International Public Sector Accounting Standards

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INTRODUCTION

International Public Sector Accounting Standards (IPSAS) are financial measurement and reporting rules recommended for adoption by governments around the world and are promulgated by the Public Sector Committee (PSC) of the International Federation of Accountants (IFAC).

Government officials should care about IPSAS for practical reasons. Their governments are directly or indirectly urged to consider adopting IPSAS. If a country already has government accounting standards, convergence or harmonization with IPSAS is recommended. Scholars in public administration and public policy, especially those specializing in budgeting and financial management, would find IPSAS intriguing. International Public Sector Accounting Standards represent a new kind of government accounting that challenges the traditional superiority of budgeting over accounting in government, and the conventional notion that budgeting and financial management practices are government's own business.

After identifying the political and economic forces that have led to the emergence of IPSAS, the article describes the institutional structure and process for setting IPSAS. The standards are explained in nontechnical terms and commented upon. Implications for public administration are stated in the Conclusion.

POLITICAL AND ECONOMIC FORCES

The winds of democracy and market economy sweeping the globe during the last two decades have encouraged government accountability and transparency.[1] These two values are the foundation for the practice of accounting and auditing in the public sector. Even when it is narrowly and condescendingly regarded as glorified bookkeeping, accounting can still contribute to government fiscal accountability by requiring accurate financial recordkeeping of public money received and spent by government. The creation and preservation of such audit trails could deter corruption and graft—violations of elementary fiscal accountability.

The modern practice of government accounting is much more than financial recordkeeping. It can facilitate sound financial management by making sure that the budget is faithfully and efficiently executed through authorized transactions and effective government actions. In particular, financial accounting in government is the systematic process of identifying, recognizing, and measuring the financial consequences of these government transactions and actions. Up to this point, accounting, even at its best, is only an adjunct to administration: the information lies inside government. As such, the information helps the government manage its financial affairs, but it does not help stakeholders hold government accountable. Stakeholder groups include legislators and regulators; voters, taxpayers, and the general public; creditors and investors in government securities; employees and vendors; and grantors and donors. All these stakeholders provide economic and political resources to government, thereby acquiring the right or need to know its finances.

The contemporary interpretation of the scope of accounting extends to financial reporting, especially to those who have the political right to know and economic need to know and yet lack the authority and resources to demand information. Accounting thus has become both a product and an enforcement mechanism of democratic accountability in the political system and of economic reciprocity in a market economy. These are the values championed by Western democracies, and by the international institutions they support and dominate especially in the post-Cold War era. No matter how imperfect democracy is and how poorly the market economy work in a particular country, as normative ideals they have inspired what has been called "a global revolution in government accounting."[2]

The revolutionary thinking in government accounting has several key elements. 1) Governments should issue audited financial reports shortly after the end of a fiscal year. Most governments prepare budgets, but not all prepare and make public financial reports derived from their accounting systems to serve as a factual check on the budget. 2) Financial reports should not be limited to cash receipts and disbursements, but should report the government's economic resources and short- and long-term liabilities. This would be a major departure from the traditional cash budget.[3] Government accounting and reporting rules should be set by independent bodies and not by governments themselves. Year-end financial reporting on the organization as a whole on the accrual basis in accordance with generally accepted accounting principles (GAAP) is required of public and private institutions in the United States and developed countries in the British Commonwealth. The "global" dimension of the revolution reflects the influence of these countries on the international and financial institutions that provide financial and technical assistance to developing countries and those in transition to a market economy.

It is also the case that Anglo-American private-sector accountants and auditors have the tradition of involvement in government. The involvement takes several interrelated forms. Their professional bodies might be directly or indirectly involved in setting government accounting standards. They might appoint a technical committee, or cosponsor a standard-setting body. Or they might designate the authoritative bodies for promulgating GAAP. These principles are used by their members to evaluate the quality of financial statements in order to express audit opinions. When governments engage private-sector auditors to audit their financial statements, accounting professional groups have considerable leverage over governments. This relationship between the accounting/auditing profession and government is elevated to the international level in creating the mechanism for setting IPSAS.

STANDARD-SETTING INSTITUTION AND PROCESS

The IFAC is worldwide alliance of 156 accountancy bodies in nearly 120 countries.[3] The IFAC's PSC, with financial support of several international organizations, began a standards program in 1996 to promote government financial accountability and performance through better accounting and financial reporting.[4]

The committee currently (in the year 2004) has part-time members from Australia, Argentina, Canada, France, Germany, Israel, Japan, Malaysia, Mexico, the Netherlands, New Zealand, Norway, South Africa, the United Kingdom, and the United States. Before its current French chairman took office, the committee had been chaired by a Canadian, a New Zealander and an Australian. The committee has a small full-time staff and is assisted by the volunteer efforts of a large number of consultants and participants on its Consultative Group and Steering Committees for various technical projects.[5]

International Public Sector Accounting Standards are set through a due process. Research is undertaken and deliberations are held before tentative positions are adopted. Exposure drafts of proposed standards are disseminated to solicit the views of interested parties. These views are considered in revising and finalizing a standard. While the primary purpose of this process is to improve the quality of the standards, a side benefit is a greater understanding and support for the final standards and the institution for setting IPSAS in general. All the committee's documents are available online for free downloading.[6]

Financial support for the committee's standard-setting project has come from the International Monetary Fund, the World Bank, the United Nations Development Program, and the Asian Development Bank. Institutional collaboration, but not funding, is provided by a group of observers: the International Organization of Supreme Audit Institutions, Organization for Economic Cooperation and Development, International Accounting Standards Board, and the European Commission.[7]

The issue of IFAC/PSC's future was recently addressed by a review panel named by the IFAC and chaired by an external chairman. The panel has recommended that the committee be renamed the IPSAS Board and that it continue to develop additional standards.[7] Such a structure would require continued funding from organizations interested in increased quality of external reporting by governments. Since IPSAS have attributes of public goods, their production and dissemination will have to rely on the donors identified above. These organizations stand to benefit from reliable government financial data, and, if they choose, could require IPSAS be used in accounting for their loans and other forms of assistance.

INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARDS

As of August 2004, IPSAS consists of 20 standards: two on accounting measurement issues; nine on financial reporting issues; and ten dealing with specific transactions or items in financial statements.[5] These standards are highly technical and are almost impossible to understand without a working knowledge of financial accounting. As a whole, IPSAS are impossible to assess without examining their basic assumptions. Consequently, this section will state the essence of IPSAS without attempting to summarize individual standards (see Table 1 for key terms); it will also try to discern the premises underlying the standards.

The PSC believes that governments should prepare government-wide (consolidated) financial statements. These general-purpose statements are intended for users who lack the ability to request specific information. A complete set of financial statements would describe the government's financial position, financial performance, and cash flows. Comparisons with the budget are encouraged but not required. The reporting entity should encompass the entities owned and controlled by the government. Appropriate disclosures should be made about distinguishable segments within the government, as well as the government's financial relationships with other entities.

Table 1 Key terms in financial accounting and reporting

Financial reporting
Reporting entity: consists of one or more organizations whose finances are of interest to intended users of a financial report.
Financial statements: report the recognized effects of transactions and events, consisting of statements of financial position and of financial performance, and of cash flows.
Government-wide (or consolidated) financial statements: financial overview of the government as a whole, after eliminating the effects of internal transactions.
General-purpose external financial statements: intended to be the primary source of historical financial information to users outside of an entity, prepared with generally accepted accounting principles.
Financial report: financial statements and other financial disclosures.
Financial position: as of a particular date, an entity's net assets are its assets offset by its liabilities.
Financial performance: changes during a period in an entity's amount of net assets, as measured by revenues net of expenses.
Cash flows: sources and uses of cash from operating, financing, and investing activities.

Financial accounting measurement
Transactions: the primary source of financial accounting data, exchanges of economic considerations between two or more parties.
Events: a significant occurrence that has direct or indirect consequences to an entity.
Financial consequences: impacts on an entity's financial position and performance or cash flows.
Elements of financial statements: indicators of financial consequences and therefore major components of financial statements: assets, liabilities, revenues, and expenses.
Assets: range from cash to any economic resources capable of producing future benefits.
Liabilities: obligations to pay in cash or to provide services due to having received benefits.
Revenues: increases in assets (or decreases in liabilities) attributable to service efforts and accomplishments or government's power to tax.
Expenses: assets used or liabilities incurred in the course of generating revenues.
Realization: financial consequences having been confirmed by an actual transaction or event.
Recognition: the decision and action to formally acknowledge certain financial consequences in the accounts and financial statements.
Cash basis: measures financial performance in terms of cash receipts and disbursements.
Accrual basis: in contrast to cash basis, broadens revenue to include receivables (claims against customers or taxpayers) and expenses to include noncash resources used and incurrence of liabilities.
Matching: offsets revenues by related expenses to arrive at a net periodic measure of financial performance (i.e., income or loss).

The information in financial reports is produced by the financial accounting system of an entity. The primary function of financial accounting is to recognize and measure the financial consequences of past transactions of an entity and of the events that directly affect it. The consequences are measured by a number of financial variables. The accounting equation "assets minus liabilities equals net assets" describes financial position. Financial performance is measured by revenues and expenses, and therefore income or loss. The inclusion of noncurrent assets and liabilities is necessary to fairly portray a government's financial position at the end of the period. The accrual basis of accounting provides a more accurate measures of service effort and accomplishments than does the cash basis of accounting. The use of the accrual basis requires a complementary statement of cash flows from operations and investing and financing activities to show changes in the government's liquidity position.

The key terms in Table 1 and the above description are intended to help readers put the individual IPSAS in a better organized framework. The first three IPSAS describe the form and contents of the three financial statements that constitute general-purpose financial statements. After that, the sequence of the individual statements does not reveal any discernible pattern. As a remedy, Table 2 differentiates general and specific standards. The very small number of standards on the important topics of recognition and measurement is noticeable.

In addition to the standards in Table 2, in response to some countries' inability or reluctance to adopt the preferred accrual basis, a standard on how to account and reporting under the cash basis was also issued. This is, however, regarded as an interim measure since all countries are urged to move to the accrual basis, even though many conceptual issues and implementation obstacles remain.

Table 2 Structure of current IPSAS (number and issue date)

General recognition and measurement standards
• Revenue from exchange transactions (no. 9; 2001)
• The effects of changes in foreign current exchange rates (no. 4; 2000)
General reporting standards
• Presentation of financial statements (no. 1; 2000)
• Cash flow statements (no. 2; 2000)
• Consolidated financial statements and accounting for controlled entities (no. 6; 2000)
• Segment reporting (no. 18; 2002)
• Financial reporting of interests in joint ventures (no. 8; 2000)
• Related party disclosures (no. 20; 2002)
• Financial reporting in hyperinflationary economies (no. 10; 2001)
• Events after the reporting date (no. 14; 2001)
• Fundamental errors and changes in accounting policies (no. 3; 2000)
Standards on specific transactions and items
• Financial instruments: disclosure and presentation (no. 15; 2001)
• Accounting for investments in associates (no. 7; 2000)
• Inventories (no. 12; 2001)
• Investment property (no. 16; 2001)
• Property, plant, and equipment (no. 17; 2001)
• Lease (no. 13; 2001)
• Provisions, contingent liabilities and contingent assets (no. 19; 2002)
• Construction contrasts (no. 11; 2001)
• Borrowing costs (no. 5; 2000)
• Net surplus or deficits for the period (no. 3; 2000)

The standards in Table 2 are the products of Phase 1 of the PSC's standards program from 1996 to 2002. They are said to constitute a "core" set of IPSAS for public sector entities. This is an overstatement because those standards hardly address the core issues in government accounting. The core issues in government accounting have to do with the unique characteristics of government: the power to tax, the production of public goods, virtually limitless responsibility, unfathomable public property (at least in financial terms), and the disclosure of budgets prior to the fiscal year (a norm in Western countries).

If the standards are to be useful for developing countries and transitional economies, the standards would have to deal with issues that connect business and government. These concern the shifting boundaries between public and private sectors, the conversion of some public property to private property, government subsidies for state-owned enterprises, government assumption of debts of failing or failed enterprises, etc. The list can go on. These are not easy and technical accounting issues, because the institutional mechanisms for defining and enforcing legal and contractual rights and obligations are either weak of nonexistent. Precisely for this reason, the research and development of accounting standards could be instrumental in reinforcing the political, economic, and institutional infrastructure of accountability.

Phase 2 of the PSC's standards program from 2002 to 2005 is addressing some of the issues unique to the public sector. These include: 1) whether and how budgetary information should be included in financial statements; 2) nonreciprocal revenues, such as taxes, grants, and transfers; 3) social policy commitments, such as social insurance; 4) assistance to developing countries; 5) heritage assets; and 6) public-/private-sector construction/financing arrangements. [4,5] Information about the current status of these projects as well as the committee's activities is available from the Internet (www.ifac.org).

The structure and contents of the first 20 IPSAS are based on several assertions. First and foremost is the belief that it is possible and desirable to have a single set of financial accounting and financial reporting standards for both business and government. Even though terms like convergence and harmonization are used, in practice, the current IPSAS are modest adaptations of business accounting and financial reporting standards promulgated by the International Accounting Standards Committee (now Board). Second, the PSC, being an international professional group, should focus on external financial reporting by government. By implication, compliance with legal, budgetary, and contractual requirements and support for financial management are outside of the PSC's concern. Third, it is appropriate to take the incremental approach by setting IPSAS one by one; a conceptual framework is in effect regarded as a luxury not as a necessity. These are debatable points. One might argue on the contrary that: there are numerous and critical differences between government and business; a government accounting systems have both internal and external missions; and a conceptual framework is essential for ensuring coherent and consistent standards.[1,8]

CONCLUSIONS

International Public Sector Accounting Standards are in essence the worldwide accounting profession's advice to governments on how to report to the public and other external parties. Based on the premise that government accounting should be as similar to business accounting as possible, they reflect Anglo-American thinking and practice. As such, the United States and developed nations in the British Commonwealth already comply with the spirit, if not the letters, of IPSAS. Other developed nations may, but do not have to, adopt IPSAS unless they are persuaded as to the merits of these standards. However, developing countries now do not have such discretion. According to the IFAC, the World Bank has accepted IPSAS for preparing financial reports on activities financed by the bank.[5] If other international donors and lending institutions follow the World Bank precedence and begin to require IPSAS, developing countries will have to consider whether to embrace IPSAS as government-wide accounting rules.

Such a decision will not be easy, in part because IPSAS are still a work in progress: standards addressing unique government issues are still being formulated. If the PSC continues to use the incremental approach, individual standards will be issued over a long period of time. Changing government accounting systems to comply with IPSAS will predictably be a prolonged and costly process. Budget directors and chief administrators responsible for approving and justifying the costs to legislatures may soon be asking: what price is more, even if better, accounting? While it is laudable to demonstrate external accountability to external users with financial statements, should not more resources be devoted to forward-looking planning and real-time financial control system? Answers to these questions may be too important to be left to accountants. It behooves public administrators and legislators to monitor and participate in the development of national and international government accounting standards.

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