

# IPSAS: Conceptual and Institutional Issues

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# Major Issues to be Addressed

- In what general ways should IPSAS be similar to – and different from – International Financial Reporting Standards (IFRS)?
- How should the uniqueness of government be addressed in IPSAS?
- Who sets, finances and enforces IPSAS?

# A Global Revolution in Government Accounting?

## An Introduction

# A Global Revolution in Government Accounting

- Recognition of importance of government accounting as an integral part of the **financial management infrastructure** of a government /nation.
- In response to demand for government **financial accountability** and **transparency** as an **international norm** demanded by donors and lenders.
- A consequence of spread of **democratization** and **market economy** since the late 1980s.

# Main Features of the Global Revolution in GA

- Business-type **accrual accounting** is proposed to replace cash accounting commonly used by government
- **Whole-of-government (consolidated) financial statements** at year-end are proposed to replace detailed budget execution reports
- These features are evident in **International Public Sector Accounting Standards (IPSAS)**

# International Public Sector Accounting Standards

## General Introduction

# International Public Finance Reporting Standards and Codes

- Financial reporting requirements in international treaties, agreements and contracts
- Government section of the UN and European System of National Accounts (SNA)
- International Monetary Fund (IMF) Government Finance Statistics (GFS)
- IMF Fiscal Transparency (FT)
- Organization for Economic Cooperation and Development (OECD) Budget Transparency

# What Is New and Different About IPSAS

- Professional recommendations (“standards”) for general -purpose external financial reporting by public sector entities world-wide
- IPSAS converge with IFRS unless public sector uniqueness requires a departure
- Set by a group of accounting experts under the auspices of IFAC – the global federation of national organizations of professional accountants and auditors
- IPSAS are endorsed by influential international donors and lenders
- Government are encouraged but not compelled by international treaty to adopt IPSAS



# Translation

- IPSAS is not set by government officials in their official capacity. Current and former officials participate in their individual **professional capacity**
- IPSAS is “**international**” in the sense that persons from several nations participate in the process, but IPSAS is not the result of official (governmental) agreements
- IPSAS has become ***de facto* global GA standards** by virtue of endorsement of powerful institutions

# Why the IPSAS Look the Way It Does

- So far, IPSAS is largely modest modification of business accounting and financial reporting standards set by the International [Business] Accounting Standards Board (**IASB**).
- **Business-like** standards are to be followed by standards dealing with unique public sector transactions and activities.
- The standards are written by accountants for accountants/auditors familiar with **business accounting**.

# Justification for the Strategy

- It is desirable to have comparability and uniformity in accounting for similar transactions in similar ways.
- It was an economical and efficient way of producing a set of “core” GA standards.
- Accrual-based business accounting standards already deal with many similar GA issues.
- Why “reinvent the wheel”?

Source: Sutcliffe (2003, p. 31).

# International Public Sector Accounting Standards

## Concepts and Structure

# The Principles Behind the Standards

- Government should issue financial reports to the public at the end of a fiscal year.
- At the core of a financial report are a set of financial statements, which are based mostly on actual transactions and activities, use the accrual basis and are presented in a consolidated format for the whole government.
- Accounting methods are chosen to achieve fair presentation in financial reports.

# Key Concepts in IPSAS

- **Reporting entity** is the whole of government as an economic/financial entity
- **Financial statements** describe financial position and financial performance measured by accrual basis, and cash flows
- Financial statements report mostly the **effects of past transactions and activities** that are acknowledged (“**recognized**”) in the accounts.

# Key Concepts in IPSAS

- **General-purpose external financial statements** should use accounting standards set by a body independent of the government, and should be examined by independent auditors.
- The **accrual basis** is preferable to the **cash basis** because accrual reflects the long-term financial consequences of past and current transactions and activities.

# Classifications of IPSAS

- Cash-basis and accrual basis: 1 vs. many
- Convergent with IFRS and **specific to the public sector**: many vs. few
- Classified by generality of topics
  - General recognition and measurement: few
  - General financial reporting: some
  - Specific transactions and items: numerous



# IPSAS: General Recognition and Measurement Standards

- Revenue from exchange transactions (No. 9)
- **Revenue from non-exchange transactions (taxes and transfers) (23<sup>rd</sup>)**
- The effects of changes in foreign current exchange rates (No. 4)

# IPSAS: General Reporting Standards

- Presentation of financial statements (1<sup>st</sup>)
- Cash flow statements (2<sup>nd</sup>)
- **... Budget information ... (24<sup>th</sup>)**
- Consolidated financial statements and accounting for controlled entities (6<sup>th</sup>)
- **Disclosure ... about General Government Sector (22<sup>nd</sup>)**
- Segment reporting (18<sup>th</sup>)
- ... Interest in joint ventures (8<sup>th</sup>)
- Related party disclosures (20<sup>th</sup>)

# IPSAS: General Reporting Standards

- Financial reporting in hyperinflationary economies (10<sup>th</sup>)
- Events after the reporting date (14<sup>th</sup>)
- Fundamental errors and changes in accounting policies (3<sup>rd</sup>)

# IPSAS: Specific Transactions and Financial Statement Elements

- Financial instruments ... (15<sup>th</sup>)
- ... Investments in associates (7<sup>th</sup>)
- Inventories (12<sup>th</sup>)
- Investment property (16<sup>th</sup>)
- Property, plant, and equipment (17<sup>th</sup>)
- **Impairment of non-cash-gen. assets (21<sup>st</sup>)**
- Impairment of cash-generating assets (26<sup>th</sup>)

# IPSAS: Specific Transactions and Financial Statement Elements

- Lease (13<sup>th</sup>)
- Provisions, contingent liabilities and contingent assets (19<sup>th</sup>)
- Construction contracts (11<sup>th</sup>)
- Borrowing costs (5<sup>th</sup>)
- Net surplus or deficit for the period (3<sup>rd</sup>)
- Employee benefits (25<sup>th</sup>)

# Exposure Drafts of Proposed Standards

- **... Service concession arrangements  
(comments due August 1<sup>st</sup>, 2008)**
- **Social benefits: disclosure of cash  
transfers to individuals and households  
(comments due July 15<sup>th</sup>)**

# Current Projects (May 2008)

- **Conceptual framework for general purpose financial reports of public sector entities**
- Review of cash-basis IPSAS
- Financial instruments
- **Fiscal sustainability of government programs and their financing**
- **Heritage assets**

# International Public Sector Accounting Standards

Standards on Issues  
Specific to Government



## No. 23 Revenues from Taxes and Transfers

- Transfers refer to fines, donations and debt forgiveness, and resources from other non-exchange transactions
- $\Delta \text{ Assets} - \Delta \text{ Liabilities} = \Delta \text{ Net Assets}$  recognized as revenue under accrual basis and measured at fair value
- Taxable event triggers potential resource flows.
- Definition of asset and liability is critical.

## No. 21 Impairment of Non-cash Generating Assets

- These are fixed assets held not for producing commercial benefits.
- Depreciation is recognized on fixed assets.
- **Impairment loss** is the decline in fair value beyond depreciation expense.
- The standard requires the recognition of loss due to impairment.

# No. 24 on Budget Information in Financial Statements

- Standard deals only with disclosure and assumes availability of budget information
- Disclosure includes:
  - Original & final budget (projected revenues and appropriations)
  - Actual amounts on the budgetary basis
  - Explanation of variances
  - Reconciliation of accrual and budgetary bases

## No. 22 Disclosure of General Government Sector

- Consolidated financial statements includes entities controlled by the reporting entity
- Some of these entities are financial and non-financial public corporations in the **General Government Sector (GGS)**
- The standards permits additional disclosures about GGS to clarify relationships

# Exposure Draft on Social Benefits

- **Social benefits** (such as public pensions) are not liabilities as currently defined, but are important enough to be disclosed outside of financial statements.
- Further research is conducted on their recognition and measurement, and on the disclosure of the **sustainability** of government programs and their financing.

# Research Project on Heritage Assets

- **Heritage assets** as a special kind of fixed assets, such as *Su Nuraxi*
- Heritage assets are owned and controlled by the reporting government
- Problems relate mostly to the availability and meaningfulness of **financial measures** of cost and economic value
- Non-financial disclosure is a likely option

# Consultation Paper on Service Concession Arrangements

- Service concession arrangements (SCA) enable a private-sector entity (operator) to deliver an asset, normally infrastructure, to government (grantor).
- A IPSAS would address the government's recognition of underlying assets and revenues, and the disclosure of risks and benefits.

# Conceptual Issues



# A List of Conceptual Issues

- The wisdom of setting standards before agreement on a conceptual framework.
- The wisdom of starting IPSAS by modifying existing international business accounting and financial reporting standards (IFRS)
- Accrual basis vs. cash basis
- Aggregated vs. disaggregated reporting
- Budgetary reporting and comparison in financial reports: yes or no; if yes, where and how

# Conceptual Framework

## Conceptual Issue 1

# A Conceptual Framework Project After Setting Many Standards

- Objectives of financial reporting
- Scope of financial reporting
- Qualitative characteristics of financial info.
- Characteristics of the reporting entity
- Definition and recognition of elements of financial statements
- Measurement
- Presentation and disclosure

# Problems With Accounting Conceptual Frameworks

- Research on conceptual framework is open-ended and time-consuming, and not of practical value.
- Conceptual frameworks are found not useful in making accounting policy choices.
- Conceptual frameworks are still needed to delineate the scope of standards and give general direction to standard setting.
- The way forward: commitment to an explicit theory, such as one based on accountability to specific stakeholders, so that accounting measures are derived from accountability requirements.

# No Coherent Standards Without Principles

- “User decision usefulness” a problematic conceptual framework.
- Disillusionment with conceptual frameworks in standard-setting: oversold and under-performed.
- Current fashion: principles-based standard setting.
- Question: What are the principles of government accounting?
- Answer: To be found case by case.
- Likely consequence: incoherent/inconsistent standards.

# Simple Government Accounting

## Principles: A Sample

- Prepare and publish budgets, maintain complete financial records, provide full disclosures, and submit to independent audits.
- Accurately measure the government's financial condition & performance.
- Measure cash and other financial consequences of transactions and events.
- Keep track of assets, liabilities, revenues, expenditures/expenses.
- Issue user-friendly financial reports.

# No Principles Without Theory

- Standards and principles are normative.
- Theory can be
  - Normative: how the world ought to work.
  - Positive: how the world works.
- Normative theory: accountability.
- Positive theory: organizational equilibrium.

# Demand for Accountability Leads to More/Better

## Accounting

- Global expansion of democracy and market economy fosters the **norm of reciprocity**.
- Government incurs **political and economic accountability**.
- **Accounting information is used to monitor and enforce terms of political and economic exchanges.**



# Political Exchanges in Constitutional Government

- Democratic governance requires
  - Separations of powers: legislature, executive and judiciary;
  - Checks and balances.
- Conflicts **exist** between the power to withhold information and the right to know.
- Openness is determined by distribution **of** power.
- Transparency reduces information asymmetry and redistributes power.

# Who is Accountable to Whom?

## Principal

- Political executives
- Legislature
- The people

## Agent

- Civil servants
- Executive departments
- Government

# Models of Accounting and Accountability

	Model X	Model Y
Major adherents	Continental Europe	Anglo-America
Relationship between budgeting & accounting	Accounting subordinated to budgeting	Accounting at par with or influential on budgeting
Accountability emphasized	Administrative and legislature	Government to the public

# Theory of Government

- Business accounting is based on an owner-centered theory of the firm (Coase, 1937).
- Public sector counterpart: voter-centered theory of government.
- From **stockholders** to **stakeholders**.
- From voters also to stakeholders: **an organization theory of government based on equilibrium of interests of stakeholders.**

# Government and Stakeholders

- Grant givers (higher-level governments)
- Donors (bilateral, international organizations)
- Taxpayers
- Fee payers
- Investors in government securities
- Creditors
- Borrower, insured,
- Contractors: vendors of goods and services
- Employees

# All Stakeholders Want to Know ...

- Government's benefits to them: amounts, timing, and degree of uncertainty.
- Government officials balance between
  - Contributions of stakeholders
  - Inducements (benefits) from government.
- Inspiration from Simon (1945) and Barnard (1938) and need for further research and development.

# Emulating Business Accounting

## Conceptual Issue 2

# A Critique of the Strategy of Emulating Business Accounting

- A set of IPSAS without dealing with issues unique to government cannot be called “core” standards.
- The PSC incurred not only actual expenditures, but also opportunity cost for six years.
- The PSC overlooked the valuable experiences of developing *GA* standards in the United States since the 1970s at least.
- The PSC ignored the critical differences between the firm and government that affect their accounting and reporting.



# Premises of Business Accounting

- Primacy of owners and creditors
- Valuation of the firm = value to owners
- Recognition of private property rights
- Voluntary market exchanges to determine prices
- Legal system for enforcing contracts
- Sufficiency of monetary measurement

# In Contrast to Business, the State ...

- Is sovereign and has power to tax and make laws
- More symmetrical status of various stakeholders
- Pursues macro-economic goals sometimes to the detriment of its own short-term financial standing
- Promotes equity by redistributing income/wealth
- Unique role in producing public goods
- Generates hard-to-measure non-financial outputs and outcomes

# Governmental Accounting

## Uniqueness of Govt.

- Public goods
- Redistributive function
- Power to tax
- Regulatory power

## Acctg. Consequences

- Cannot individualize prices and match expenses
- Equity as performance criteria
- Non-reciprocal transactions
- Not obligated to accept private-sector rules

# Some Characteristics of Government

- Divided power in constitutional government
- Nature of public property in terms of origin, value other than economic value, longevity
- Broad interpretation of government responsibility for general welfare
- Tax and “transfer” revenues cannot be recognized on the basis of services rendered

# Not All's Well With Business Accounting

- “Rational expectations”: transactions structured to avoid or take advantage of accounting rules.
- Accounting rules – accruals and reporting entity – susceptible to manipulation to boost earnings.
- Inconclusive debates on values vs. costs.
- Multiple acceptable methods for depreciation and inventory, with huge impacts on numbers.
- Ad hoc and strategic earnings forecasts.

# Accrual Basis

## Conceptual Issue 3

# IPSAS Board's Stance and Dilemma

- Accrual of revenue and expense is tied to recognition and measurement of assets and liabilities
- Fundamental commitment to accrual basis is contradicted by cash-basis IPSAS for countries which are the target adopters of IPSAS.
- No clear alternative to full accrual of revenue based on service effort and accomplishment
- Cash and accrual are viewed as polar opposites, while accrual is really a matter of degree.

# Back to the Basic Financial Accounting Framework

- Accounting equation (identity):  
assets - liabilities = net assets
- Revenues and expenses/expenditures as increases and decreases in NA, respectively
- Basic requirements for accrual accounting:
  - A beginning balance sheet with a chart of asset and liability accounts
  - A double-entry recording system
  - The ability to interpret financial consequences of transactions and events in terms of effects on financial position



# Other Than Full Accrual:

## Degrees of Accrual

- **Mild accruals:** short-term financial assets and short-term liabilities.
- **Moderate accruals:** add long-term financial assets and long-term liabilities.
- **Strong accruals:** add capital assets and contingent liabilities.
- “Radical” accruals: add legislated benefits.

# Transition to Accrual

- Disallow the cash-basis; distinguish between “cash flow accounting” and “cash basis accounting”
- Agree to the balance sheet perspective
- Adopt the gradual, symmetrical approach
  - Gradual: from mild to moderate to strong
  - Symmetrical: at each degree, recognize assets *and* liabilities to avoid distortion and manipulation

# Level of Aggregation in Reporting

Conceptual Issue 4

# Premise of Consolidated Financial Statements in Corporate Reporting

- Management control over all resources
- Majority ownership interest in subsidiary as quantitative criterion of consolidation
- Users of financial statements prefer economic substance over legal form
- Investors and creditors need to know about the whole reporting entity
- Additional disclosures can be made for dissimilar lines of business

# Nature of Public Sector Entities

- The range of government functions depends on political and economic system
- Government functions can include: state or governmental activities, business-type activities, and fiduciary activities (e.g. pensions)
- Besides ownership, there are other complex and indirect methods of control and influence
- Political power is often diffused among levels of government, and among branches of government at the same level

# Variations of Consolidated Financial Reporting

- One column for the reporting entity
- Reporting entity = Primary government (PG) + legally independent organizations for which the PG is accountable
- Primary government only in one column
- PG total = Governmental activities + Business activities

# Sources of the Problem

- One set of general-purpose financial statements for diverse user groups
- Lack of consensus on external user groups
- Lack of information about intermediary and end users, and their needs and capabilities.
- Appropriate level of appropriation cannot be determined without adequate info. about users.

# Budget Reporting and Comparison

Conceptual Issue 5



# Sources of Problem

- The budget is inherently speculative and financial statements are necessarily tardy
- Separate institutional structures for setting budgeting and accounting rules
- Different theoretical foundation, professions and training
- Different concepts, standards and methods due to differences in purpose

# Including Budgets and Financial Statements of Different Years

- To overcome the inherent limitations of a budget and financial statements:
- Budget document for year (t+1) could show financial statements for year (t-1) and budget for year t.
- Financial statements for year (t) could show budget for year (t+1) and possibly (t+2).

# Accounting in Relation to Budgeting

	Model B	Model A
Major adherents	Traditional Continental Europe	Anglo-America
Power relationship	Accounting subordinated to budgeting	Accounting at par with or influential on budgeting
Accountability	Administrative and legislature	Government to the public

# Reconciliation as a First Step Toward Integration

- Use of budgetary basis for “actual to budget” comparisons
- Reconciliation is the most that can be expected due to differences in
  - Purpose: control vs. fair presentation
  - Emphasis: flows vs. stocks and flows
  - Time horizon: annual vs. long-term
  - Measurement: cash and obligational vs. accrual

# Indications of Accounting Influences on Budgeting

- Legally and formally accounting is not permitted to regulate budgeting
- Budgeting cannot avoid dealing current and future financial consequences of past decisions
- Budgeting can/should use accrual accounting information
- Perhaps this is “accrual budgeting”

# Contemporary Government Accounting in Perspective

# Priority of Accounting Services for Government?

- **Basic purpose:** To safeguard public money by preventing and detecting corruption and graft.
- **Intermediate purpose:** To facilitate sound financial management.
- **Advanced purpose:** To demonstrate and discharge financial accountability to the public.

# Developing **Accounting Capacity** in Support of Management

- IPSAS represent the most advanced development
- First **stage**: cash management
- Second stage: managing short-term financial resources and liabilities
- Third stage: managing long-term financial resources and liabilities
- Fourth stage: managing operating fixed assets
- Fifth stage: protection of all fixed assets



# Institutional Issues

Who sets standards for whom?

# IPSAS: “Authoritative and Independent”

- “... for the first time there is an authoritative set of independent financial reporting standards for government” – International Federal of Accountants, Public Sector Committee (1987-2004) succeeded by the IPSAS Board since 2004.

# Goals of IPSAS

- Greater government accountability in all countries.
- Improved quality and reliability in accounting and financial reporting.
- Better financial & economic performance.
- Better financial management and discipline.
- Harmonization of reporting requirements.
- International harmonization.

Source: IFAC Quarterly (1996), p. 2.

# Guiding Philosophy and Strategy

- Commitment to **convergence with IFRS** unless there is a public sector specific reason for a departure
- **High quality standards** for global use in preparing general purpose financial statements
- **Add value** to quality and transparency of public sector financial reporting

# The Standard Setters

- IPSAS Board is a part of the International Federation of Accountants (IFAC), composed of 157 national associations of professional accountants in 123 nations
- IPSAS Board has 15 members nominated by national bodies, and 3 public members
- IPSAS Board is assisted by a Consultative Group

# Funders and Observers

- Observers who provide(d) financial support:
  - International Monetary Fund
  - World Bank
  - United Nations Development Program
  - Asian Development Bank
- Observers who do not provide financial support:
  - International Organization of Supreme Audit Institutions
  - Organization for Economic Cooperation and Development
  - International Accounting Standards Board
  - European Commission

# Due Process

- Wide dissemination of research studies and exposure drafts of proposed standards
- Consideration of comments
- Open meetings around the world
- Adoption of standards by at least  $\frac{3}{4}$  of members present (9 members constitute a quorum).

# Institutional Issues



# The Success and Leadership Role of Business Accountants and Auditors

- By virtue of expertise, IFAC is understandably closely allied with IASC
- In most countries and globally, accounting and auditing profession is dominated by members working in the private [not public] sector
- Business accounting has the longest and most successful professional standard setting globally and in some countries
- Harmonization of specialties enhances the unity of the accounting profession and discipline

# Reverse Regulation?

- The accounting and auditing profession argues for greater independence, i.e. free from government and political interference
- Professional licensing and standards rest on a legal foundation
- Can / Cannot governments regulate its own accounting?

# The Roles of Official Representatives of Governments

- **Legislators**, who have the authority to write laws on a jurisdiction's government accounting and can provide/withhold legal basis and appropriations for IPSAS
- **Finance ministers**, who oversee a government's accounting
  - Budget directors, who provide/withhold resources
  - Chief Accounting Office, who implement any changes
- **Government auditors**, who use financial data in investigations and attest to financial statements

# Distribution of Board Seats

- Nomination by IFAC institutional members vs. public members
- Possible bases of distribution of membership
  - Geographical, nationality
  - Stages of national economic development
  - Types of government accounting system
  - Professional experience and expertise
- Issue: relationship between adoption of standards and representation on IPSAS board

# What Does “Adoption” Mean?

- “Adoption” and “process of adoption” are too vague for the list of adopter nations to be complete and reliable.
- At issue is the varying interpretation of “accrual”
- Is adoption of cash-basis IPSAS equivalent to accrual-basis IPSAS? Not in my view
- *De facto* adoption by nations whose GA standards are “broadly consistent” with IPSAS
- Adoption should be a formal decision accompanied by an implementation plan with adequate resource commitments

# IPSAS and Developing Countries

- The cash-basis IPSAS, in effect, is an escape clause for many developing countries
- Personal view: Accrual in principle for all nations, but implementation in stages
- Step 1: The willing to leave an audit trail
- Step 2: The ability to analyze transactions and record effects in a double-entry system
- Gradual advance from mild to moderate degree

# Conclusion

# A Premature Revolution

- Intellectually:
  - Transferability of business GAAP to govt.
  - Competing models: good, better, and best?
  - Uniform rules for a diverse world.
- Institutionally:
  - Professional authority over govt. authority.
  - Accounting profession over other professions.
  - IFAC over other international organizations.



# Business Accounting Rules for Government

- The business of government is more than government businesses.
- Inheriting problems along with solutions.
- Business – lead; government - lag.
- “Drips” (standards) vs. “package” (system change-over).
- Global markets vs. nation-states.

# Superiority of Model A?

- A model resting on soft foundations:
  - Info. costs and user's rational ignorance.
  - The sum and the parts: the fallacy of consolidated financial statements.
  - Effect of advance budget disclosure on the info. value of year-end financial reports.
- Good, better, and best models: the lack of a consensus standard for judging standards.
- Existence and legitimacy of Model B.

# Globalization of Model A

- Minimum requirements or unreachable stars?
- Issues: comparability vs. uniformity; principles vs. standards.
- How much accounting uniformity, given national diversity in:
  - Political and government systems.
  - Economic systems.
  - Culture.
  - Stages of development.
  - Public sector involvement of accounting profession.

# Professional and Governmental Authority

- The virtues of the professional.
- Should accounting rules *of* government be set *by* government or *for* government?
- Rules of professional engagement: government's delegation or invitation? Over-reaching initiative?
- The primacy of GAAP in relation to laws and regulations: audit opinions in capital markets and political markets.

# Accounting Standards by Accountants (Alone)?

- The accountant's professional relatives: budgeters, auditors, managers,...
- Constituencies of accounting standards boards: the incidence of costs and benefits.
- Participation and due process: a seat at the table –who? how many?

IPSAS raises at least as many  
questions as answers!

# References and Further Readings

- *Public Money and Management* (Jan. 2003)
  - “The Global Revolution in Government Accounting” by D. Heald.
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  - “Measuring and Reporting the Nation’s Finances: Statistics and Accounting” by R. Jones.
  - “The Standards Programme of the IFAC’s Public Sector Committee” by P. Sutcliffe.

Thank you!

Please address comments and  
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