

Financial Reporting of Development Assistance by Recipients

BACKGROUND

Project Initiation

The Multilateral Development Banks Financial Harmonization Working Group (the MDB Working Group) wrote to the PSC in November 2001 noting that:

- current arrangements for financial reporting to lenders require borrowers to provide to each lender special purpose financial reports relating to each project. The formats for these reports are agreed with each lender and may differ;
- there was the potential for significant benefits in respect of an enhancement in the consistency and quality of financial reporting and a reduction of compliance costs to be derived from shifting the basis of financial reporting by recipients of development assistance towards compliance with appropriate international standards. In this context, the PSC may wish to consider whether an IPSAS on this topic should be developed; and
- it was anticipated that any IPSAS would apply primarily to entities applying the cash basis of accounting.

Mr. Manning, chair of the Task Force of Donor Practices Development Assistance Committee of the OECD (OECD-DAC) also wrote to the PSC confirming the interest of his group in such a project.

At its March 2002 meeting, the PSC considered whether or not to include this issue on its work program. At that meeting, the PSC also considered a draft project brief prepared by staff to indicate some of the key features of such a project.

Relationship to the PSC's Mandate

The financial statements designed to report to donors on development assistance are currently special purpose in nature.

The IPSASs deal with general purpose financial statements and the PSC's standards-development focus is on general purpose financial statements, whether under the cash or the accrual basis of accounting. While the current mandate of the PSC does not preclude it from dealing with special purpose reporting issues, such issues would not fit with the objectives established for IPSASs.

The PSC agreed that the disclosure of relevant information about development assistance is an appropriate subject for general purpose financial statements. It will provide information useful for decision-making, and to demonstrate the accountability of the entity for the resources entrusted to it.

Members noted that such disclosures would enhance the ability of financial statements to disclose information about, or useful in the assessment of such matters as:

- the sources, allocation and uses of financial resources;
- how the entity financed its activities and met its cash requirements;

- the entity's ability to finance its activities and to meet its liabilities and commitments;
- the financial condition of the entity and changes in it; and
- the entity's performance in terms of service costs, efficiency and accomplishments.

Project Confirmation

At its meeting in March 2002, the PSC agreed that a project should be actioned consistent with the terms of a revised project brief, subject to the agreement of the MDB working Group and OECD-DAC. The PSC chair wrote to the Working Group to that effect, seeking their response to the project brief. The PSC chair and director made presentations to the OECD-DAC, which also included members of the Working Group in June 2002. Correspondence from the Working Group and OECD-DAC supporting the project brief as proposed by the PSC, and identifying additional key features to be considered, is included at Agenda item 11.3.

The Proposed Directions for the Exposure Draft (Agenda item 11.4 attached) includes the key features of the project brief, previously agreed by the PSC together with the matters raised by the Working Group and OECD-DAC in their subsequent correspondence. It has also been updated to reflect the changes that have occurred in the cash basis IPSAS since March 2002.

Key features of the project

In framing the project brief the PSC considered and agreed its position on the following:

- 1. Should the proposed IPSAS deal with financial reporting under both the cash and accrual basis of accounting (not only the cash basis)*

The initial correspondence from the Working Group and OECD-DAC focused on financial reporting by entities reporting on the cash basis. The PSC was of view that the requirements of any IPSAS which is developed are likely to enhance the accountability and transparency of financial reports of entities reporting under both the cash and accrual bases and the project initiated on this topic should commence with a broad remit. Accordingly, a separate "stand alone" IPSAS on development assistance applicable to both entities reporting on the cash or accrual basis should be developed. This reflects the view expressed by the Working Group and the OECD-DAC that they would see benefits in making the IPSAS as self contained as possible.

In respect of entities that apply the cash basis IPSAS, that remit should include additional disclosures that respond to the issues raised by the Working Group and are consistent with the PSC's objectives of:

- encouraging note disclosure which enhance the usefulness of primary statements prepared on the cash basis; and
- assisting entities currently reporting on the cash basis to move along the spectrum to the accrual basis.

2. *The definition of “development assistance”*

Development assistance may be provided in the form of:

- a non exchange transfer such as a grant or gift of monetary or non-monetary assets. In many cases, such transfers will be subject to restrictions and conditions in respect of the purpose and timing of their use. In these circumstances, the development assistance is likely to be in the nature of revenue (the impact of “restrictions” and “conditions” on the timing of recognition is being considered by the non exchange revenue Steering Committee).
- in some jurisdictions, development assistance may be provided by way of an exchange transaction in which the donor purchases prescribed goods and services from the recipient on behalf of residents or citizens; or
- in some cases, loans which the recipient will be required to repay.

The PSC was of the view that for general purpose financial statements:

- the definition of development assistance should be sufficiently robust to ensure that all forms of assistance are encompassed by the project, and the reporting of such assistance is comprehensive; and
- the separate types of development assistance should be defined and disclosures required in respect of them to ensure that the financial reporting consequences of each form of assistance are reliably reported.

Correspondence from the Working Group (see Agenda item 11.3) identifies additional forms of development assistance and additional circumstances in which that assistance may be provided and advocates that a broad definition of developmental assistance be adopted in the IPSAS.

3. *The nature of the project (recognition or only disclosure) and its relationship to other IPSASs which have been published or are under development*

The PSC has already issued, or has under development, a number of IPSASs which may include recognition, measurement and disclosure requirements that relate to development assistance. For example:

- The PSC is finalizing its IPSAS on *Financial Reporting Under the Cash Basis of Accounting*. The draft IPSAS currently proposes the disclosure of third party settlements on the face of the statement of cash receipts and payments and encourages the note disclosure of additional information, including additional information about liabilities, assets, costs and cost recoveries. As the project on development assistance progresses, the interaction and overlap between the disclosure of third party settlements in the statement of cash receipts and payments and disclosures advocated by this project will need to be carefully monitored.

- IPSAS 1 *Presentation of Financial Statements* which applies to financial reporting under the accrual basis of accounting and establishes broad parameters for disclosures in financial statements.
- IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets* which will interface with the development assistance project to the extent that development assistance represent a liability whose timing or amount is uncertain
- IPSAS 9 *Revenue From Exchange Transactions* which sets out requirements for the recognition measurement and disclosure of information about revenue from exchange transactions.
- The *Steering Committee on Non Exchange Revenue* which has the responsibility for such matters as:
 - considering the recognition and measurement of grants from donor agencies by recipients; and
 - identifying disclosure that should be made about any revenues, assets, liabilities or net assets/equity that are recognised as a consequence of non-exchange/non-reciprocal transactions (or transfers).

Clearly there is significant overlap between the development assistance project and the project on non-exchange revenue and the IPSAS on the cash basis. The development assistance and non-exchange revenue projects will need to “maintain” contact. Disclosures emanating from the development assistance project will need to be fine-tuned to articulate with the recognition and measurement requirements of the non-exchange revenue project and other IPSASs.

Given this overlap, the PSC agreed that the development assistance project should:

- deal only with note disclosure of development assistance received in any period. This will ensure that the recognition criteria will be dealt with by existing IPSASs and those projects currently under development. Particularly the cash basis IPSAS and the Steering Committee on non exchange revenue.
- include disclosure of information of development assistance by way of loans and the likely timing of that repayment. These matters will not be dealt with by the non exchange revenue project.

4 *The relationship of this Project to International Financial Reporting Standards (IFRSs) that might be issued on a similar subject by the IASB.*

International Accounting Standard IAS 20, *Accounting for Government Grants and Disclosure of Government Assistance* was approved for issue by the Board of the former IASC in 1982. The original text was reformatted (but not revised) in 1994. IAS 20 includes requirements for the recognition and disclosure of government grants and government assistance by enterprises. (The

appropriateness/applicability of IAS 20 will be considered by the Steering Committee on non exchange revenue.)

In dealing with projects on Investment Property and Agriculture, the former IASC noted some difficulties with IAS 20 in respect of its application under a fair value model. The IASC also noted that IAS 20 did not deal with “similar assistance from non-government sources (such as the World Bank and the United Nations)”.

The guidance on disclosures by governments and government agencies about development assistance that will be the subject of this project may also have relevance for private sector entities that receive development assistance. The IASB has considered whether a project on financial reporting by enterprises in emerging economies should be initiated, and has a “watching brief” on this issue. It appears opportune to invite the IASB to participate in the PAP.

Conclusion

The PSC was of the view that this project should be included on the PSC’s active work program because:

- it responds to the needs of an important group of constituents;
- it provides a mechanism to enhance the quality and consistency of general purpose financial statements in respect of the financial reporting of transactions and events that are significant to the ongoing operations of many governments and government agencies; and
- consistent reporting of relevant and reliable information about development assistance is central to the discharge of accountability for many governments and government agencies.

INTERNATIONAL FEDERATION OF ACCOUNTANTS
PUBLIC SECTOR COMMITTEE

Financial Reporting of Development Assistance by Recipients
Directions for Development of an Exposure Draft
Staff views on key characteristics of an Exposure Draft and the Development Process

Timing

The commencement date and speed of progress on development of this project are dependant on:

- finalization of the cash basis IPSAS. Correspondence from the MBD Working Group and OECD-DAC indicate that a major interest of the donor community is in the disclosure of information by entities reporting under the cash basis. As such, it is proposed that this project not be progressed until such time as the cash basis IPSAS has been finalized; and
- availability of staff resources. Currently staff resources are spread thinly over a number of major PSC projects. Jerry Gutu has previous experience with the issues and will be a key PSC staff member on this project. However, additional staff resources will need to be secured to progress this project. This was contemplated by the PSC, and correspondence from the MDB-working Group and OECD-DAC acknowledge that actioning this project has resource implications for the PSC.

Objective

The objective of the project is to develop an IPSAS dealing with note disclosure of information about development assistance received by public sector entities. The IPSAS is to be applied by entities which receive such assistance irrespective of whether those entities apply the accrual basis or the cash basis of accounting.

It is not proposed that this project deal with recognition of revenue in the primary financial statements. Issues related to the recognition in the financial statements of grants and other forms of development assistance under the cash basis will be dealt with by the cash basis IPSAS currently nearing completion. In respect of accrual basis entities:

- IPSAS 9 *Revenue From Exchange Transactions* deals with revenue arising in respect of any grants or development assistance that have the characteristic of exchange transactions; and
- the IPSAS on non exchange revenue developed through the Steering Committee process will deal with revenue arising from grants or development assistance which are not in the nature of exchange transactions.
- IPSAS 19 *Provisions, Contingent Assets and Contingent Liabilities* deals with the recognition of development assistance which give rise provisions.

Whilst not dealing with recognition in the primary financial statements, the project will need to identify the circumstances which will “trigger” a note disclosure. In addition, an ongoing watching brief will be necessary to maintain and update the

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development assistance IPSAS as the non exchange revenue project develops and additional refinements are made to the cash basis IPSAS.

Process

This project will be progressed at Committee level with the assistance of the Project Advisory Panel (PAP) comprising representatives of the Working Group, OECD-DAC and other key representatives of the donor community and recipient governments and government agencies. A representative of the IASB should also be invited to join the PAP. The role of the PAP will be to provide input on key issues to be dealt with by an IPSAS on this topic, and to operate as a sounding board to staff in the exposure draft development process. In the course of development of the project, it is proposed that staff/PSC members as appropriate meet with the PAP or key members thereof.

Project Timetable

Given the interrelationship between this project and the cash basis IPSAS and the need to secure additional staff resources (noted above), it is proposed that this project not commence the cash basis IPSAS has been issued.

- 2003 Develop draft Exposure Draft (ED) for review by PSC
- 2003 Finalize ED in the fourth quarter of 2003 and issue late 2003/early 2004
- 2004 Review responses during the second and third quarters of 2004 and finalize IPSAS by the end of 2004/early 2005
- 2004 Issue IPSAS during first half of 2005

Matters to be addressed

The first draft of the Exposure Draft prepared for PSC review should include:

A definition of “development assistance” or similar relevant term which encompasses “aid” provided by the MDBs and other “donors”. For the purposes of this ED, the same definition is to be applied to entities reporting under the cash basis and the accrual basis. The definition is to be sufficiently broad to encompass all forms of development assistance including:

- non exchange transfers of monetary or non monetary assets;
- development assistance made by way of an exchange transaction; and
- loans.

In developing and testing the definition, staff and the PAP will consider key issues and practices. In particular, the financial reporting implications of the following for individual and consolidated reporting entities are to be drawn out:

- re-lending assistance through layers of government; and
- assistance provided to Non Government Organizations.

Identification of the circumstances in which development assistance is to be disclosed by the recipient as having been “received” or “made available” during the reporting period. It is this area that is likely to relate most closely to the work of

the Steering Committee on non exchange revenue and the cash basis IPSAS, and will need ongoing monitoring.

In developing guidance on this matter, the draft ED will consider such matters as:

- when control of the assistance arises;
- whether disclosure of assistance that is “available” (controlled) but not yet drawn on should be made; and
- how the impact of any eligibility criteria that need to be satisfied, and any conditions and restrictions on use of funds, are to be dealt with.

This aspect may well be developed by way of a requirement to disclose all assistance promised with separate disclosures of amounts used, amounts currently available for use and amounts available for use subject to satisfaction of eligibility criteria and/or certain conditions.

Requirements relating to the basis of measurement of cash and non-cash assistance that are disclosed. In progressing this aspect of the exposure draft, guidance in existing IPSASs including in particular IPSAS 17 *Property Plant and Equipment* will be adopted where appropriate; and

Detailed disclosure requirements, including at least those outlined below. The disclosure requirements will be directed at enabling the entity to be accountable for, and users to be able to identify:

- the full range of assistance that has been made available to the entity during the reporting period;
- the extent to which assistance provided has been expended (cash) or used (non-cash) during the period as intended;
- amounts that remain available for use in future periods, the nature of those amounts and whether there are conditions and restrictions on their use; and
- the amount of financial obligations to repay assistance received during the existing or prior periods and the likely timing of those repayments.

To satisfy these broad disclosure objectives, the first draft of the Exposure Draft should include the following disclosure requirements:

- the total amount of assistance, identifying the amount provided directly to the entity and the amount provided indirectly via settlement by a third party;
- the amount of assistance provided by way of loan, tied/conditional grant and/or by other forms of assistance;
- in accrual based financial statements, the amount of any assistance that has been classified as exchange revenue consistent with the definition in IPSAS 9 and recognized on that basis in the primary financial statements, the amount of assistance that has been recognized as non-exchange (or other) revenue and the amount of assistance recognized in the primary statements other than as revenue (for example as a liability in accrual statements);
- in cash basis financial statements, the amount of any assistance recognised in the statement of cash receipts and payments as cash controlled by the entity and the amount displayed as third party settlements;

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- the amount provided by way of cash and the fair value of non-monetary assistance provided. In the preparation of the ED, the PAP will be engaged in identifying whether there are issues specific to the nature of assistance or specific to the donor/recipient community that need to be addressed in determining the fair value of non-monetary assistance;
- the amount provided by Multilateral Development Banks, by other international agencies and by domestic donors (such as another level of government). A requirement for the disclosure of the identity of the 5 major providers of assistance and the amount provided by each should be included in the first draft for consideration by the PSC and the PAP;
- the amount of assistance expended during the period, identifying whether the amounts were expended on services: or acquisition of property, plant and equipment; or acquisition of other non-current assets;
- whether expenditures during the period were made in accordance with conditions specified by the “donor” in respect of assistance provided. (The requirement for a note disclosure of whether conditions are satisfied would mean that this would be subject to audit);
- the amount of assistance received during the period and unexpended as at reporting date and the amount of such assistance that is subject to undischarged conditions and any amounts which are to be returned because they were not expended; and
- the cumulative amount of assistance received by way of loan funds and yet to be repaid, with a schedule of repayments due within 1 year, 2-5 years, more than five years. This reflects the schedule in IPSAS 13 *Leases* in respect of the minimum lease payments due under non-cancelable operating leases. Staff will seek PAP input on whether such disclosures are consistent with enhanced accountability and transparency in financial reporting and are useful to key constituent groups in the donor community would be useful. Staff will also seek to input on whether the disclosures should identify separately the amount of principal and accumulated interest.