

Appendix 1. International Public Sector Accounting Standards

As of January 2003, the International Federation of Accountants Public Sector Committee (PSC) had issued the following International Public Sector Accounting Standards (IPSAS):

- IPSAS 1 *Presentation of Financial Statements* prescribes the overall considerations for the presentation of financial statements, guidance for the structure and minimum requirements for the content of financial statements prepared under the accrual accounting basis.
- IPSAS 2 *Cash Flow Statements* requires the provision of information about the historical changes in cash and cash equivalents of an entity by means of a cash flow statement that classifies cash flows during the period from operating, investing and financing activities. Cash flow information allows users to ascertain how a public sector entity raised the cash it required to fund its activities and the manner in which that cash was used.
- IPSAS 3 *Net Surplus or Deficit for the Period, Fundamental Errors and Changes in Accounting Policies* requires the classification and disclosure of extraordinary items and the separate disclosure of certain items in the financial statements. It also specifies the accounting treatment for changes in accounting estimates, changes in accounting policies and the correction of fundamental errors.
- IPSAS 4 *The Effect of Changes in Foreign Exchange Rates* deals with accounting for foreign currency transactions and foreign operations. IPSAS 4 sets out the requirements for deciding which exchange rate to use and how to recognize in the financial statements the financial effect of changes in exchange rates.
- IPSAS 5 *Borrowing Costs* prescribes the accounting treatment for borrowing costs and generally requires the immediate expensing of borrowing costs. However, the Standard permits, as an allowed alternative treatment, the capitalization of borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset.

- IPSAS 6 *Consolidated Financial Statements and Accounting for Controlled Entities* requires all controlling entities to prepare consolidated financial statements, which consolidate all controlled entities on a line-by-line basis. The Standard also contains a detailed discussion of the concept of control as it applies in the public sector and guidance on determining whether control exists for financial reporting purposes.
- IPSAS 7 *Accounting for Investments in Associates* requires all investments in associates to be accounted for in the consolidated financial statements using the equity method of accounting, except when the investment is acquired and held exclusively with a view to its disposal in the near future in which case the cost method is required.
- IPSAS 8 *Financial Reporting of Interests in Joint Ventures* specifies proportionate consolidation as the benchmark treatment for accounting for such joint ventures entered into by public sector entities. IPSAS 8 also permits—as an allowed alternative—joint ventures to be accounted for using the equity method of accounting.
- IPSAS 9 *Revenue from Exchange Transactions* establishes the conditions for the recognition of revenue arising from exchange transactions, requires such revenue to be measured at the fair value of the consideration received or receivable and includes disclosure requirements.
- IPSAS 10 *Financial Reporting in Hyperinflationary Economies* describes the characteristics of a hyperinflationary economy and requires financial statements of entities that operate in such economies to be restated.
- IPSAS 11 *Construction Contracts* defines construction contracts, establishes requirements for the recognition of revenues and expenses arising from such contracts and identifies certain disclosure requirements.
- IPSAS 12 *Inventories* defines inventories, establishes measurement requirements for inventories (including those inventories which are held for distribution at no or nominal charge) under the historical cost system and includes disclosure requirements.

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- IPSAS 13 *Leases* prescribes the appropriate accounting policies and disclosures to apply in relation to finance and operating leases.
 - IPSAS 14 *Events After the Reporting Date* prescribes when entities should adjust their financial statements for events after the reporting date; and disclosures that entities should give about the date when the financial statements were authorized for issue and about events after the reporting date.
 - IPSAS 15 *Financial Instruments: Disclosure and Presentation* provides guidance on the significance of on-balance-sheet and off-balance-sheet financial instruments to a government's or other public sector entity's financial position, performance and cash flows.
 - IPSAS 16 *Investment Property* prescribes the accounting treatment for investment property and related disclosure requirements.
 - IPSAS 17 *Property, Plant and Equipment* describes the principal issues in accounting for property, plant and equipment, including the timing of recognition of the assets, the determination of their carrying amounts and the depreciation charges to be recognized in relation to them.
 - IPSAS 18 *Segment Reporting* establishes principles for reporting financial information about distinguishable activities of a government or other public sector entity.
 - IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets* defines provisions, contingent liabilities and contingent assets; and identifies the circumstances in which provisions should be recognized, how they should be measured and the disclosures that should be made about them. The Standard also requires that certain information be disclosed about contingent liabilities and contingent assets in the notes to the financial statements to enable users to understand their nature, timing, and amount.
 - IPSAS 20 *Related Party Disclosures* 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. This information is required for accountability purposes and to facilitate a better understanding of the financial position and performance of the

reporting entity. The principal issues in disclosing information about related parties are identifying which parties control or significantly influence the reporting entity and determining what information should be disclosed about transactions with those parties.

- Cash Basis IPSAS *Financial Reporting under the Cash Basis of Accounting* includes requirements for a government and government entity to report all cash receipts, payments and balances that it controls and to disclose information about amounts settled on its behalf by third parties. It encourages note disclosure of additional information about, for example, assets, liabilities, transactions administered on behalf of others and whether budgeted amounts have been exceeded.

Appendix 2. Government-Specific Accounting Issues

This appendix describes several public sector-specific accounting issues.⁸⁹ These issues are equally relevant to developed and developing countries.

The Reporting Entity and Aggregate Consolidation

Governments comprise different levels and sectors (see Figure 1 on page 4), which complicates reporting entity definitions. The primary test is that of control. In particular, the treatment of non-central (i.e., local governments) for consolidation purposes varies depending on historical and constitutional arrangements. For instance, whereas the United Kingdom intends to consolidate local governments into the aggregate government financial statements, the United States (US) does not.

The Enron collapse illustrated problems defining the reporting entity for accounting purposes—i.e., a significant proportion of Enron's liabilities were held by special purpose entities, which (arguably) were not required to be consolidated under US generally accepted accounting principles.

Infrastructure Assets

Infrastructure assets mainly comprise highways and other network assets (such as water supply systems). These assets usually have significant values. Key accounting issues involving these assets include:

- These assets have very long useful lives, which makes decisions about appropriate depreciation treatments difficult. In response, a few countries do not depreciate infrastructure assets, but certify that they are being maintained to such an extent that they have infinite life spans.
- It is often difficult to estimate the original acquisition costs of these assets due to their old age and difficulties in separating out original investments and maintenance costs.
- Valuation methods have an exceptionally high impact on these assets.
- Recognizing and depreciating infrastructure assets can have two major policy impacts: (i) it can highlight the need for often-neglected

⁸⁹ This section is based on the following paper: OECD. 2002. *Accrual Accounting and Budgeting: Key Issues and Recent Developments*. Paris.

maintenance expenditures; and (ii) depending on financial arrangements, the implicit effect of requiring resources to be set aside for asset replacement can significantly reduce the amount of expenditures available for other activities.

Social Insurance Programs

The treatment of social insurance programs—such as general old-age pension programs—is a contentious issue in an accrual environment. This does not refer to the treatment of government employees' pension programs; these are contractual obligations and their treatment as a liability is clear-cut. Some believe certain obligations to provide future benefits under social insurance programs should be treated as government liabilities; others do not.

Valuation Issues

The traditional valuation basis has been historic cost (e.g., the original asset purchase price). However, there is a trend to fair value accounting. Conceptually, current valuations are generally viewed as superior, but practical considerations often lead to use of the historic cost approach. Both the System of National Accounts (SNA) and Governance Finance Statistics (GFS) require that assets be revalued.

Military Assets

There have been two schools of thought regarding military assets (such as warplanes). On one hand, some governments capitalize and depreciate these assets. Conversely, some countries expense military asset purchases.

Heritage Assets

Heritage assets comprise historical buildings, monuments and archaeological sites; and museum, gallery and archive collections. International Public Sector Accounting Standard (IPSAS) 17 *Property, Plant and Equipment* allows, but does not require, heritage assets to be recognized (accounted for). Conversely, SNA 1993 and GFS require historic monuments to be identified and valued:

“Buildings and structures that are also historic monuments are included within the appropriate category of buildings and structures. Historic monuments are structures or sites of special archaeological, historic, or cultural significance. They are usually accessible to the general public, and visitors are often charged for admission to the monuments or their vicinity. General government units typically use historic monuments to produce cultural or entertainment-type services. They can be valued directly, however, only when their significance has been recognized by someone other than the owner, typically by a sale or a formal appraisal. Historic monuments should be valued at the most recent sale price, updated, if need be, by a general price index. If no sale price is available, then an alternative valuation, such as an insurance appraisal, should be used.”⁹⁰

The practice of some countries in recognizing and valuing their heritage assets creates controversy. First, opponents contend that a monetary value cannot be placed on something whose value is inherently cultural and not monetary. Second, the usefulness of reporting heritage asset values in government balance sheets has been questioned. Conversely, supporters argue that there are benefits to be gained in terms of improved asset stewardship. In any case, for most countries, heritage assets will not comprise a significant proportion of a government’s assets.

⁹⁰ IMF. 2001. *Government Finance Statistics Manual*. Washington, DC. para 7.39.

Appendix 3. Cost-Benefit Analysis of the New Zealand Adoption of Accrual Accounting

This appendix presents a cost-benefit analysis of the New Zealand implementation of accrual budgeting and accounting. The analysis presented in the table next page was prepared on the following basis:

- An attempt is made to quantify the benefits of enhanced credibility, brought about by the introduction of accrual accounting, and its impact on borrowing costs. Although mention has been made of evidence from the United States (US) that “states that use accrual information borrow at better terms than those states that use solely cash information,”⁹¹ we were unable to locate the evidence.⁹² However, in the absence of the supporting empirical evidence, it is (arguably) assumed that (i) implicit savings on borrowing costs caused by the introduction of accrual accounting are 0.04%; and (ii) benefits begin to be realized in year 4.
- No attempt is made to estimate the following benefits as their effects cannot be accurately quantified:
 - better estimates of the macroeconomic impact of government fiscal policy;
 - better information on payment arrears;
 - more comprehensive information;
 - improved liquidity management;
 - improved management of non-financial assets;
 - consistency with other macroeconomic statistical systems;
 - enhanced simplicity and understandability;
 - reduced opportunities for manipulation;
 - enhanced comparability;

⁹¹ Brumby, Jim in Schiavo-Campo, Salvatore and Daniel Tommasi (eds). 1999. *Managing Government Expenditure*. Manila: ADB. p. 360.

⁹² In an attempt to hunt down the cited study, the authors of the following related studies were contacted:

- Alt, James E., David D. Lassen and David Skilling. 2001. Fiscal Transparency and Fiscal Policy Outcomes in OECD Countries. Paper presented at the 2001 annual meeting of the American Political Science Association.
- Porterba, James M. and Kim Rueben. State Fiscal Institutions and the US Municipal Bond Market, in Porterba, James M. and Jurgen von Hagen (eds). 1999. *Fiscal Institutions and Fiscal Performance*. A National Bureau of Economic Research Conference Report. University of Chicago Press. pp. 181–208.

- better information on the sustainability of fiscal policy settings;
 - better information on the macroeconomic Impacts of current and capital flows;
 - improved information to support fiscal strategy decisions;
 - improved measures of intergenerational equity;
 - improved accountability;
 - improved resource management;
 - better information on future commitments;
 - better information to support liquidity management;
 - better information to support pricing decisions; and
 - improved access to financial personnel and financial information systems.
- A static analysis has been prepared—debt levels are assumed to remain constant.
 - The internal rate of return (IRR) calculation is based on a 20-year period.
 - Implementation costs are estimated, based on an NZ Audit Office study that estimated the total cost of financial-management reform for the period 1987–92 was \$99 million (NZ\$160-180 million) or about 0.1% of government expenses during this period. This study included direct costs such as (i) financial management information system (FMIS) purchases and implementation; and (ii) consulting expenses. It also estimated indirect expenses, such as staff time.⁹³ Implementation costs are phased over a 5-year period, reflecting implementation activities.

⁹³ Cited in: Scott, Graham, Ian Ball and Tony Dale (Summer 1997). New Zealand's Public Sector Management Reform: Implications for the United States. *Journal of Policy Analysis and Management* 16.3: 357-381

Cost-Benefit Analysis of Country Implementation

	Year									
	1987	1988	1989	1990	1991	1992	1993	1994	...	2006
Quantifiable Benefits: Enhanced credibility and its impact on borrowing costs:										
Gross Debt Outstanding (\$ million)	50,000									
Transparency effect on borrowing rates	0.04%									
Implicit interest saving	20									
Benefits (reduction in borrowing costs; assumed that benefits begin in year 4)	..	..	..	10	20	20	20	20	20	20
...
Total Quantifiable Benefits	..	..	..	10	20	20	20	20	20	20
Quantifiable Implementation Costs										
Based on NZ Audit Office study	36	54	54	18	18	..	..	..	..	..
Total Quantifiable Costs	36	54	54	18	18	..	..	..	..	..
Net Benefits/(Costs)	-36	-54	-54	-8	2	20	20	20	20	20
Internal Rate of Return (IRR, %)	7%									

According to the analysis, the implementation would yield an internal rate of return of +7%. This is likely to be a very conservative analysis given the following considerations:

- The analysis **excludes almost all benefits** because they cannot be accurately quantified (see above).
- The interest-rate adjustment factor used applies in a low-interest-rate environment (US municipal government). However, the **interest-rate benefits are likely to be understated** because prevailing New Zealand interest rates were higher.
- The **implementation costs are overstated** because they include the entire estimated costs of New Zealand’s financial management reforms; including for instance, the costs associated with performance contracting and output specification.

Appendix 4. OECD Implementation Experiences

This appendix describes the approaches of 4 OECD member countries to implementing accrual budgeting and accounting.

Canada

Throughout the 1980s, Canadian provincial governments significantly changed their financial reporting practices, moving from cash to accrual accounting and from separate account reporting to consolidated financial statements.⁹⁴

In 1995, Canada established the Financial Information Strategy (FIS) with the goal of bringing FIS systems on-line by 1 April 2001 (which was met). This involved changing the way government departments and agencies kept their books for more than 100 years.

For consolidated government financial reporting at a federal level, monthly financial statements will continue on a modified accrual basis until publication of the annual audited 2001-2002 financial statements on a full accrual basis. The Canadian Parliament is currently considering how it might introduce accrual-based appropriations.

Germany

German public sector financial management reforms are largely a direct consequence of attempts to reform the public sector through privatization, corporatization, decentralization, devolved management, competition and the output performance orientation. The changes have been relatively slow and careful to avoid uncertainty. They were first introduced in local government, and later in Länder (state) and federal government. They focused on budgeting and managerial accounting.⁹⁵

The step-by-step approach involved pilot projects. This avoided the need to amend the legal basis of financial management in the early phase of the reform process. On one hand, this approach resulted in many projects with poor conceptual bases, unclear objectives, insufficient coordination and an absence of systematic outcomes evaluations. On the other hand, the

⁹⁴ Hillier, Diana R. *From Cash to Accrual: The Canadian Experience*, in International Federation of Accountants (IFAC). 1996. Perspectives on Accrual Accounting. Occasional Paper 3. New York: Public Sector Committee.

⁹⁵ Lüder, Klaus. 2002. Government Budgeting and Accounting Reform in Germany. *OECD Journal on Budgeting*. Vol 2(1). December. pp. 224-242.

pilot project approach is beneficial in the early phase of public sector financial management reform because it enables jurisdictions to test new ideas, particularly in countries with very stringent and detailed legal provisions for public sector financial management.

There is, however, a danger that the reform process may never get beyond piloting. To combat this danger, sufficient conceptual guidance, clear objectives and a limited time frame are crucial for pilot projects to be a useful element in the reform process.

Länder and federal governments are following local governments in changing their financial management systems. But a majority of them still prefer an additive reform approach—they intend to supplement the existing system with new elements, such as output budgeting and cost and performance accounting. A complete substitution of an accrual budgeting and accounting system for the traditional system is still inconceivable for most of these governments and their political leaders.

Sweden

Following a gradual 2-year implementation, accrual accounting was fully implemented in the Swedish central Government from 1 July 1993. Although it involved a significant effort, the implementation was problem-free for two reasons. First, no organizational changes were necessary—the structure of Swedish Government suited the implementation of accruals and results-based management. Second, accruals were initially only implemented for agency accounting and for whole-of-government reporting, but not for budgetary (appropriation) purposes. This reduced complications.⁹⁶

Implementation efforts involved (i) adjusting accounting systems; (ii) developing accounting policies; (iii) altering processes and procedures; and (iv) executing a significant information, education and training campaign. The costs of these activities were not easily identifiable.⁹⁷

Heritage assets were not included (due to valuation difficulties) and defense assets were initially expensed rather than capitalized.⁹⁸

⁹⁶ Swedish National Financial Authority (Ekonomistyrningsverket). 2001. *Accrual Accounting in Swedish Central Government*. May. Stockholm.

⁹⁷ *Ibid.*

⁹⁸ Ström, Sten. Full Accrual Government Accounting in Sweden, in IFAC. 1996. *Perspectives on Accrual Accounting*. Occasional Paper 3. New York: Public Sector Committee. p. 26-30.

Before implementation, most agencies used a centralized **computerized accounting system** that was introduced in the late 1960s. This system was modified to handle accruals. In addition, a new system was made available to agencies. The new system is a commercial accounting system widely used by private companies throughout the world. The introduction of the new system made it possible to decentralize government accounting.⁹⁹

Government **accounting policies** began to be aligned with the private sector in the 1980s. However, the policies were not fully accrual-based until 1993. Moreover, certain adaptations were made to reflect specific government needs.

Education, training and communication activities were conducted before implementation began. First, materials explaining the changes were produced. Second, training for financial personnel was conducted, mainly through seminars. Finally, a National Financial Authority staff member was assigned to each agency as a contact point and advisor.

Notably, the professionalism of formerly lowly-ranked **accounting personnel** was raised considerably and it is now possible to recruit trained accountants into government agencies.

United Kingdom

The United Kingdom has adopted accrual accounting at the agency level and is looking to produce aggregate consolidated financial statements for 2006. It plans to prepare consolidated financial statements in a staged manner:

- Stage 1 will involve consolidating the unaudited central government accounts using 2001-02 National Accounts (System of National Accounts) information.
- Stage 2 will involve consolidating accrual 2003-2004 central government accounts.
- Stage 3 will involve a whole-of-government accounts consolidation for 2005-2006.

⁹⁹ Swedish National Financial Authority (Ekonomistyrningsverket). 2001. *Accrual Accounting in Swedish Central Government*. May. Stockholm.

Appendix 5. Useful Internet Sites and Resources

Useful Internet Sites

Government Accounting Standards Board (US)	GASB	www.gasb.org
Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting of the United Nations Conference on Trade and Development (UNCTAD)	ISAR	www.unctad.org/isar/
International Accounting Standards Board	IASB	www.iasb.org.uk
International Federation of Accountants	IFAC	www.ifac.org
International Organization of Supreme Audit Institutions	INTOSAI	www.intosai.org

International Public Sector Material

As of June 2002, the International Federation of Accountants Public Sector Committee had released the following studies and guidance materials.

International Public Sector Studies

- Study 1 *Financial Reporting by National Governments* addresses the fundamental underpinnings of governmental financial reporting.
- Study 2 *Elements of the Financial Statements of National Governments* considers the elements (types or classes of financial information) to be reported in financial statements prepared under the different bases of accounting that may be employed by national governments and their major units and the way in which those elements may be defined.
- Study 3 *Auditing for Compliance with Authorities: A Public Sector Perspective* addresses aspects of the audit for compliance in the public sector that, in many countries, is subject to very different mandates and objectives than in the private sector.
- Study 4 *Using the Work of Other Auditors: A Public Sector Perspective* addresses using the work of other auditors, including both other external and internal auditors, in financial attest and compliance audits.

- Study 5 *Definition and Recognition of Assets* identifies and describes the variety of views that exist about whether, when, and how specific assets should be measured and reported in the public sector.
- Study 6 *Accounting for and Reporting Liabilities* provides a public sector perspective on the definition and recognition of liabilities.
- Study 7 *Performance Reporting by Government Business Enterprises* identifies principal users of performance information, considers the needs of those users and outlines forms of reporting that could be available to meet those needs.
- Study 8 *The Government Financial Reporting Entity* considers the implications of different approaches to the definition of the government financial reporting entity and different techniques for the construction of government financial reports to the achievement of objectives of financial reports.
- Study 9 *Definition and Recognition of Revenues* examines concepts, principles and issues related to the definition and recognition of revenues in the general purpose financial statements of national governments and other nonbusiness public sector entities.
- Study 10 *Definition and Recognition of Expenses and Expenditures* examines the concepts, principles and issues related to the treatment of expenses/expenditures in general purpose financial statements of governments and other nonbusiness public sector entities.
- Study 11 *Government Financial Reporting: Accounting Issues and Practices* aims to assist governments at all levels in the identification of issues associated with financial reporting (on both the cash and accrual accounting bases).
- Study 12 *Perspectives on Cost Accounting for Governments* is intended to assist government financial aid officers and other government accountants in their efforts to develop and implement cost accounting.
- Study 13 *Governance in the Public Sector* examines public sector governance issues.
- Study 14 *Transition to the Accrual Basis of Accounting: Guidance for Governments and Government Entities* is intended to help entities intending to

move to the accrual basis of accounting and comply with the accrual-based International Public Sector Accounting Standards.

Occasional Papers

- No. 1 *Implementing Accrual Accounting in Government-The New Zealand Experience*
- No. 2 *Auditing Whole of Government Financial Statements-The New Zealand Experience*
- No. 3 *Perspectives on Accrual Accounting* aims to inform readers about a range of perspectives on accrual accounting from a number of contributors who have experience in implementing accounting reform in the public sector or who have observed its progress.
- No. 4 *The Delegation of Public Services in France-An Original Method of Public Administration: Delegated Public Service* describes the specific framework designed in France to manage the relationship between a government entity and a private sector entity contracted to deliver a certain service, and to ensure an adequate level of information and accountability.
- No. 5 *Resource Accounting: Framework of Accounting Standard Setting in the United Kingdom Central Government Sector* considers the experiences of the United Kingdom, which decided to move to an accrual basis for both budgeting and financial reporting in 1995.
- No. 6 *The Modernization of Government Accounting in France: The Current Situation, the Issues and the Outlook.*

Appendix 6. Suggested Readings

The following publications provide useful information on accrual budgeting and accounting issues in government.

- Diamond, Jack. 2002. *Performance Budgeting: Is Accrual Accounting Required?* Working Paper WP/02/240. Washington, DC: IMF.
- IFAC. 2002. *Transition to the Accrual Basis of Accounting: Guidance for Governments and Government Entities*. Public Sector Study 14. New York.
- . 1996. *Perspectives on Accrual Accounting*. Occasional Paper 3. New York: Public Sector Committee.
- IMF. 2002. *Government Finance Statistics 2001 Companion Material*. Washington, DC.
- . 2001. *Manual on Fiscal Transparency*. Washington, DC: Fiscal Affairs Department.
- Mellor, Thuy. 1996. Why Governments Should Produce Balance Sheets. *Australian Journal of Public Administration*. 55(1). March. pp. 78-81.
- OECD. 2002. *Accrual Accounting and Budgeting: Key Issues and Recent Developments*. PUMA/SBO(2002)10. Paris.
- . 2002. Models of Public Budgeting and Accounting Reform. *OECD Journal on Budgeting*. Vol 2(1). December. pp. 5-6.
- Schiavo-Campo, Salvatore and Daniel Tommasi. 1999. *Managing Government Expenditure*. Manila: Asian Development Bank.
- Warren, Ken. 2000. *The Impact of GAAP on Fiscal Decision Making: A Review of Ten Years Experience with Accrual and Output-based Budgets in New Zealand*. Paper prepared for the Australasian Treasury Officers Conference. October.
- World Bank. 1998. *Public Expenditure Management Handbook*. Washington, DC.