well as the promised retirement benefits themselves.

**Statement of Changes in Net Assets Available for Benefits**

- Employer/sponsor contributions
- Participant contributions
- Investment income
- Other income
- Benefits paid or payable (analyzed, for example, as retirement, death and disability benefits, or lump sum payments)
- Transfers from and to other plans
- Administrative expenses
- Other expenses
- Taxes on income

Opening and closing balances of net assets available for benefits should be presented, with the movement analyzed into those items listed above that are applicable to the retirement benefit plan.

The structure of a retirement benefit plan – such as whether it is a defined benefit plan or defined contribution plan and whether it is funded or pay-as-you-go – may determine how contributions and benefits are accounted for.

Some retirement benefit plans account for contributions and benefits as revenue and expenses respectively, while others account for contributions and benefits as changes in liabilities to participants.

In some cases, the structure of retirement benefit plans might mean that a mixed approach is taken to accounting for contributions and benefits. Depending on the circumstances, the line items for contributions and benefits paid may need to be shown differently on the face of the statement of changes in retirement benefit obligations or in the disclosure of the reconciliation between the opening and closing retirement benefit obligation balances.

These differences in how contributions and benefits are accounted for explain why IPSAS 49 does not require retirement benefit plans to prepare a statement of financial performance.

**Cash Flow Statement**

A retirement benefit plan is required to prepare a cash flow statement, using the direct method, in accordance with IPSAS 2, *Cash Flow Statements*.

Use of the direct method is a requirement because the structure of the other financial statements makes it unlikely that an annual surplus or deficit will be reported, making the indirect method impracticable.

**Changes in Retirement Benefit Obligations**

Changes in retirement benefit obligations may be presented either as a financial statement or as a reconciliation in the notes to the financial statements. The statement or note should show the opening and closing balance of the retirement benefit obligations, with the changes analyzed between the following line items, where these are applicable to the retirement benefit plan:

- Amendments to the plan (e.g., changes in participant benefits)
- Changes in the nature of the plan (e.g., a merger with another plan)
- Participant benefits allocated to defined contribution participant accounts
- Net changes to defined benefit participant accrued benefits (e.g., actuarial movements)
- Employer/sponsor contributions
- Participant contributions
- Taxes on contributions
- Benefits paid
- Administration expenses

## Examples

The following examples show which items are likely to be applicable to different types of retirement benefit plans. In these examples:

- **IE 1** relates to a defined benefit plan where the contributions and benefits are treated as revenue and expenses.
- **IE 2** relates to a defined benefit plan where the contributions are treated as a liability and the benefits as a reduction in that liability.
- **IE 3** relates to a defined contribution plan where the contributions and benefits are treated as revenue and expenses.

### Statement of Financial Position

| | IE 1 (DB) | IE 2 (DB) | IE 3 (DC) |
|---|---|---|---|
| **Assets** | | | |
| Cash and cash equivalents | X | X | X |
| Plan investments (suitably classified) | X | X | X |
| Accrued interest and dividends receivable | X | X | X |
| Contributions receivable | X | X | X |
| Other assets | X | X | X |
| **Total Assets** | **X** | **X** | **X** |

| | | | |
|---|---|---|---|
| **Liabilities** | | | |
| Payables | X | X | X |
| Benefits due and payable | X | X | X |
| Income tax payable | X | X | X |
| Other liabilities | X | X | X |
| **Total liabilities excluding benefit obligations to participants** | **X** | **X** | **X** |
| **Net assets available for retirement benefits** | **X** | **X** | **X** |
| **Provision for the actuarial present value of promised retirement benefits** | **X** | **X** | **N/A** |
| **Defined contribution obligation** | **N/A** | **N/A** | **X** |
| Other reserves | X | X | X |
| **Excess or deficit of funding** | **X** | **X** | **X** |

The example above does not include a hybrid plan, which would report both a provision for the actuarial present value of promised retirement benefits and a defined contribution obligation.

## Statement of changes in net assets available for benefits

| | IE 1 (DB) | IE 2 (DB) | IE 3 (DC) |
|---|---|---|---|
| **Net assets available for benefits (beginning of year)** | **X** | **X** | **X** |
| **Investment earnings** | | | |
| Net change in fair value of plan investments | X | X | X |
| Interest revenue | X | X | X |
| Investment revenue | X | X | X |
| Dividend revenue | X | X | X |
| Other revenue | X | X | X |
| | **X** | **X** | **X** |

| | | | |
|---|---|---|---|
| **Contributions** | | | |
| Employer | X | X | X |
| Participant | X | X | X |
| Benefits accrued | X | X | N/A |
| Funding from sponsor | X | X | X |
| **Total increase in net assets available for benefits** | **X** | **X** | **X** |
| Benefits paid | X | X | X |
| Investment related expenses | X | X | X |
| Operational and administrative expenses | X | X | X |
| Other expenses | X | X | X |
| Tax on income | X | X | X |
| **Total decrease in net assets available for benefits** | **X** | **X** | **X** |
| Transfers to and from other plans | X | X | X |
| **Net increase/decrease in assets available for benefits** | **X** | **X** | **X** |
| **Net assets available for benefits (end of year)** | **X** | **X** | **X** |

## Statement of changes in retirement benefit obligations

| | IE 1 (DB) | IE 2 (DB) | IE 3 (DC) |
|---|---|---|---|
| **Retirement benefit obligations (beginning of year)** | **X** | **X** | **X** |
| **Contributions** | | | |
| Employer | N/A | X | X |
| Participant | N/A | X | X |
| Funding from sponsor | N/A | X | X |
| Transfers from other plans | X | X | X |
| Changes in actuarial assumptions | X | X | N/A |
| Benefits accrued | X | X | N/A |
| **Total increase in retirement benefit obligations** | **X** | **X** | **X** |
| Benefits paid | X | X | X |
| Transfers to other plans | X | X | X |
| Tax on contributions | N/A | X | X |
| **Total decrease in retirement benefit obligations** | **X** | **X** | **X** |
| **Retirement benefit obligations (end of year)** | **X** | **X** | **X** |

IPSAS 49 permits the information presented above in the statement of changes in retirement benefit obligations to be presented either in the statement shown or in the notes to the financial statements.

## Disclosures

- General information
  - Accounting policies
  - Basis of valuation including fair value disclosures
  - Etc.
- For defined benefit plans, details of the actuarial present value of promised retirement benefits
- Description of the plan

A retirement benefit plan, whether defined benefit or defined contribution, is required to disclose the following information in the notes to the financial statements:

- A summary of significant accounting policies
- A description of the plan and the effect of any changes in the plan during the period:
  - The name(s) of the employer(s)/sponsor(s) and the participant groups covered
  - The number of participants receiving benefits and the number of other participants, classified as appropriate;
  - The type of plan – defined contribution or defined benefit;
  - A note as to whether participants contribute to the plan;
  - A description of the retirement benefits promised to participants;
  - A description of any plan termination terms; and
  - Changes in the items above during the period covered by the financial statements
- The basis for the valuation of all plan assets, including fair value measurement disclosure per class of plan assets as required by the applicable IPSAS
- Details of any single investment exceeding either 5 percent of the net assets available for benefits or 5 percent of any class or type of security
- Details of any investment in the employer/sponsor
- Liabilities other than the provision for actuarial present value of promised retirement benefits or the defined contribution obligation to participants
- A description of the funding policy, including any obligations by the employer/sponsor to meet any actuarial determined shortfall in assets in a funded retirement benefit plan

A defined benefit plan shall also disclose the following information about the actuarial present value of promised retirement benefits:

- The actuarial present value of promised retirement benefits, distinguishing between vested benefits and non-vested benefits
- A description of the:
  - Significant actuarial assumptions made; and
  - Method used to calculate the actuarial present value of promised retirement benefits;
- The effect of any changes in actuarial assumptions that have had a significant effect on the actuarial present value of promised retirement benefits
- The date of the actuarial valuation and when the next valuation will be undertaken

## Questions and Discussion

Visit the IPSASB webpage

http://www.ipsasb.org

That concludes our module on retirement benefit plans. Participants should refer to the review questions to test themselves on their knowledge.

# Review Questions

## Question 1

**Which of the following financial statements is a retirement benefit plan required to present?**

a) A statement of financial position
b) A statement of financial performance
c) A statement of changes in net assets available for benefits
d) A statement of changes in retirement benefit obligations
e) A cash flow statement

## Question 2

"Retirement benefit obligations owed to participants are recognized in the statement of financial position as a provision for the actuarial present value of the promised retirement benefits."

**The sentence above explains the requirements for what type of retirement benefit plan?**

## Question 3

**Is the following sentence True or False?**

A retirement benefit plan should always measure all of its plan assets at fair value.

# Answers to Review Questions

## Question 1

### The answer is a), c) and e)

A retirement benefit plan is required to present a statement of financial position, a statement of changes in net assets available for benefits and a cash flow statement.

IPSAS 49 does not require a retirement benefit plan to prepare a statement of financial performance. A retirement benefit plan ***may*** prepare statement of changes in retirement benefit obligations, but it is also permitted to disclose this information in the notes to the financial statements rather than in a statement.

## Question 2

### The answer is a defined benefit plan.

The requirements for a defined contribution plan are that retirement benefit obligations owed to participants are recognized in the statement of financial position as defined contribution obligations.

Some retirement benefit plans are hybrid schemes, and will therefore recognize both a provision for the actuarial present value of the promised retirement benefits and a defined contribution obligation.

## Question 3

### The answer is False.

IPSAS 49 requires retirement benefit plans to measure their plan investments – those assets that are required specifically for their investment potential to fund payment of retirement benefit obligations – at fair value. However, other plan assets, for example the offices and computers used in administering the plan are required to be measured in accordance with other IPSAS. In many cases, these assets will not be measured at fair value; for example property, plant and equipment might be measured at historical cost.